Insurance Agent Exam Prep: Life, Health, Property & Casualty

First edition | 10 units | 50 lessons + a full practice exam | A video for every lesson

FIRST EDITION

Course guide

This is a full-year, career-pathway course for high-school students (grades 11–12) who want one of the most reachable licensed professions in America: the **insurance agent**. Unlike medicine or law, this door opens with a high-school diploma. Every state licenses its own agents (the law calls them **producers**), and the path is short and plain: study, pass a state exam of multiple-choice questions, get fingerprinted in most states, apply for the license, and be appointed by insurance companies. Some states require no classroom hours at all before the exam; others require roughly 20 to 40 hours per line. For an adult the whole road commonly takes two to eight weeks. The federal Bureau of Labor Statistics reports a median pay of about **$60,370** for insurance sales agents (May 2024) with roughly 47,000 openings a year — and because agents are paid partly by commissions and renewals, a diligent agent's ceiling is far higher than the median.

The course prepares a student for **both great families of licenses.** Units 3–5 cover **life and health**: term and whole life, universal and variable designs, annuities, beneficiaries and riders, medical expense insurance, disability income, Medicare and long-term care. Units 6–8 cover **property and casualty**: the homeowners and personal auto policies, negligence and liability, umbrellas, workers' compensation and the commercial lines that insure Main Street. Wrapped around them are the things every line shares: how insurance works at all (risk pooling and the law of large numbers), the strange and wonderful contract at its heart (Unit 2), the state law that governs every agent (Unit 9), and the career itself (Unit 10). Each lesson begins with **the story** (London burning in 1666, the sailors' bets at Lloyd's coffee house, Franklin's leather fire buckets, the orphaned manses that built the first American life insurer, San Francisco in 1906, the courtroom bargain that became workers' compensation), then **the big idea** with its definitions, then **on the exam today**: how a

state licensing exam asks about it, with the traps named. Every lesson ends with worked examples, a practice set in the exam's own four-choice format, and a project. Each unit ends with a 100-point test, there is a 60-question midterm after Unit 5, and the final is a full-length 150-question practice licensing exam.

The course teaches the policies, the mathematics and the ethics of the profession; it never recommends an insurer or a policy to any reader, and all of its cases use pretend families and pretend money. Licensing rules, fees and figures differ by state and change over time, so the course teaches each requirement as a range, labels every number as an example, and shows the student how to look up the real ones at the state insurance department and nipr.com. Throughout, the agent's work is taught as what it has always been: organized neighborliness — many hands bearing one family's loss — and a promise kept to people on the worst day of their lives. "A prudent man foreseeth the evil, and hideth himself: but the simple pass on, and are punished" (Proverbs 22:3). A student who learns to tell the truth on an application, to sell only what a family needs and to keep promises when keeping them is expensive has learned the hardest material on any state's exam — and something better than the exam.

> Videos were chosen lesson by lesson from public and educational sources: Khan Academy, Two Cents (PBS), the Federal Reserve Bank of St. Louis, state insurance departments, The Plain Bagel and a few other teaching channels. Every video was checked in preview for accuracy and content. Insurance licensing has few general-audience explainers, so several law and policy lessons use videos from teachers who also sell exam-prep materials; their teaching was previewed and stands on its own, and nothing in this course requires buying anything. Exam fees, licensing rules and dollar figures change and differ by state, so treat any numbers in a video as examples and look up the current figures at your state insurance department's website and nipr.com. A few channels end with a sponsor message or an invitation to subscribe; you can stop when the teaching ends.

Start with Lesson 1.1 →

Who it is for

Written for students in grades 11–12. The only hard prerequisite is comfort with percents, decimals and simple formulas (Algebra I is plenty); the heavier load is

vocabulary and careful reading, which the course builds gradually with constant review. The School Launch Personal Finance & Investing course is a helpful companion but not required. Students work fairly independently; a parent or mentor checks the practice sets, discusses the ethics cases and proctors the timed exams. Licensing itself is a state decision: nearly every state requires an agent to be 18, so most students should plan to sit for the real exam near or after graduation. The license has no college requirement and no sponsoring-firm requirement — the student chooses a line (life & health, or property & casualty, or both), meets the state's study requirement if it has one, passes the state exam, clears the fingerprint and background check, and applies. Check the current rules at your state insurance department before paying any fee.

How to use this course

1. **The weekly rhythm.** Each lesson takes three sessions of about 50 minutes. Session 1: the warm-up, the video, the core ideas and the worked examples. Session 2: the project and the exam notebook. Session 3: the practice set in exam format, checked against the answers, with every miss corrected in the notebook. Each unit ends with a test day; the midterm and final each get a review day. At five sessions a week the course fills a school year of about 33 weeks.
2. **Story, then the big idea, then the exam.** Read the core ideas in order. The story explains why the coverage or the rule exists, and a rule whose reason you know is a rule you do not have to memorize. Every lesson ends with "on the exam today": how a state licensing exam actually asks about the idea and the standard traps.
3. **Answer like the exam.** The practice sets use the real exams' format: four choices, one best answer, no penalty for guessing. Train the habit from week one: read the question's last line first, strike out the two clearly wrong choices, and answer every question. Most states pass a candidate at 70% — so a careful student can miss three questions in ten and still pass.
4. **The exam notebook.** Keep one notebook for the year. Left pages: definitions, the unit's comparisons (term vs. whole life, named-peril vs. open-peril, agent vs. broker) and the unit's "trap list." Right pages: every practice question you missed, rewritten with the right answer and one sentence on why you missed it. The week before each exam, study only your right-hand pages.
5. **Your state is the textbook's last chapter.** This course teaches the material that is common to the states, which is most of the exam. But every licensing fact — study

hours, exam length, fees, fingerprinting, the testing vendor — is your state's decision. From Lesson 1.5 onward you will keep a one-page, dated **state facts sheet** built from your own state insurance department's website and its exam candidate handbook, and you will check it again before anyone pays a fee.

6. **Example numbers are examples.** Premiums, fees, benefit figures and tax thresholds in this course are labeled "in this example" because the real ones differ by state, company and year. When a lesson says "in this example," it is teaching the method, not the number.
7. **Practice sets.** Problems are marked easy, medium, hard and challenge. Do all of the easy and medium problems and most of the hard ones; the challenge problem is for students who want more. Mark your work against the answers the same day, and rework every miss in the notebook.
8. **Picture study.** Each lesson has one public-domain painting, print or historic photograph. Look at it quietly for two minutes, put it away and tell what you remember, then work through the "look for" items and questions, which point to the risk, the loss or the promise in the picture.
9. **Timed exams, honestly proctored.** Take each unit test closed-book. Take the midterm in one two-hour sitting and the final — a full 150-question practice licensing exam — in one sitting of two and a half hours, proctored by a parent, with no notes, exactly like test day at the testing center. Treat the score honestly: the final tells you whether you are ready for a real candidate seat.
10. **No real recommendations.** The course teaches how the profession works; it does not tell you or anyone what to buy, and it names no company as better or worse. All families, policies and premiums in the projects are pretend. Real decisions belong to your family — and, for clients someday, to the needs-based, truth-telling care this course exists to teach.

Scope and sequence

UNIT 1 · WEEKS 1–4

The Calling and the Path

What an insurance agent is and does; how insurance began — the Great Fire of London, Lloyd's coffee house, Franklin's Contributionship and the Ministers' Fund of 1759; risk, perils, hazards and the law of large numbers; how insurance came to be regulated by the fifty states; and the license itself — lines of authority, your state's requirements and a study plan for this course.

1.1 The Insurance Agent: A Promise-Keeper's Calling

1.2 The Great Fire and the Coffee House: How Insurance Began

1.3 Spreading the Risk: The Law of Large Numbers

1.4 Fifty Regulators: Paul v. Virginia, SEUA and McCarran-Ferguson

1.5 The License: Lines, Exams and Your Study Plan

UNIT 2 · WEEKS 4–7

The Contract and the Agent's Authority

The insurance contract — its four elements and its five peculiar characters (aleatory, adhesion, unilateral, conditional, personal); insurable interest and indemnity; utmost good faith with representations, warranties, concealment and fraud; the agent's express, implied and apparent authority with waiver and estoppel; and underwriting — the application, the MIB, classification and the price of risk.

2.1 A Contract Like No Other: Elements and Characteristics

2.2 Insurable Interest and Indemnity: No Betting Allowed

2.3 Utmost Good Faith: Representations, Warranties and Concealment

2.4 The Agent's Three Authorities: Express, Implied and Apparent

2.5 Underwriting: The Application, the MIB and the Price of Risk

UNIT 3 · WEEKS 7–10

Life Insurance: The Policies

Why families buy life insurance — needs analysis and human life value; term insurance in its level, decreasing, renewable and convertible forms; whole life and its cash value, limited-pay and single-premium designs with participating dividends; the flexible designs — universal, indexed and variable life, and why variable products demand a securities license; and group life, credit life and the special policies.

3.1 Why Life Insurance: Needs, Human Life Value and the Ministers' Fund

3.2 Term Life: Renting the Promise

3.3 Whole Life: The Promise That Endures

3.4 Flexible Designs: Universal, Indexed and Variable Life

3.5 Group Life and the Special Policies

UNIT 4 · WEEKS 10–14

Life Insurance: Provisions, Riders and Annuities

The standard provisions every life policy carries — ownership, grace period, reinstatement, loans, incontestability and misstatement of age; beneficiaries and settlement options; the riders and the nonforfeiture options built into the promise; annuities — immediate and deferred, fixed, indexed and variable, and their payout options; and policy delivery, replacement rules, Section 1035 exchanges and how life insurance is taxed.

4.1 The Policy's Promises: Standard Provisions and Exclusions

4.2 Beneficiaries and Settlement Options

4.3 Riders and Nonforfeiture: Options Built Into the Promise

4.4 Annuities: The Income That Cannot Be Outlived

4.5 Delivery, Replacement and the Taxman: Life Insurance Taxation

UNIT 5 · WEEKS 14–17

Health Insurance

Medical expense insurance — deductibles, coinsurance, out-of-pocket maximums and the HMO, PPO and high-deductible designs; disability income and the definitions that decide everything; Medicare, Medicaid, Medicare supplements and long-term care; the uniform provisions and the renewability ladder every health policy obeys; and group health, COBRA, HSAs, and the AD&D, dental, vision and limited policies.

5.1 Medical Expense Insurance: Deductibles, Networks and the Big Bill

5.2 Disability Income: Insuring the Paycheck

5.3 Medicare, Medicaid and Long-Term Care

5.4 The Uniform Provisions: How a Health Policy Behaves

5.5 Group Health, HSAs and the Specialized Policies

UNIT 6 · WEEKS 17–20

Property Insurance: The Home

The grammar of property insurance — named and open perils, direct and indirect loss, actual cash value, replacement cost and the coinsurance formula; the homeowners policy's property coverages (A–D) and its liability side (E–F) with the flood and earthquake gaps; the dwelling, renters and condominium forms; and the claim itself — duties after a loss, adjusters, appraisal, other-insurance clauses and subrogation.

6.1 Perils, Hazards and the Price of a Loss: ACV, Replacement Cost and Coinsurance

6.2 The Homeowners Policy: Dwelling and Belongings

6.3 The Homeowners Policy: Liability and the Gaps

6.4 Dwelling, Renters and Condominium Policies

6.5 After the Fire: Claims, Adjusters and Subrogation

UNIT 7 · WEEKS 20–24

Casualty Insurance: Autos and Liability

Negligence and the four elements by which the law assigns blame, with its defenses and its strict and vicarious forms; the personal auto policy part by part — liability, medical payments, uninsured and underinsured motorists, collision and other-than-collision; the personal umbrella above it all; and workers' compensation — the great bargain by which workers gave up lawsuits and employers accepted no-fault duty.

7.1 Negligence and the Four Elements: How the Law Assigns Blame

7.2 The Personal Auto Policy: Liability and Medical Payments

7.3 The Personal Auto Policy: Uninsured Motorists and Physical Damage

7.4 The Umbrella: Liability for the Catastrophic Day

7.5 Workers' Compensation: The Great Bargain

UNIT 8 · WEEKS 24–27

Commercial Lines

The commercial lines that insure Main Street: commercial property and the business income that stops when the building burns; the commercial general liability policy with its occurrence and claims-made forms; the businessowners policy and the commercial package; commercial auto and the marine lines that reach back to Lloyd's; and crime coverages, fidelity and surety bonds and professional liability.

8.1 Commercial Property and the Income That Stops

8.2 The CGL: Commercial General Liability

8.3 The Businessowners Policy: Main Street's Package

8.4 Commercial Auto, Inland and Ocean Marine

8.5 Crime, Bonds and Professional Liability

UNIT 9 · WEEKS 27–30

The Law of the License

The state insurance commissioner's powers, examinations and penalties; getting and keeping the license — renewals, continuing education, appointments and terminations, and the duty to report; the unfair trade practices by name — misrepresentation, twisting, rebating, defamation and coercion; unfair claims practices, consumer privacy and insurance fraud, including the federal felony-consent law; and suitability and best-interest duties in selling.

9.1 The Commissioner: Powers, Examinations and Penalties

9.2 Getting and Keeping the License: Renewals, CE and Appointments

9.3 Unfair Trade Practices: Twisting, Rebating and False Promises

9.4 Unfair Claims Practices, Privacy and Fraud

9.5 Suitability and Best Interest: Selling What the Client Needs

UNIT 10 · WEEKS 30–33

The Career and the Capstone

The pathway itself, walked step by step: enrollment, fingerprints and exam day at the testing vendor; appointment by carriers and the captive-versus-independent choice; building an honest book of business by prospecting, referrals and service; the agent's income — commissions, renewals and a clear-eyed look at the first three years; and the capstone — the pathway file, the career ladders beyond the license and the full-length practice exam.

10.1 Exam Day: Enrollment, Fingerprints and the Testing Center

10.2 Appointed: Carriers, Contracts and the Captive–Independent Choice

10.3 An Honest Book of Business: Prospecting, Referrals and Service

10.4 The Agent's Income: Commissions, Renewals and the First Three Years

10.5 The Capstone: Your Pathway File and the Practice Exam Plan

Weekly pacing calendar

WEEK	PLAN
1	• Day 1: Lesson 1.1 The Insurance Agent: A Promise-Keeper's Calling: video, teaching and worked examples • Day 2: Lesson 1.1: project and notebook • Day 3: Lesson 1.1: practice set and corrections • Day 4: Lesson 1.2 The Great Fire and the Coffee House: How Insurance Began: video, teaching and worked examples • Day 5: Lesson 1.2: project and notebook *Five sessions a week of about 50 minutes. Families on a four-day week can combine the practice day of one lesson with the teaching day of the next.*

WEEK	PLAN
2	• Day 1: Lesson 1.2: practice set and corrections • Day 2: Lesson 1.3 Spreading the Risk: The Law of Large Numbers: video, teaching and worked examples • Day 3: Lesson 1.3: project and notebook • Day 4: Lesson 1.3: practice set and corrections • Day 5: Lesson 1.4 Fifty Regulators: Paul v. Virginia, SEUA and McCarran-Ferguson: video, teaching and worked examples
3	• Day 1: Lesson 1.4: project and notebook • Day 2: Lesson 1.4: practice set and corrections • Day 3: Lesson 1.5 The License: Lines, Exams and Your Study Plan: video, teaching and worked examples • Day 4: Lesson 1.5: project and notebook • Day 5: Lesson 1.5: practice set and corrections
4	• Day 1: Unit 1 test • Day 2: Lesson 2.1 A Contract Like No Other: Elements and Characteristics: video, teaching and worked examples • Day 3: Lesson 2.1: project and notebook • Day 4: Lesson 2.1: practice set and corrections • Day 5: Lesson 2.2 Insurable Interest and Indemnity: No Betting Allowed: video, teaching and worked examples
5	• Day 1: Lesson 2.2: project and notebook • Day 2: Lesson 2.2: practice set and corrections • Day 3: Lesson 2.3 Utmost Good Faith: Representations, Warranties and Concealment: video, teaching and worked examples • Day 4: Lesson 2.3: project and notebook • Day 5: Lesson 2.3: practice set and corrections
6	• Day 1: Lesson 2.4 The Agent's Three Authorities: Express, Implied and Apparent: video, teaching and worked examples • Day 2: Lesson 2.4: project and notebook • Day 3: Lesson 2.4: practice set and corrections • Day 4: Lesson 2.5 Underwriting: The Application, the MIB and the Price of Risk: video, teaching and worked examples • Day 5: Lesson 2.5: project and notebook

WEEK	PLAN
7	• Day 1: Lesson 2.5: practice set and corrections • Day 2: Unit 2 test • Day 3: Lesson 3.1 Why Life Insurance: Needs, Human Life Value and the Ministers' Fund: video, teaching and worked examples • Day 4: Lesson 3.1: project and notebook • Day 5: Lesson 3.1: practice set and corrections
8	• Day 1: Lesson 3.2 Term Life: Renting the Promise: video, teaching and worked examples • Day 2: Lesson 3.2: project and notebook • Day 3: Lesson 3.2: practice set and corrections • Day 4: Lesson 3.3 Whole Life: The Promise That Endures: video, teaching and worked examples • Day 5: Lesson 3.3: project and notebook
9	• Day 1: Lesson 3.3: practice set and corrections • Day 2: Lesson 3.4 Flexible Designs: Universal, Indexed and Variable Life: video, teaching and worked examples • Day 3: Lesson 3.4: project and notebook • Day 4: Lesson 3.4: practice set and corrections • Day 5: Lesson 3.5 Group Life and the Special Policies: video, teaching and worked examples
10	• Day 1: Lesson 3.5: project and notebook • Day 2: Lesson 3.5: practice set and corrections • Day 3: Unit 3 test • Day 4: Lesson 4.1 The Policy's Promises: Standard Provisions and Exclusions: video, teaching and worked examples • Day 5: Lesson 4.1: project and notebook
11	• Day 1: Lesson 4.1: practice set and corrections • Day 2: Lesson 4.2 Beneficiaries and Settlement Options: video, teaching and worked examples • Day 3: Lesson 4.2: project and notebook • Day 4: Lesson 4.2: practice set and corrections • Day 5: Lesson 4.3 Riders and Nonforfeiture: Options Built Into the Promise: video, teaching and worked examples

WEEK	PLAN
12	• Day 1: Lesson 4.3: project and notebook • Day 2: Lesson 4.3: practice set and corrections • Day 3: Lesson 4.4 Annuities: The Income That Cannot Be Outlived: video, teaching and worked examples • Day 4: Lesson 4.4: project and notebook • Day 5: Lesson 4.4: practice set and corrections
13	• Day 1: Lesson 4.5 Delivery, Replacement and the Taxman: Life Insurance Taxation: video, teaching and worked examples • Day 2: Lesson 4.5: project and notebook • Day 3: Lesson 4.5: practice set and corrections • Day 4: Unit 4 test • Day 5: Lesson 5.1 Medical Expense Insurance: Deductibles, Networks and the Big Bill: video, teaching and worked examples
14	• Day 1: Lesson 5.1: project and notebook • Day 2: Lesson 5.1: practice set and corrections • Day 3: Lesson 5.2 Disability Income: Insuring the Paycheck: video, teaching and worked examples • Day 4: Lesson 5.2: project and notebook • Day 5: Lesson 5.2: practice set and corrections
15	• Day 1: Lesson 5.3 Medicare, Medicaid and Long-Term Care: video, teaching and worked examples • Day 2: Lesson 5.3: project and notebook • Day 3: Lesson 5.3: practice set and corrections • Day 4: Lesson 5.4 The Uniform Provisions: How a Health Policy Behaves: video, teaching and worked examples • Day 5: Lesson 5.4: project and notebook
16	• Day 1: Lesson 5.4: practice set and corrections • Day 2: Lesson 5.5 Group Health, HSAs and the Specialized Policies: video, teaching and worked examples • Day 3: Lesson 5.5: project and notebook • Day 4: Lesson 5.5: practice set and corrections • Day 5: Unit 5 test

WEEK	PLAN
17	• Day 1: Review day for the midterm • Day 2: Midterm exam (60 questions, two hours, one sitting) • Day 3: Lesson 6.1 Perils, Hazards and the Price of a Loss: ACV, Replacement Cost and Coinsurance: video, teaching and worked examples • Day 4: Lesson 6.1: project and notebook • Day 5: Lesson 6.1: practice set and corrections
18	• Day 1: Lesson 6.2 The Homeowners Policy: Dwelling and Belongings: video, teaching and worked examples • Day 2: Lesson 6.2: project and notebook • Day 3: Lesson 6.2: practice set and corrections • Day 4: Lesson 6.3 The Homeowners Policy: Liability and the Gaps: video, teaching and worked examples • Day 5: Lesson 6.3: project and notebook
19	• Day 1: Lesson 6.3: practice set and corrections • Day 2: Lesson 6.4 Dwelling, Renters and Condominium Policies: video, teaching and worked examples • Day 3: Lesson 6.4: project and notebook • Day 4: Lesson 6.4: practice set and corrections • Day 5: Lesson 6.5 After the Fire: Claims, Adjusters and Subrogation: video, teaching and worked examples
20	• Day 1: Lesson 6.5: project and notebook • Day 2: Lesson 6.5: practice set and corrections • Day 3: Unit 6 test • Day 4: Lesson 7.1 Negligence and the Four Elements: How the Law Assigns Blame: video, teaching and worked examples • Day 5: Lesson 7.1: project and notebook
21	• Day 1: Lesson 7.1: practice set and corrections • Day 2: Lesson 7.2 The Personal Auto Policy: Liability and Medical Payments: video, teaching and worked examples • Day 3: Lesson 7.2: project and notebook • Day 4: Lesson 7.2: practice set and corrections • Day 5: Lesson 7.3 The Personal Auto Policy: Uninsured Motorists and Physical Damage: video, teaching and worked examples

WEEK	PLAN
22	• Day 1: Lesson 7.3: project and notebook • Day 2: Lesson 7.3: practice set and corrections • Day 3: Lesson 7.4 The Umbrella: Liability for the Catastrophic Day: video, teaching and worked examples • Day 4: Lesson 7.4: project and notebook • Day 5: Lesson 7.4: practice set and corrections
23	• Day 1: Lesson 7.5 Workers' Compensation: The Great Bargain: video, teaching and worked examples • Day 2: Lesson 7.5: project and notebook • Day 3: Lesson 7.5: practice set and corrections • Day 4: Unit 7 test • Day 5: Lesson 8.1 Commercial Property and the Income That Stops: video, teaching and worked examples
24	• Day 1: Lesson 8.1: project and notebook • Day 2: Lesson 8.1: practice set and corrections • Day 3: Lesson 8.2 The CGL: Commercial General Liability: video, teaching and worked examples • Day 4: Lesson 8.2: project and notebook • Day 5: Lesson 8.2: practice set and corrections
25	• Day 1: Lesson 8.3 The Businessowners Policy: Main Street's Package: video, teaching and worked examples • Day 2: Lesson 8.3: project and notebook • Day 3: Lesson 8.3: practice set and corrections • Day 4: Lesson 8.4 Commercial Auto, Inland and Ocean Marine: video, teaching and worked examples • Day 5: Lesson 8.4: project and notebook
26	• Day 1: Lesson 8.4: practice set and corrections • Day 2: Lesson 8.5 Crime, Bonds and Professional Liability: video, teaching and worked examples • Day 3: Lesson 8.5: project and notebook • Day 4: Lesson 8.5: practice set and corrections • Day 5: Unit 8 test

WEEK	PLAN
27	• Day 1: Lesson 9.1 The Commissioner: Powers, Examinations and Penalties: video, teaching and worked examples • Day 2: Lesson 9.1: project and notebook • Day 3: Lesson 9.1: practice set and corrections • Day 4: Lesson 9.2 Getting and Keeping the License: Renewals, CE and Appointments: video, teaching and worked examples • Day 5: Lesson 9.2: project and notebook
28	• Day 1: Lesson 9.2: practice set and corrections • Day 2: Lesson 9.3 Unfair Trade Practices: Twisting, Rebating and False Promises: video, teaching and worked examples • Day 3: Lesson 9.3: project and notebook • Day 4: Lesson 9.3: practice set and corrections • Day 5: Lesson 9.4 Unfair Claims Practices, Privacy and Fraud: video, teaching and worked examples
29	• Day 1: Lesson 9.4: project and notebook • Day 2: Lesson 9.4: practice set and corrections • Day 3: Lesson 9.5 Suitability and Best Interest: Selling What the Client Needs: video, teaching and worked examples • Day 4: Lesson 9.5: project and notebook • Day 5: Lesson 9.5: practice set and corrections
30	• Day 1: Unit 9 test • Day 2: Lesson 10.1 Exam Day: Enrollment, Fingerprints and the Testing Center: video, teaching and worked examples • Day 3: Lesson 10.1: project and notebook • Day 4: Lesson 10.1: practice set and corrections • Day 5: Lesson 10.2 Appointed: Carriers, Contracts and the Captive–Independent Choice: video, teaching and worked examples
31	• Day 1: Lesson 10.2: project and notebook • Day 2: Lesson 10.2: practice set and corrections • Day 3: Lesson 10.3 An Honest Book of Business: Prospecting, Referrals and Service: video, teaching and worked examples • Day 4: Lesson 10.3: project and notebook • Day 5: Lesson 10.3: practice set and corrections

WEEK	PLAN
32	• Day 1: Lesson 10.4 The Agent's Income: Commissions, Renewals and the First Three Years: video, teaching and worked examples • Day 2: Lesson 10.4: project and notebook • Day 3: Lesson 10.4: practice set and corrections • Day 4: Lesson 10.5 The Capstone: Your Pathway File and the Practice Exam Plan: video, teaching and worked examples • Day 5: Lesson 10.5: project and notebook
33	• Day 1: Lesson 10.5: practice set and corrections • Day 2: Unit 10 test • Day 3: Review day for the final • Day 4: Final exam: a full-length practice state licensing exam (150 questions, two and a half hours, one sitting) • Day 5: Score the final as a state would (70% — 105 of 150 — passes), review every miss, and plan the real licensing steps with your parents

Materials

A calculator

A basic or scientific calculator is enough; testing centers provide or allow a simple calculator, so practice doing exam problems with nothing fancier.

Exam notebook (a bound notebook), pencil and ruler

For definitions, comparisons, trap lists, the state facts sheet, and every corrected practice question — the single most valuable study tool in the course.

Index cards

For the vocabulary: a state licensing exam is half a vocabulary exam. Build the deck unit by unit; by Unit 10 it will hold about 400 cards.

Free spreadsheet software (Google Sheets or LibreOffice Calc)

Used in several projects: premium and needs-analysis tables, the coinsurance and claim-settlement calculators, and the first-three-years income model.

Your state insurance department’s website and exam candidate handbook

Free and official. Find your state at naic.org (the directory of all fifty departments), download the candidate handbook from the state’s testing vendor, and keep the dated state facts sheet from Lesson 1.5 current all year.

A kitchen timer or stopwatch

Exam training is time training: about one minute per question. Used from Unit 1 onward on every practice set, and for the proctored midterm and final.

Optional: one of the books or resources listed in a unit

Never required. See the list in each unit.

Grading

Grades come from the practice sets, the projects, the exam notebook, the ten unit tests, the midterm and the full-length practice final. A multiple-choice answer earns credit only when the student can defend it; on review days, pick five questions at random and ask "why is this the answer, and why are the other three wrong?" A calculation earns full credit when the formula, the substitution and the answer with its units are all shown.

PART	%
Practice sets (completed and corrected)	**15**
Projects (real numbers, organization, explanation)	**20**
Exam notebook (definitions, trap lists, state facts sheet, corrected misses)	**10**
Unit tests	**30**
Midterm exam (60 questions, timed)	**10**
Final exam (full-length 150-question practice licensing exam, timed)	**15**

Scale: A 90–100, B 80–89, C 70–79, D 60–69, F below 60.

- Practice sets are graded for completion and correction, not first-try accuracy: a question missed, understood and rewritten in the notebook earns full credit.
- The final is also reported the way a state would score it: 70% — 105 of 150 — passes. A student who passes the course final under honest exam conditions is ready to study a real state's candidate handbook and plan for a real seat.

- A project earns full marks when its numbers are complete and labeled, its totals are correct, and it ends with a paragraph on what the student learned.
- For a high-school transcript this course is one full credit of business/finance (career and technical education). Keep the exam notebook, the projects and the scored practice final as the course portfolio.

A NOTE TO PARENTS

You do not need an insurance background to run this course well. Your jobs are to keep the rhythm (three sessions per lesson), check the practice sets against the answers, ask the student to defend a few answers aloud each week, discuss the ethics cases at the table, and proctor the three timed exams honestly — closed book, full time, no pauses. The course is self-explaining; the student does the work.

Be clear-eyed about the pathway, and hopeful. This is one of the most reachable licensed careers in the country: no college requirement, a short study runway (some states require no classroom hours at all; others roughly 20 to 40 per line), a state exam that most prepared candidates pass, and a licensing process that an adult commonly finishes in two to eight weeks. Nearly every state requires a licensee to be 18, so the wise plan for most students is to master the material now and sit for the real exam near or after graduation. The same honesty applies to the job: the federal Bureau of Labor Statistics reports a median around $60,370 (May 2024), commissions and renewals raise the ceiling well above it, and the first years are the hard ones — Unit 10 does that arithmetic without varnish, and also teaches the student to recognize and walk past recruiting schemes that sell the job instead of the work. Current rules and fees are at your state insurance department and nipr.com; this course states them as ranges and labels every figure as an example. School Launch has no connection to any insurer, testing vendor or licensing authority, and this course is a preparation, not a guarantee.

The history is told honestly: fires, shipwrecks and frauds are taught as lessons, without sensationalism, and the laws that grew out of them are taught as settled history, not present-day debates. The deeper aim is older than the industry: insurance began as neighbors agreeing to carry one another's losses, and Scripture calls the prudent man to see trouble coming and provide for his own house (Proverbs 22:3; 1 Timothy 5:8). If your student ends this course able to pass a hard

exam and unwilling to sell a family anything it does not need, it has succeeded twice. *Fabricando fit faber*: by making, one becomes a maker.

UNIT 1

The Calling and the Path

Before you memorize a single policy provision, you should meet the profession and hear where it came from. In this unit you will meet the **insurance agent** — the law calls him a **producer** — the licensed person who matches families with the coverage they need and then stands beside them when the loss comes. You will hear the cable Cuthbert Heath sent from London after the 1906 San Francisco earthquake — pay the policyholders in full — and learn why a business built on paper promises lives or dies by keeping them. Then you will walk back to the beginning: London burning in 1666, Nicholas Barbon's Fire Office of 1681, the sailors and merchants at Edward Lloyd's coffee house writing their names *under* the risks, Benjamin Franklin's Philadelphia Contributionship of 1752, and the Presbyterian Ministers' Fund of 1759 that became America's first life insurer.

From the stories you will draw the machinery: **pure risk**, perils and hazards, the four ways to manage a risk, and the **law of large numbers** that Jacob Bernoulli proved in a book published in 1713 — the mathematics that turns many small premiums into one kept promise. You will watch the Supreme Court hand insurance regulation to the states in *Paul v. Virginia* (1869), take it back in the *South-Eastern Underwriters* case (1944), and watch Congress return it by the McCarran-Ferguson Act (1945) — which is why fifty state regulators, not one federal agency, will license you. The unit ends at your own door: the lines of authority, the licensing steps in order, your state's actual rules on a dated facts sheet, and the 33-week study plan this course follows.

PREREQUISITES

- Can work comfortably with percents and decimals (find 70% of 150, multiply a probability by a dollar amount)
- Can read a timeline and keep a tidy, dated notebook
- Can look up a source online (naic.org, nipr.com, your state insurance department) and record what it says
- Has completed a basic personal-finance course or can define premium, policy and risk in one sentence each

MASTERY CHECKLIST

- ☐ I can define an insurance agent (producer) and a broker and state whom each one legally represents.
- ☐ I can describe an agent's working week — needs analysis, quoting, applications, service and claims advocacy — and contrast captive and independent agents.
- ☐ I can tell the story of insurance from the Great Fire of London (1666) through Lloyd's coffee house, Franklin's Contributionship (1752) and the Ministers' Fund (1759), and define underwriter, mutual and stock insurer.
- ☐ I can distinguish pure from speculative risk, a peril from a hazard, and physical, moral and morale hazards, and name the four risk-management choices.
- ☐ I can state the law of large numbers, list the characteristics of an ideally insurable risk, define adverse selection, and compute an expected loss and a simple pure premium.
- ☐ I can tell the regulation story — Paul v. Virginia (1869), South-Eastern Underwriters (1944), McCarran-Ferguson (1945) — and classify insurers as admitted or non-admitted and domestic, foreign or alien.
- ☐ I can name the major lines of authority and recite the licensing

steps in order, from choosing a line to carrier appointment, with the common figures as of 2026.

- ☐ I can build a dated state facts sheet from my own state's insurance department and candidate handbook, and lay out a 33-week study calendar with a weekly review habit.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: State Insurance Departments directory**: Free, official. The National Association of Insurance Commissioners' map of all fifty state departments — the front door to your state's licensing rules, candidate handbook and consumer services. Open it in Lesson 1.4 to find your commissioner, and again in Lesson 1.5 to build your state facts sheet. Ages 14 and up.
- **Insurance Information Institute (iii.org)**: Free. The industry's consumer-education site: plain-language explainers on how auto, home and life insurance work, with facts and statistics pages. Browse the basics articles alongside Lessons 1.1 and 1.3 to see how the ideas in this unit are explained to the public an agent serves. Ages 14 and up.
- **NIPR (National Insurance Producer Registry)**: Free to browse, official. The nonprofit registry through which most producer license applications actually flow, with state-by-state licensing requirements. Look up your state with Lesson 1.5 — this is the site you will use for real after you pass. Ages 15 and up.
- ***The Autobiography of Benjamin Franklin***: Free on the Internet Archive. Franklin tells in his own words how Philadelphia organized itself — the Junto, the Union Fire Company of 1736, the subscription projects that led to the Contributionship of 1752. Read a chapter with Lesson 1.2 for the flavor of organized neighborliness. Ages 14 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

1.1 The Insurance Agent: A Promise-Keeper's Calling

3 sessions of 50 minutes

1.2 The Great Fire and the Coffee House: How Insurance Began

3 sessions of 50 minutes

1.3 Spreading the Risk: The Law of Large Numbers 3 sessions of 50 minutes

1.4 Fifty Regulators: Paul v. Virginia, SEUA and McCarran-Ferguson

3 sessions of 50 minutes

1.5 The License: Lines, Exams and Your Study Plan 3 sessions of 50 minutes

Unit 1 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about a minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; there is no guessing penalty, so an unanswered question is simply wrong. Where a question says “in this example,” use the figures given, and remember that real fees, hours and question counts live at your state insurance department and in its candidate handbook. A state licensing exam would pass you at 70% — 14 of 20 — but aim higher. Choose the one BEST answer.

1. **5 pts**

   In a standard agency relationship, an insurance agent legally represents:

   A. The applicant

   B. The insurer that appointed him

   C. The state insurance department

   D. The testing vendor

2. **5 pts**

   Under modern state licensing law, a “producer” is best defined as:

   A. Any person licensed to sell, solicit or negotiate insurance

   B. Only an agent appointed by a single insurer

   C. Only a broker representing buyers

   D. An insurer’s home-office underwriter

3. 5 pts

Which statement about captive and independent agents is TRUE?

A. The captive agent typically owns his book of business

B. The independent agent may sell for only one insurer group

C. The captive agent represents the buyer

D. The independent agent typically holds appointments from several insurers and owns his book of business

4. 5 pts

A newly licensed producer may act as a particular insurer's agent only after:

A. Passing a second state exam

B. Joining the NAIC

C. That insurer appoints her, filing the appointment with the state

D. Five years of experience

5. 5 pts

The Great Fire of London, which exposed the need for fire insurance, occurred in:

A. 1666, beginning in a bakehouse on Pudding Lane

B. 1752, beginning in Independence Hall

C. 1906, beginning along a California fault line

D. 1681, beginning at the Royal Exchange

6. 5 pts

A mutual insurer is owned by:

A. Its stockholders

B. The state guaranty association

C. Its policyholders

D. Its appointed agents

7. 5 pts

The term “underwriter” comes from:

A. Clerks who copied policies by hand

B. Merchants at Lloyd’s coffee house who wrote their names under a described risk, accepting a share of it

C. Printers who set policy forms in type

D. Judges who signed insurance disputes into law

8. 5 pts

Which best describes Lloyd’s of London?

A. The world’s largest mutual insurance company

B. A stock insurer founded by Edward Lloyd

C. A British government agency

D. A marketplace where syndicates of underwriters accept shares of risks

9. 5 pts

The first life insurance corporation in America was:

A. The Philadelphia Contributionship (1752)

B. The Presbyterian Ministers’ Fund (1759)

C. Barbon’s Fire Office (1681)

D. The South-Eastern Underwriters Association (1944)

10. 5 pts

Which of the following risks is insurable?

A. A homeowner’s risk that fire will destroy her house

B. An investor’s risk that his stock will fall

C. A gambler’s risk of losing a wager

D. A merchant’s risk that a new product will not sell

11. 5 pts

Lightning strikes a house with an old wood-shingle roof, causing a fire. The lightning and the roof are, respectively:

A. Hazard and peril

B. Both perils

C. Peril and physical hazard

D. Both hazards

12. 5 pts

An insured leaves his car unlocked with the keys inside “because theft is covered,” while another insured stages a theft that never happened. These illustrate, respectively:

A. Moral hazard and morale hazard

B. Physical hazard and moral hazard

C. Morale hazard and physical hazard

D. Morale hazard and moral hazard

13. 5 pts

The law of large numbers allows an insurer to:

A. Prevent losses from occurring

B. Predict the group’s total losses more accurately as the number of similar exposures increases

C. Guarantee that no individual insured suffers a loss

D. Eliminate the need for underwriting

14. 5 pts

The tendency of persons most likely to suffer losses to seek and keep insurance most eagerly is called:

A. Adverse selection

B. Subrogation

C. Reciprocity

D. Indemnity

15. 5 pts

An insurer covers 1,000 similar houses, each with a 1-in-200 annual chance of a $180,000 total loss, in this example. The pure premium per house is:

A. $90

B. $180

C. $900

D. $1,800

16. 5 pts

Paul v. Virginia (1869) held that:

A. Insurance is interstate commerce subject to federal antitrust law

B. Congress must license all insurance agents

C. Rate-fixing by insurers violates the Sherman Act

D. Issuing an insurance policy is not a transaction of interstate commerce, leaving regulation to the states

17. 5 pts

Under the McCarran-Ferguson Act (1945), the business of insurance is regulated:

A. Exclusively by the federal government

B. Primarily by the states, with federal antitrust law applying only to the extent the states do not regulate it

C. By the NAIC directly

D. By no one, as a matter of contract freedom

18. 5 pts

An insurer incorporated in Iowa and licensed to sell in Nebraska is, from Nebraska's standpoint:

A. A foreign, admitted insurer

B. An alien, admitted insurer

C. A domestic, non-admitted insurer

D. A foreign, non-admitted insurer

19. 5 pts

A producer tells a hesitant prospect, "The state guaranty association will pay your claim even if this insurer fails, so there's no risk." This statement is:

A. Good practice, because it is substantially true

B. Required disclosure under state law

C. Permitted only in writing

D. A prohibited sales practice — the guaranty association may not be used to induce a sale

20. 5 pts

A producer holding only a life line of authority wants to sell variable annuities and asks what more, if anything, she needs. The correct answer is:

A. Nothing; a life license covers all annuities

B. A property & casualty license

C. FINRA securities registration in addition to her life license

D. Written consent under 18 U.S.C. §1033

ANSWER KEY

1. B. The agent is the insurer's representative; the broker represents the buyer. A describes a broker — the exam's favorite reversal.
2. A. Producer is the umbrella licensing term covering agents and brokers alike. B and C each name only half of it, and D is a company employee role, not a producer.
3. D. Independence means multiple appointments and ownership of the book. A and B swap the models' traits, and C confuses agents with brokers — both kinds of agent represent insurers.
4. C. One license, but a separate appointment from each insurer represented. A applies only to a new line of authority, and B misunderstands the NAIC, which is the regulators' association.
5. A. September 2, 1666 — about 13,200 houses and old St. Paul's. 1681 is Barbon's Fire Office, 1752 the Philadelphia Contributionship, 1906 the San Francisco earthquake.
6. C. Policyholders own a mutual and may receive non-guaranteed policy dividends; stockholders (A) own a stock insurer.
7. B. Risk-takers signed beneath the risk on the broker's slip — wrote under it. Today the word also names the insurer's risk-selection professional.
8. D. Lloyd's is a market of underwriting syndicates, not an insurance company — the distinction exams test by listing "Lloyd's associations" as a separate insurer type.
9. B. Chartered in 1759 to provide for ministers' widows and orphans. The Contributionship (A) was earlier but insured houses; C is English fire insurance; D was a rating bureau.
10. A. Insurance covers pure risk only — loss or no loss, no chance of gain. B, C and D are speculative risks, which include the possibility of profit and are uninsurable.
11. C. The peril is the cause of loss — lightning (and the fire it starts); the shingle roof is a physical hazard, a condition making loss likelier or worse. A reverses the pair.
12. D. Carelessness bred by coverage is morale hazard; dishonesty is moral hazard. A reverses them — the single most-missed pairing on licensing exams.
13. B. Large numbers make group results predictable; they make no individual loss less likely (A, C) and underwriting is still needed against adverse selection (D).

14. A. Adverse selection tilts the pool toward poor risks; underwriting is its remedy. B, C and D are real terms from other lessons that do not describe the tilt.
15. C. Expected losses: $1{,}000 \div 200 = 5$; total $5 \times \$180{,}000 = \$900{,}000$; per house $\$900{,}000 \div 1{,}000 = \$900$. A and B come from skipping the loss amount or the pool division.
16. D. Paul kept insurance with the states for 75 years. A describes the SEUA decision of 1944 that reversed it; C describes SEUA's consequence; B happened in neither case.
17. B. The act restored state primacy on condition the states regulate — and boycott, coercion and intimidation remain federally punishable regardless. The NAIC (C) drafts models but regulates nothing directly.
18. A. Another state makes it foreign (another country would make it alien); its Nebraska certificate of authority makes it admitted there.
19. D. Advertising or invoking the guaranty association in selling is forbidden, even when technically accurate, because it erases the buyer's incentive to choose financially sound insurers.
20. C. Variable products are both insurance and securities, requiring FINRA registration (Series 6 or 7) on top of the life line. §1033 consent (D) concerns felony convictions, not product authority.

PORTFOLIO PIECE: MY PATHWAY FILE

Assemble the file that maps the profession and your road into it: the one-page profession map of agent, broker, captive and independent with the two product worlds (Lesson 1.1); the completed timeline from the Great Fire of 1666 through the Ministers' Fund of 1759 to the regulation layer of 1869, 1871, 1944 and 1945, with your state's commissioner and department named on the page (Lessons 1.2 and 1.4); the risk map of your own household with its peril-and-hazard columns and pool arithmetic (Lesson 1.3); and the dated state facts sheet with every row sourced, beside the 33-week study calendar countersigned by a parent (Lesson 1.5).

Close the file with a one-page cover letter addressed to your future first client, explaining in your own words what an insurance agent is, why the business began among neighbors bearing one another's burdens, and why — citing the Good Samaritan and Cuthbert Heath's 1906 cable — they will be able to trust you with their worst day. Date it; in Unit 10 you will read it again beside the full-length practice exam and see how far the file has come.

LOOK FOR	WHAT IT MEANS
Profession map	Agent and broker are correctly contrasted by whom each represents; captive and independent by companies, book ownership and support; the two license families are shown; and the dated BLS and reachability facts carry their sources.
Timeline	All anchor events are present, dated and correctly placed — 1666, 1681, c. 1688, 1736, 1752, 1759, 1869, 1871, 1944, 1945 — each regulation entry carries its one-line holding, and the student can narrate the whole line aloud in under four minutes without errors.
Risk map	Eight real exposures are listed with sensible perils; each hazard is correctly labeled physical, moral or morale; every risk is assigned a defensible technique; and the pool arithmetic (expected losses, total cost, pure premium) is computed correctly and labeled as an example.
State facts sheet and calendar	Every licensing fact carries an answer and an official source, at least five rows are check-marked as verified in the candidate handbook itself, the sheet is dated "as of," and the 33-week calendar shows unit tests, midterm, final, a weekly review slot, the timed drill and a parent's countersignature.

LOOK FOR	WHAT IT MEANS
Cover letter and reflection	The letter defines the agent's calling accurately, uses the 1906 story and the Scripture honestly rather than decoratively, names whom an agent represents without fudging, and connects the student's own study plan to the faithfulness the profession requires.

1.1 The Insurance Agent: A Promise-Keeper's Calling

OBJECTIVES

- Define an insurance agent (producer) as the insurer's licensed representative and a broker as the buyer's representative, and state whom each legally serves.
- Describe an agent's working week: needs analysis, quoting, applications, policy delivery, service and claims advocacy.
- Contrast captive (exclusive) and independent agents, and name the two great families of licenses: life & health and property & casualty.
- State the profession's entry facts as of 2026 — high-school diploma, state exam, about two to eight weeks for an adult — and the BLS pay and outlook figures with their dates.
- Explain the agent's work as promise-keeping and stewardship, using the Good Samaritan as the pattern of the neighbor who shows up.

> **Warm-up.** In five minutes, list every insurance policy you think your household carries — car, home or renters, life, health, anything else. Beside each, write one sentence on what you imagine the agent who sold it actually did to earn the sale. Keep the paper: at the end of the lesson, correct your own job description.

WATCH

What does an insurance agent do and what should they do?

Think Insurance · 10:22

https://www.youtube.com/watch?v=eoFl8zIxKkk

> **WHEN TO WATCH**
> Watch after reading the big idea; list each task the teacher names in an agent's day, then star the ones that happen after the sale — service and claims are where promises get kept.

BACKUP VIDEO

Insurance Agent, Broker, Producer, What are the Differences?

Kevin Knauss · 11:19

https://www.youtube.com/watch?v=I4ic5h1ggA0

A working agent untangles the three titles; watch it before the project if the agent–broker–producer distinctions still blur, and write his one-line version of each.

KEY TERMS

insurance agent

A licensed individual who legally represents an insurance company, soliciting and selling its policies and serving its policyholders.

broker

A licensed person who represents the insurance buyer, shopping among insurers for coverage; a broker does not legally represent any insurance company.

producer

The modern legal term in most states for any licensed person who sells, solicits or negotiates insurance — agents and brokers alike.

appointment

An insurer's official authorization, filed with the state, that makes a licensed producer its agent for selling its policies.

captive (exclusive) agent

An agent who represents a single insurer or insurer group and sells only its products.

independent agent

An agent appointed by several insurers who places each client's business among them and typically owns his book of business.

needs analysis

The fact-finding conversation and arithmetic by which an agent measures what a family stands to lose before recommending any coverage.

premium

The price the policyholder pays the insurer for the promise of coverage, usually monthly, semiannually or annually.

commission

The agent's compensation: a percentage of the premium, paid by the insurer, often larger in a policy's first year with smaller renewal commissions after.

policyholder

The person or business that owns an insurance policy and is owed its promises.

line of authority

A category of insurance — such as life, accident & health, property or casualty — that a producer's license authorizes him to sell.

CORE IDEAS

The story. At 5:12 in the morning on April 18, 1906, the ground tore open along the San Andreas Fault and San Francisco shook apart; the fires that followed burned for three days and leveled most of the city's heart — more than 28,000 buildings. Then came the second test. Families held fire policies, but the fires had been started by an earthquake, and some insurers reached for that loophole to pay only part of what they owed, or nothing. In London, an underwriter at Lloyd's named **Cuthbert Heath** — the man whose syndicates had written much of the American business — sent his San Francisco agent a cable that insurance people still quote: pay all of our policyholders in full, irrespective of the terms of their policies. Paying cost Lloyd's a staggering sum — tens of millions of dollars when a dollar was a day's wage — and it

bought something money cannot usually buy: a century of American trust. Insurers that paid in full advertised the fact for decades; the ones that dodged were remembered too. That is the whole profession in one morning: insurance is a promise on paper, worth exactly as much as the will to keep it.

How they figured it out. An insurance company is a stack of contracts in a distant office; a family cannot shake hands with it. So from the beginning the business ran on a person in town — the **agent** — who knew the company's products and the family's circumstances and stood between them. Through the nineteenth century, American insurers built networks of local agents into every county seat, and the law grew up around the relationship: the agent legally *represents the insurer*, is **appointed** by it in a filing with the state, and binds it by his authorized acts (Unit 2 takes up that authority in detail). A second figure grew up beside him: the **broker**, who represents the *buyer* and shops the market on the buyer's behalf. Today most states license both under one modern word — **producer**, a person licensed to sell, solicit or negotiate insurance — but the exam still asks the old question, and you must know the old answer: the agent represents the company; the broker represents the customer.

The big idea. What does an agent actually do all day? Less selling than you think, and more serving. He sits with a family and does a **needs analysis** — income, debts, dependents, house, cars, health — because honest insurance starts with measuring what a loss would actually cost. He quotes coverage and explains it in plain words, including what a policy does *not* cover. He completes applications carefully and truthfully, because he is the insurer's first underwriter in the field. He delivers policies and explains them again. Then the long part begins: he services the book — address changes, new babies, new drivers, annual reviews — and when the loss comes, he is the **claims advocate** who tells the family what to do first and walks their claim through the company. The sale takes an afternoon; the promise runs for years. Agents are paid by **commission** — a percentage of premium, typically front-loaded in the first year with smaller renewals after — so a lasting book of well-served clients, not a stack of one-time sales, is what an agent's living is made of.

Hold the agent–broker distinction steady, because the law hangs real consequences on it. An **agent** is appointed by an insurer; his knowledge is the company's knowledge, and within his authority his acts bind the company. A **broker** holds no appointment from the insurer on a given sale; he represents the applicant, finds the market, and is commonly paid a commission by the insurer even so — one of the

small oddities of the trade, fully legal and fully disclosable. Many working producers function as both on different transactions, which is exactly why the states folded the titles into one producer license. But on an exam question, the hats matter: if the question says the person represents the company, he is acting as an agent; if he represents the buyer, he is acting as a broker — whatever his business card says.

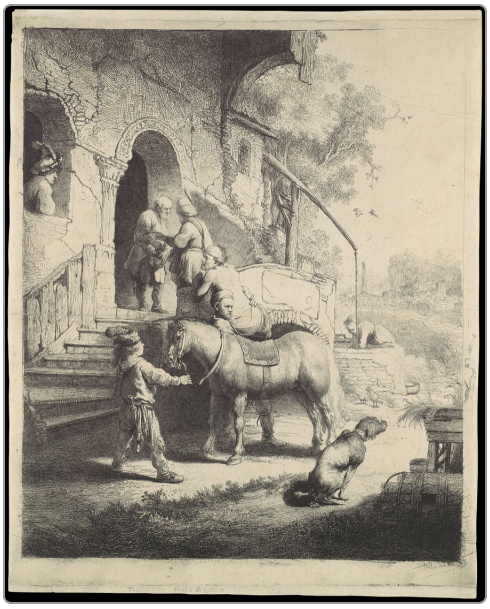
Agents also sort by how many companies they serve. A **captive** (or exclusive) agent represents one insurer or insurer group: he typically gets training, brand, office support and leads, and in exchange sells that company's products only and usually does not own his book of business. An **independent** agent is appointed by several insurers: he shops each client among his companies, owns his book and its renewals, and finds his own clients. Neither model is better; they fit different people, and Unit 10 weighs them honestly when your own choice gets near. Crosswise to that choice run the two great product worlds: **life & health** — policies about people: dying too soon, getting sick, living long — and **property & casualty** — policies about things and liability: houses, cars, storms, lawsuits. The licenses come by **line of authority**, and many agents eventually hold both families; this course prepares you for both.

Now the honest look at the door you are considering, with the figures dated. This is among the most reachable licensed professions in America: no college degree is required by any state, no sponsoring company is needed to sit the exam, and nearly every state licenses at age 18. An adult commonly goes from first study day to licensed agent in about two to eight weeks. The federal Bureau of Labor Statistics reports median pay of **$60,370** for insurance sales agents (May 2024), about 47,000 openings a year, and roughly 4% growth projected for 2024–34. Commissions and renewals raise the ceiling well above the median — and the floor is real too: first years are lean while the book grows, and Unit 10 does that arithmetic without varnish. What the numbers cannot show is the shape of the work: an agent spends his career being trusted with other families' worst days. Scripture's word for that is **steward** — entrusted with what is another's, required to be found faithful — and this course will keep both books open, the rate book and that one.

On the exam today. State licensing exams open here on every outline. Know the clean line: the *agent represents the insurer; the broker represents the applicant or insured* — and expect the trap answer that reverses it. Know that **producer** is the umbrella licensing term for those who sell, solicit or negotiate. Know that a producer must be **appointed** by an insurer before acting as its agent, and that the insurer files the

appointment with the state (Lesson 1.5 and Unit 9 return to this). Captive versus independent appears as a definitions question — one company versus several, who owns the book. And the exam loves the quiet point in this lesson's middle: the agent completing an application is doing *field underwriting*, the company's first look at the risk, which is why his truthfulness is a legal duty and not a courtesy.

PICTURE STUDY



The Good Samaritan, Rembrandt van Rijn, 1633 · Etching · The Metropolitan Museum of Art, New York

Image: Wikimedia Commons, public domain

Rembrandt was twenty-six when he etched the Good Samaritan — not the famous roadside rescue, but the less dramatic scene afterward: the inn, the handing-over, the Samaritan counting out two pence to the innkeeper and promising to repay whatever more the care should cost. It opens this lesson because that unglamorous moment — arranging and paying for another man's recovery — is the insurance transaction in its oldest form, and the agent's calling is to be the neighbor who organizes the help before and after the worst day.

Look closely

- Find the wounded man being eased down from the horse. How many people does his care already require?
- Find the Samaritan on the steps with the innkeeper. What is changing hands, and what promise goes with it?
- Notice the figure watching from the window and the man at the well, going on with ordinary work. Trouble arrives in the middle of everyday life — who stops for it?
- Look at the light. Rembrandt brightens the doorway where the arrangement is being made, not the victim. Why might the artist put the drama there?

Talk about it

1. The Samaritan pays now and promises more later — "when I come again, I will repay thee." How is an insurance policy like that promise, and who plays the Samaritan's part today?
2. The priest and the Levite in the parable crossed the road to avoid a neighbor's loss. What does this lesson's 1906 story say about companies — and agents — facing the same choice?
3. Jesus ends the parable with a command, not a definition: "Go, and do thou likewise." What would doing likewise look like in the working week of an agent you would want serving your own family?

PROJECT

The Profession Map: One License, Two Hats, Two Worlds

You will build the one-page map that opens your Pathway File: who the agent is, whom he represents, how he is paid, and the choices — captive or independent, life & health or property & casualty — that shape the career. This page hangs at the front of your exam notebook all year, because the exam's very first definitions live on it.

You will need

- One sheet of unlined paper (or a single spreadsheet page)
- Your exam notebook and pen, plus two ink colors
- This lesson's key terms, and the iii.org basics pages from the kit if you want examples

Steps

1. Across the top, write the law's one word — PRODUCER — and under it the two hats: AGENT (represents the insurer, holds an appointment) and BROKER (represents the buyer, holds no appointment on the sale).
2. Rule a two-column block below: CAPTIVE vs. INDEPENDENT. Fill four rows for each: how many companies, who owns the book of business, who supplies training and leads, who finds the clients.
3. Add a circle divided in two labeled THE TWO WORLDS: life & health on one side (dying too soon, sickness, living long), property & casualty on the other (homes, autos, liability). Note under it: separate exams, many agents eventually hold both.
4. Draw the agent's week as a six-step cycle around the page's edge: needs analysis → quote → application → delivery → service → claims advocacy, and star the steps that happen after the sale.
5. Add a dated facts row along the bottom: diploma is enough, age 18 in nearly every state, no sponsoring company required, about 2–8 weeks for an adult, BLS median $60,370 (May 2024), about 47,000 openings a year — and write "check your state" beside the licensing items.

6. Test the map: write these five people in the margin and label each one — a licensed producer appointed by one insurer group; a producer appointed by six insurers; a licensed person shopping the market for a factory owner; an unlicensed office scheduler; a company underwriter at headquarters. (Agent-captive; agent-independent; broker; neither; neither.)
7. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make a flashcard for each key term in this lesson, term on the front, one-sentence definition on the back — the first cards in a box that will hold about 400 by Unit 10.
2. Draw a two-circle diagram: one circle labeled REPRESENTS THE INSURER (agent), one labeled REPRESENTS THE BUYER (broker), and in the overlap write "producer — one license, ask which hat."
3. Write a five-line trap list titled "Agent vs. broker," ending with: the commission check does NOT decide whom a producer represents.

> **From history.** Cuthbert Heath's 1906 cable was not his only mark on the business. Nicknamed the father of the non-marine market, he had already written Lloyd's first burglary insurance in 1889 — his underwriting box reportedly took the risk as a curiosity and built it into a market — and after San Francisco he pioneered excess-of-loss reinsurance, insurance for insurers, so that no single catastrophe could again threaten to break the houses that paid honestly.

WORKED EXAMPLES

Example 1. In this example, an agent sells a homeowners policy with a $1,400 annual premium at a 12% commission, and a term life policy with a $600 annual premium paying 80% first-year commission and 5% renewals. What does the agent earn from each in year one, and from the life policy in year two if it renews?

Show solution

1. Homeowners, year one: $0.12 \times \$1{,}400 = \$168$.
2. Term life, year one: $0.80 \times \$600 = \$480$.
3. Term life, year two renewal: $0.05 \times \$600 = \$30$.
4. Notice the shapes: property & casualty commissions are moderate but repeat at similar rates each renewal; life commissions are front-loaded, then small. Both models pay best for the same behavior — policies that stay in force because they fit the client and are serviced well.

Answer: Homeowners: $168; life year one: $480; life year two: $30. Commission rates vary by company and product — these are example figures, not quotes.

Example 2. Exam style. In a standard agency relationship, an insurance agent legally represents:

A. The applicant

B. The insurance company that appointed him

C. The state insurance department

D. Whoever pays his commission on that sale

Show solution

1. Recall the clean line: agent — insurer; broker — buyer.
2. A describes a broker, not an agent; the exam counts on you swapping them.
3. C confuses licensing with representation: the state licenses the producer but is no one's principal in a sale.
4. D is a tempting cynicism, and wrong in law: even a broker is commonly paid commission by the insurer yet still represents the buyer. Representation is set by the agency relationship, not the payment path.

Answer: B. Appointment makes the agent the insurer's representative; whom a producer represents never turns on who cuts the commission check.

Example 3. Exam style. A producer licensed in her state wants to start selling the policies of a second insurance company. Before she may act as that insurer's agent, what must happen?

A. Nothing; her license covers all insurers in the state

B. She must pass a second licensing exam

C. The insurer must appoint her, filing the appointment with the state

D. She must convert from captive to independent status

Show solution

1. Separate the license from the appointment: the state issues one producer license per line of authority, but each insurer must separately authorize her as its agent.
2. A is the classic trap — a license alone lets no one act as a company's agent.
3. B is wrong because no new exam attaches to a new company, only to a new line of authority.
4. D confuses a business model with a legal requirement; independent agents simply hold multiple appointments.

Answer: C. Appointment is the insurer's act, filed with the state; one license, as many appointments as companies she represents.

PRACTICE

1. Easy Whom does an insurance agent legally represent, and whom does a broker legally represent?

   Show answer

   The agent represents the insurance company that appointed him; the broker represents the insurance buyer. This single line answers a surprising number of exam questions.

2. Easy What is a producer?

   Show answer

   The modern licensing term for any person licensed to sell, solicit or negotiate insurance — it covers both agents and brokers under one license.

3. **Easy** Name the two great families of insurance licenses this course prepares you for.

Show answer

Life & health (policies about people: death, sickness, longevity) and property & casualty (policies about things and liability: homes, autos, lawsuits).

4. **Medium** An agent sells an auto policy with a $1,100 annual premium at a 10% commission in this example. What does he earn at the sale, and what does he earn next year if the client renews at the same premium and rate?

Show answer

$0.10 \times \$1{,}100 = \$110$ each year. Property & casualty commissions commonly pay at similar rates on renewal — which is why a serviced, retained book compounds.

5. **Medium** Which of the following persons is acting as a broker?

A. A producer appointed by one insurer, selling its homeowners policy

B. A producer representing a restaurant owner, shopping four insurers for the best liability coverage

C. A company employee who underwrites applications at headquarters

D. A producer appointed by three insurers, selling one of their auto policies

Show answer

B. Representing the buyer and shopping the market is broking. A and D are agents acting under appointments — an independent agent (D) still represents the insurers, not the buyer. C is not a producer role at all.

6. **Medium** A captive agent and an independent agent each tell you honestly about their work. Name two trade-offs that separate the models.

Show answer

The captive agent gets one company's training, brand and leads but sells only its products and usually does not own his book; the independent agent shops several companies and owns his book and renewals but must find his own clients and support. Neither model is better — they fit different people.

7. Medium True or false, and why: a producer's state license authorizes her to sell the policies of any insurer admitted in the state.

Show answer

False. The license qualifies her; each insurer must still appoint her — an authorization the insurer files with the state — before she may act as its agent.

8. Hard Why is the agent called the company's first underwriter?

Show answer

Because the agent completes the application face to face with the applicant — field underwriting — and the company's first picture of the risk is only as truthful and complete as the agent makes it. That is why his accuracy is a legal duty, not a courtesy.

9. Hard From the story: after the 1906 earthquake, some insurers resisted paying because fire policies arguably excluded earthquake-caused fires, while Cuthbert Heath cabled his agent to pay in full. Explain in two or three sentences what each choice cost and bought.

Show answer

The resisters saved claim money and spent their names: policyholders and regulators remembered who dodged. Lloyd's spent tens of millions of dollars and bought a century of American trust — Heath treated the policy's purpose as the promise, not the loophole. The exam will never ask this question, and every client you ever serve will.

10. Hard A life agent in this example sells policies averaging $900 annual premium at 75% first-year commission and 4% renewals. If he sells 4 policies a month for a year and 90% of them stay on the books, roughly what do renewals pay him the following year?

Show answer

He writes 48 policies; about 43 persist. Renewals: $43 \times \$900 \times 0.04 \approx \$1{,}548$ — small beside the roughly $32,400 of first-year commission, which is why life agents must keep selling early on, and why persistency (policies that stay in force) is the quiet measure of honest selling.

11. **Challenge** A neighbor says: “Agents are just salesmen — once the check clears, you’re on your own.” Using this lesson’s six-step cycle and the 1906 story, write three sentences answering him.

Show answer

Most of the cycle — delivery, service, claims advocacy — happens after the check clears, and an agent paid by renewals keeps his living only by keeping clients. In 1906 the difference between insurers was not their policies’ paper but who showed up and paid when the city burned. A good agent is the person a family calls on its worst day; a mere salesman is what the licensing law, and this course, exist to prevent.

12. **Challenge** The Samaritan paid the innkeeper two pence and promised, “when I come again, I will repay thee.” Write three sentences mapping the parable onto modern insurance: who plays the traveler, the innkeeper, the Samaritan — and where does the agent stand?

Show answer

The traveler is the family struck by loss; the innkeeper is the hospital, builder or body shop that supplies the care and repairs; the Samaritan — the one whose promise funds the recovery — is the insurer, and behind it the pool of premium-payers bearing one another’s burdens. The agent stands where the Samaritan stood on the inn steps: arranging the care, making the promise plain, and seeing that it is kept. The parable adds the one thing no contract can: the Samaritan did it because he had compassion.

COMMON MISTAKES

- Reversing the representation line — the agent represents the insurer and the broker represents the buyer, no matter which of them the insurer pays.
- Thinking a producer license alone authorizes selling a company’s policies; acting as an insurer’s agent also requires that insurer’s appointment, filed with the state.
- Assuming “producer” means only agents; it is the umbrella term for anyone licensed to sell, solicit or negotiate insurance.
- Calling the independent agent the buyer’s representative because he shops several companies — he holds appointments and represents those insurers; shopping the market is not broking unless he represents the buyer.

- Treating the sale as the job; licensing exams and real clients both test the after-sale duties — delivery, service and claims handling.
- Quoting pay figures without their date and source; the exam will not ask, but your Pathway File states BLS figures as “median $60,370, May 2024” or not at all.

Make it a game · Agent, Broker or Neither?. Write twelve short characters on slips: a producer appointed by one insurer; a producer shopping five companies for a dairy farmer; a claims adjuster; a producer with eight appointments selling one company’s auto policy; an unlicensed receptionist; a bank teller; and six more of your own. A parent or sibling draws and reads each slip; you have ten seconds to call AGENT, BROKER or NEITHER, then one sentence of why — naming whom the person represents earns a bonus point. One point per correct call; swap roles for round two, because writing tricky slips teaches more than sorting them. Best of twelve wins the pen.

Scripture. “And he said, He that shewed mercy on him. Then said Jesus unto him, Go, and do thou likewise.” (Luke 10:37, KJV)

The lawyer answered correctly: the true neighbor was the one who showed mercy — and showed it with money, arrangements and a promise to return. An agent’s trade is built from exactly those materials. The command is not “feel likewise” but “do likewise,” and this course measures the profession, and its student, by that standard.

1.2 The Great Fire and the Coffee House: How Insurance Began

OBJECTIVES

- Tell the story of the Great Fire of London (1666) with its scale — about 13,200 houses — and explain what it exposed about bearing losses alone.
- Explain how Nicholas Barbon's Fire Office (1681) turned rebuilding into a business, and what fire marks and insurer fire brigades were.
- Tell how marine underwriting grew at Edward Lloyd's coffee house (c. 1688) and why risk-takers are called underwriters.
- Recount America's beginnings: Franklin's Philadelphia Contributionship (1752) and the Presbyterian Ministers' Fund (1759), the first American life insurer.
- Define and contrast mutual and stock insurers and state who owns each.

> **Warm-up.** With pencil and paper, suppose your family's house burned down tonight and insurance did not exist. List every source of help you could actually call on — savings, relatives, church, neighbors — and estimate honestly how much of the house they could rebuild. Keep the list; this lesson is the story of how the world answered that arithmetic.

WATCH

How a London Coffeehouse Shaped Modern Insurance

History Meets Finance · 8:17

https://www.youtube.com/watch?v=p2Yi4W5QTfk

> **WHEN TO WATCH**
> Watch after the core ideas; each time a name or date appears — Lloyd, the coffee house, the underwriters — pencil it onto a scratch timeline, and check it later against your project.

BACKUP VIDEO

The London History Show: The Great Fire

J. Draper · 16:10

https://www.youtube.com/watch?v=4bvB_gJThYk

A lively historian's telling of the fire itself — watch it the evening after session one if you want the full story of the four days behind this lesson's first paragraph.

KEY TERMS

underwriter

One who accepts a risk for a premium — named for the Lloyd's custom of writing one's name under the risk described on the policy; today, the insurer's professional who selects and prices risks.

stock insurer

An insurance company owned by stockholders, who supply its capital and receive any dividends the company declares on their shares.

premium

The payment that buys the insurer's promise; from the Latin praemium, a reward or prize.

syndicate

A group of underwriters who share a risk together, each liable for his agreed share — the working unit of Lloyd's to this day.

marine insurance

Coverage on ships and cargoes against the perils of the sea — the oldest branch of the business and the trade of Lloyd's coffee house.

mutual insurer

An insurance company owned by its policyholders, who may receive dividends as a non-guaranteed return of divisible surplus.

policy

The written contract of insurance — from the Italian polizza, a written promise or receipt.

fire mark

A metal badge an insurer fastened to an insured building, announcing which company — and in early days, whose fire brigade — stood behind it.

Lloyd's association

A marketplace of individual and corporate underwriters who insure risks through syndicates — not an insurance company itself, a distinction exams enjoy.

assessment mutual

An early form of mutual in which members are charged their share of losses after they happen, rather than a fixed premium in advance.

fraternal benefit society

A nonprofit lodge or society — often church-connected — that provides insurance benefits to its members; a living reminder of insurance's mutual-aid roots.

CORE IDEAS

The story. In the small hours of September 2, 1666, fire broke out in Thomas Farriner's bakehouse on Pudding Lane, near London Bridge. The city was timber, the summer had been dry, and a strong east wind drove the flames street by street for four days. When the ashes cooled, about **13,200 houses** and 87 parish churches were gone, old St Paul's Cathedral stood as a burned shell, and some 70,000 to 80,000 Londoners — of a city of perhaps 350,000 — had no homes. Remarkably few deaths were recorded; the catastrophe was a catastrophe of property. And that exposed the hole in the world as it then was: a family whose house burned had savings, relatives and charity, and nothing else. No contract anywhere promised to rebuild. London was rebuilt slowly, out of private purses and parish collections — and a few sharp minds concluded that a city of wooden houses and candle flames needed something better than hope.

How they figured it out. The first answer was a business. In 1681, a physician-turned-builder named **Nicholas Barbon** — who had made a fortune rebuilding burned London — opened his **Fire Office** behind the Royal Exchange: the first fire insurance company, selling policies on houses for a premium paid in advance. Barbon's office already contained the trade's deep logic: it charged more to insure timber houses than brick — the price followed the risk — and it issued each insured house a lead badge, the **fire mark**, so that the company's own fire brigade could find the buildings it had promised to save. Rivals followed with marks of their own, and a burning London street soon told you exactly whose promise hung on which wall. Collect many premiums, pay the few losses, and keep watch over the risks you chose: by 1700 the fire office had turned neighborly hope into enforceable contract.

The big idea. What was invented in those decades was not kindness — villages had always passed the hat after a fire — but the **contract**: a promise made *before* the loss, purchased for a **premium**, written in a **policy**, enforceable in court. Mutual aid depends on how the neighbors feel when the ashes cool; insurance replaces that

uncertainty with obligation. The two oldest ways of organizing it still divide the industry, and the exam tests the line. A **stock insurer** is owned by stockholders who put up the capital and take the profit or loss. A **mutual insurer** is owned by its own policyholders — there are no stockholders — and when the year goes well it may return part of the surplus to them as policy dividends. Early mutuals were often **assessment mutuals**, billing members their share after each loss; modern mutuals charge fixed premiums like anyone else. Ownership is the test the exam asks: stock company — stockholders; mutual company — policyholders.

The sea, meanwhile, had its own answer brewing — in a coffee house. Around 1688, **Edward Lloyd** opened a coffee house on Tower Street, near the Thames docks, and made it the place where shipping news arrived first. Merchants with ships at sea came for the news and stayed to do business: a broker would carry a slip describing a ship, her cargo and her voyage from table to table, and men willing to bear a share of the risk for a share of the premium would write their names *under* the description — which is why, to this day, one who accepts risk is an **underwriter**. No one man would take a whole ship; a **syndicate** of underwriters shared each risk, each liable for his line. Lloyd died in 1713, but the market kept his name: the underwriters organized as the Society of Lloyd's in 1771 and moved into the Royal Exchange in 1774. Note carefully what Lloyd's is — a **marketplace of underwriters**, not an insurance company — the oldest continuous insurance market on earth, and the one that would cable San Francisco in 1906.

America's story begins, as so much does, with Benjamin Franklin. Philadelphia in the 1730s was another wooden city, and Franklin — printer, organizer, chief of the volunteer *Union Fire Company* he founded in 1736 — pushed past bucket brigades to the English idea: in 1752 he and his neighbors organized the **Philadelphia Contributionship for the Insurance of Houses from Loss by Fire**, the oldest American property insurer, a mutual whose fire mark showed four clasped hands — hand in hand. The Contributionship behaved like a real underwriter from the first: it surveyed every house before insuring it, charged by construction and condition, and famously declined risks it judged too dangerous. Insurance had crossed the Atlantic as what it remains: neighbors organized by contract, with standards.

Seven years later the other great branch took American root — in a church. Colonial Presbyterian ministers were poor, and their deaths routinely left widows and children destitute. Led by minister-scholar **Francis Alison**, the synod chartered in

1759 the Corporation for the Relief of Poor and Distressed Presbyterian Ministers and their Widows and Children — known ever after as the **Presbyterian Ministers' Fund** — the first life insurance corporation in America. Ministers paid modest annual premiums; the fund invested them and paid annuities to the families left behind. Mark the shape of the fact: American life insurance was born not at a gambling table but in a church, as organized provision for widows and orphans — and the **fraternal benefit societies** that still sell insurance through lodges and congregations carry that lineage today. When Unit 3 opens with why families buy life insurance, this is the answer's oldest form.

On the exam today. The dates themselves will not be on your state exam, but the vocabulary this history minted is tested constantly. Know **underwriter** — and that at a modern insurer it names the home-office professional who selects and classifies risks (Lesson 2.5). Know the ownership question cold: a **stock** insurer is owned by its stockholders, a **mutual** by its policyholders, and policy dividends paid by a mutual (or by a participating policy) are a return of surplus and are never guaranteed. Know that **Lloyd's** is a market of underwriting syndicates, not a company — exams list "Lloyd's associations" among insurer types for exactly that trap. And keep the fire mark in your mind's eye: the whole modern apparatus of inspection, classification and rating is Barbon's brick-versus-timber pricing grown up, and you will meet it again as underwriting in Unit 2.

PICTURE STUDY



The Great Fire of London, with Ludgate and Old St. Paul's, Unknown (Anglo-Dutch school), c. 1670 · Oil on canvas · Yale Center for British Art, New Haven

Image: Wikimedia Commons, public domain

Some unknown painter — likely Dutch or English, working within living memory of the fire — set the viewer safely on the west side of the city, watching the blaze crest the hill around old St. Paul's and pour toward Ludgate. Paintings like this one fixed the catastrophe in the public mind for a generation: the generation that then invented fire insurance. It opens this lesson because every institution you will study this year — fire offices, fire marks, mutuals, Lloyd's — is, at bottom, someone's answer to this picture.

Look closely

- Find old St. Paul's on the skyline, ringed in flame. The cathedral had stood for 600 years; what does its burning say about which losses were thinkable?
- Follow the crowds in the dark foreground. What are the people carrying, and what could they not carry?
- Notice how the painter shows the fire's edge — whole streets alight at once, driven by wind. Why did bucket brigades fail against this?
- Look at the stone gate of Ludgate standing in the fire's path. Even stone survived poorly; what would an underwriter later charge to insure timber against this, versus brick?

Talk about it

1. A Londoner in this crowd loses everything and owes nothing to anyone who must help him. What exactly did the fire offices of the 1680s add to his world that charity could not?
2. The painter shows the catastrophe, not the rebuilding. Who actually bore the cost of rebuilding London in 1667 — and who would bear it today, under contract?
3. Scripture commands believers to bear one another's burdens (Galatians 6:2). Is a fire-insurance pool obedience to that command, a substitute for it, or something of each? Defend your answer at the dinner table.

PROJECT

The Origins Timeline, 1666–1759

You will draw the timeline that anchors the course's whole story: one line from the Great Fire to the Ministers' Fund, with the inventions above the line and the disasters and needs that forced them below it. Lesson 1.4 extends this line to 1869, 1944 and 1945, so leave room on the right — by unit's end it will carry the whole birth and governance of the profession on one page.

You will need

- A sheet of paper turned sideways, ruler, pencil and two ink colors
- Your exam notebook
- This lesson's core ideas, and a chapter of Franklin's Autobiography from the kit if you want his own telling

Steps

1. Draw a horizontal line and mark even decades from 1660 to 1770, leaving the right third of the page blank and labeled "regulation — Lesson 1.4."
2. Below the line, enter the needs: 1666 Great Fire of London (Pudding Lane, about 13,200 houses, 87 churches, old St. Paul's) and, near 1759, a note for the ministers' widows and orphans the colonial church could not provide for.
3. Above the line, enter the answers with dates: 1681 Barbon's Fire Office (premiums by brick vs. timber, fire marks, company brigades); c. 1688 Edward Lloyd's coffee house (shipping news, names written under risks, syndicates); 1736 Franklin's Union Fire Company; 1752 Philadelphia Contributionship (mutual, hand-in-hand mark, surveys before insuring); 1759 Presbyterian Ministers' Fund (first American life insurer).
4. Under 1681 and 1752, write STOCK? MUTUAL? and label each correctly (Barbon's office was a proprietorship run for profit — ancestor of the stock model; the Contributionship a mutual), then add a two-line legend: stock — owned by stockholders; mutual — owned by policyholders.
5. Sketch a small fire mark beside the Contributionship — four clasped hands — and beside Lloyd's a slip of paper with three signatures under a ship's name.

6. Say the line aloud from left to right, dates and all, until you can tell the whole story in under three minutes without looking.
7. Date the page and clip it into your Pathway File beside your profession map.

EXAM NOTEBOOK

1. Make flashcards for underwriter, mutual insurer, stock insurer, syndicate, fire mark and Lloyd's association, and add them to your box.
2. Draw the coffee-house slip: a rectangle with a ship's name, voyage and value at top, and three signatures with shares written beneath — label it "why they are called underwriters."
3. Write a four-line trap list titled "Who owns whom," ending with: Lloyd's is a MARKET, not a company.

> **From history.** Edward Lloyd understood that his real product was news. He posted arrivals, wrecks and cargo prices for his customers, and in 1696 briefly printed Lloyd's News; the market he fathered later founded Lloyd's List in 1734 — a shipping newspaper published continuously for nearly three centuries, among the oldest in the world. Reliable information, the underwriters knew, is the raw material of fair pricing — a truth your Unit 2 lessons on applications and disclosure will repeat in legal dress.

WORKED EXAMPLES

Example 1. An assessment mutual in this example has 120 member households. A member's barn burns with a covered loss of $36,000, and the bylaws assess all members equally. What does each household owe — and what happens to the assessment if only 60 households had joined?

Show solution

1. Equal assessment with 120 members: $\$36{,}000 \div 120 = \$300$ per household.
2. With 60 members: $\$36{,}000 \div 60 = \$600$ per household — half the pool, double the burden.
3. Read the lesson in the arithmetic: the more households share the risk, the lighter and steadier each share becomes. That observation, made precise, is next lesson's law of large numbers.

Answer: $300 each with 120 members; $600 each with 60. Bigger pools make losses lighter and more predictable per member.

Example 2. Exam style. Which statement correctly describes the ownership of insurers?

A. A mutual insurer is owned by its stockholders
B. A stock insurer is owned by its policyholders
C. A mutual insurer is owned by its policyholders
D. Lloyd's of London is a single insurance company owned by its agents

Show solution

1. Recite the line first: stock — stockholders; mutual — policyholders.
2. A and B each swap the owners; both are the standard wrong answers.
3. D fails twice: Lloyd's is a marketplace of underwriting syndicates, not a company, and agents own neither.
4. C states the rule exactly.

Answer: C. Policyholders own a mutual; stockholders own a stock company; Lloyd's is a market of underwriters, not a company at all.

Example 3. Exam style. The term “underwriter” originally described:

A. A government clerk who registered ship cargoes

B. A merchant who wrote his name under a risk described on a policy, accepting a share of it

C. A printer who produced policy forms

D. An attorney who drafted insurance contracts

Show solution

1. Picture the coffee house: the broker’s slip describes the ship and voyage; men accepting shares of the risk sign beneath the description.
2. The name is literal — writing under — so B is the origin.
3. A, C and D invent plausible-sounding offices; none explains the word itself.
4. Carry the modern meaning forward too: today the underwriter is the insurer’s risk-selection professional.

Answer: B. Underwriters wrote their names under the described risk at Lloyd’s coffee house; the word has meant risk-acceptor ever since.

PRACTICE

1. Easy When and where did the Great Fire of London begin, and about how many houses did it destroy?

   Show answer

   It broke out September 2, 1666, in Thomas Farriner’s bakehouse on Pudding Lane, and destroyed about 13,200 houses and 87 churches, including old St. Paul’s.

2. Easy Who owns a mutual insurer, and who owns a stock insurer?

   Show answer

   A mutual insurer is owned by its policyholders; a stock insurer is owned by its stockholders.

3. Easy Why are the people who accept insurance risks called underwriters?

Show answer

At Edward Lloyd's coffee house, men accepting a share of a ship's risk wrote their names under the description of the risk on the broker's slip — they wrote under, so they were underwriters.

4. Medium What did Nicholas Barbon's Fire Office of 1681 do that charity after a fire could not?

Show answer

It promised before the loss, by enforceable contract, to pay for rebuilding — in exchange for a premium priced to the risk (brick cheaper than timber). Charity depends on generosity after the ashes; insurance is obligation agreed in advance.

5. Medium Which of the following was the first life insurance corporation in America?

A. The Philadelphia Contributionship (1752)
B. The Presbyterian Ministers' Fund (1759)
C. Lloyd's of London (1771)
D. Barbon's Fire Office (1681)

Show answer

B. The Ministers' Fund, chartered 1759 to provide for ministers' widows and orphans, was America's first life insurer. A insured houses, not lives; C and D are English, and Lloyd's is a market besides.

6. Medium A fire mark told three things to a 1690s London street. Name two of them.

Show answer

Which insurer stood behind the building (its promise and its advertising), and — in the early days — which company's fire brigade should fight for it. It also marked the house as a selected, surveyed risk.

7. Medium Your cousin says, “Lloyd’s of London is the world’s biggest insurance company.” Correct him in two sentences.

Show answer

Lloyd’s is not a company at all: it is a marketplace where syndicates of underwriters each accept shares of risks, as they have since the coffee house. Exams list “Lloyd’s associations” as a distinct insurer type for exactly this distinction.

8. Hard A participating policyholder in a mutual receives a policy dividend after a good year. Is that dividend guaranteed, and what is it a return of?

Show answer

Not guaranteed. It is a return of divisible surplus — premiums collected beyond what losses and expenses required — paid to the policyholder-owners when results allow.

9. Hard An assessment mutual with 80 members faces covered losses of $28,000 this year. Compute each member’s equal assessment, and explain one weakness of assessment funding that fixed advance premiums solve.

Show answer

$\$28{,}000 \div 80 = \$350$ per member. Assessment funding sends unpredictable bills after losses — members may be unable or unwilling to pay just when the money is needed — while advance premiums collect a known amount before losses and hold it ready.

10. Hard Barbon charged brick houses less than timber houses. Name the modern underwriting principle this embodies, and give one example of the same principle from today’s insurance.

Show answer

Price follows risk — classification and rating: insureds with lower expected losses pay lower premiums. Today a home with a nearby hydrant and a new roof rates better than one without, and a driver with clean record rates better than one with accidents.

11. **Challenge** The Contributionship surveyed houses before insuring them and declined some risks entirely. Was refusing a neighbor's house un-neighborly? Answer in three sentences using the interests of the other policyholder-owners.

    Show answer

    A mutual's money is its members' money, so accepting a plainly dangerous house spends every member's premiums on one man's hazard. Declining — or charging the risk honestly, or requiring the hazard be fixed — protects the common pool that makes anyone's promise good. Neighborliness in insurance is not taking every risk; it is keeping the pool sound so promises are kept.

12. **Challenge** American life insurance was born in a church fund for widows and orphans. Write three sentences on how that origin should shape how a life agent today thinks about his product and his selling.

    Show answer

    The product began as organized provision for the helpless left behind, which means its purpose is protection, not speculation or sales quotas. An agent who remembers the Ministers' Fund measures a policy by whether it would actually keep a particular widow and children housed and fed. Selling less than a family needs — or more than it needs to enrich the seller — both betray the founding idea.

COMMON MISTAKES

- Swapping the owners: policyholders own a mutual; stockholders own a stock insurer — the exam will offer both reversals.
- Calling Lloyd's an insurance company; it is a marketplace of underwriting syndicates, listed on exams as its own insurer type.
- Treating policy dividends from a mutual or participating policy as guaranteed; they are a non-guaranteed return of surplus.
- Confusing the underwriter's two meanings: historically one who signed under a risk; today the insurer's home-office risk selector — context tells you which a question means.
- Thinking insurance replaced charity; it replaced uncertainty with contract — a promise purchased before the loss and enforceable after it.
- Dating American insurance from life rather than property: the Contributionship (1752, property) came before the Ministers' Fund (1759, life).

Make it a game · Timeline Scramble. Write these on eight index cards, one per card, with the dates on the back: Great Fire of London; Barbon's Fire Office; Edward Lloyd opens his coffee house; Union Fire Company; Philadelphia Contributionship; Presbyterian Ministers' Fund; Society of Lloyd's organized; Cuthbert Heath's San Francisco cable. Shuffle. A parent deals them face up and starts a two-minute timer: order them left to right, then say one sentence per card about what it was. One point per correct position, one per correct sentence; lose a point for any date you cannot land within a decade when the cards flip. Replay until you beat sixteen points, then deal them to a sibling and keep score.

Scripture. "Bear ye one another's burdens, and so fulfil the law of Christ." (Galatians 6:2, KJV)

Insurance mechanizes a command the church was already obeying — the Ministers' Fund was a synod bearing its widows' burdens by plan rather than by panic. A pool of premiums is many hands under one neighbor's load; the agent's calling is to keep that machinery honest enough to deserve the verse.

1.3 Spreading the Risk: The Law of Large Numbers

OBJECTIVES

- Distinguish pure risk from speculative risk and state which one insurance covers.
- Define peril, hazard and loss exposure, and classify hazards as physical, moral or morale.
- Name and apply the four risk-management choices: avoid, retain, reduce and transfer.
- State the law of large numbers and list the characteristics of an ideally insurable risk, including the problem of adverse selection.
- Compute an expected loss and a simple pure premium from a probability and a loss amount.

> **Warm-up.** With pencil and paper: imagine 100 identical houses, and suppose each has a 1-in-100 chance of burning this year, with a $200,000 loss if it does. In five minutes answer two questions: about how many houses do you expect to burn, and how much would each of the 100 owners have to chip in to cover it? You have just priced your first insurance pool.

WATCH

Get Your Insurance License: Risk Pooling and Law of Large Numbers - What do they mean?

Morton Schools · 9:36

https://www.youtube.com/watch?v=1SLpDV20krk

> **WHEN TO WATCH**
> Watch after the big idea; every time the teacher says “predict,” write down what becomes predictable and why — the law of large numbers is a statement about prediction, not protection.

BACKUP VIDEO

Peril vs Hazard and Moral vs Morale Hazard: Insurance Exam Basics

License Blocks · 14:29

https://www.youtube.com/watch?v=Ro_wtaI4mIA

A second pass aimed straight at the most-missed distinctions; watch before the practice set and say each example aloud as peril, physical, moral or morale before the teacher does.

KEY TERMS

risk

Uncertainty about loss; the chance that an outcome will differ from what is expected.

speculative risk

A risk that includes the chance of gain as well as loss, such as gambling or investing; not insurable.

hazard

A condition that increases the likelihood or severity of a loss from a peril.

moral hazard

A character-based hazard: dishonesty that raises the chance of loss, such as a willingness to fake a claim.

loss exposure

Any person, property or interest that could suffer a loss — the unit an insurer counts and pools.

adverse selection

The tendency of those most likely to suffer loss to seek or keep insurance most eagerly — the tilt underwriting exists to correct.

pure risk

A risk with only two outcomes — loss or no loss, with no chance of gain — the only kind of risk insurance covers.

peril

The cause of a loss — fire, windstorm, theft, death, sickness.

physical hazard

A tangible condition that raises the chance of loss, such as frayed wiring, icy steps or a wood-shingle roof.

morale hazard

Carelessness or indifference to loss because insurance exists — leaving doors unlocked since “insurance will pay.”

law of large numbers

The statistical principle that as the number of similar, independent exposures grows, actual results come ever closer to expected results, making losses predictable for the group.

pure premium

The share of the premium that funds expected losses alone, before the insurer’s expenses and profit are loaded on.

The story. In Basel, Switzerland, a mathematician named **Jacob Bernoulli** spent some twenty years circling one question: can we reason precisely about uncertain things? A single coin flip tells you nothing; but Bernoulli proved that flips in quantity behave with almost lawlike obedience — that as trials multiply, the observed share of heads is morally certain to hug the true probability as closely as you please. He called it his golden theorem, and he died in 1705 before publishing it; his nephew Nicolaus finally brought out the book, *Ars Conjectandi* — "The Art of Conjecturing" — in **1713.** Bernoulli himself saw where it pointed: civil and economic life, he wrote, could apply it wherever outcomes come in crowds. He was right beyond his guessing. Every insurance company on earth is a machine built on the golden theorem: no one can say whose house will burn, and a company holding a hundred thousand similar houses can say almost exactly how many will. Insurance does not remove uncertainty; it moves it to a place — the large group — where uncertainty itself becomes tame.

How they figured it out. The insight had been working in the world even before the mathematics caught up. Lloyd's underwriters priced voyages from experience of many voyages; the fire offices priced brick and timber from the city's burning history; and in 1693 the astronomer **Edmond Halley** had built one of the first scientific mortality tables from the birth and death records of the city of Breslau, showing that death, the least predictable event in any one life, keeps strict schedules across thousands of lives. Bernoulli's theorem explained why all of this worked: regularity lives in large numbers. The practical recipe followed: gather many **loss exposures** that are similar and independent, collect from each a contribution scaled to the expected loss, and the pool can promise payment with near-certainty. The whole craft of underwriting — Unit 2's subject — is keeping the pool's exposures genuinely similar, genuinely independent and honestly described, because the theorem keeps its promises only on those terms.

The big idea. Now fix the vocabulary the exam builds everything on. **Risk** is uncertainty about loss. A **pure risk** offers only loss or no-loss — your house burns or it does not — while a **speculative risk** offers gain as well, like a bet or a business venture. *Insurance covers pure risks only*; it exists to restore, never to enrich, and Unit 2 will give that principle its legal name, indemnity. A **peril** is the cause of loss itself: fire, wind, theft, death. A **hazard** is any condition that makes loss from a peril more

likely or more severe, and the exam insists on three kinds: **physical** hazards you can touch (frayed wiring, icy steps), **moral** hazards of character (the insured willing to burn his own warehouse or pad a claim), and **morale** hazards of attitude (carelessness bred by the comfort of being covered — doors left unlocked, smoke alarms without batteries). One sentence sorts them forever: the peril is what strikes; the hazard is why it was likelier here.

A family or business facing a risk has exactly four honest choices, and the exam names them. **Avoid** the risk: never own the trampoline, never fly the plane — effective and often impractical, since avoiding all risk means avoiding life. **Retain** it: bear the loss yourself, knowingly (an emergency fund, a chosen deductible) or by simple neglect. **Reduce** it: smoke alarms, locks, exercise, defensive driving — lower the chance or shrink the damage. **Transfer** it: move the financial burden to someone contractually bound to carry it — and insurance is the great transfer mechanism, shifting pure risk from the one to the many for a premium. Real prudence mixes all four: the wise family reduces what it can, retains what it can afford (that is what a deductible is), transfers what would sink it, and avoids what no premium should make acceptable.

Not every pure risk can be insured, and the exam loves the checklist of the **ideally insurable risk.** There must be a *large number of homogeneous exposure units* — many similar houses, cars, lives — or the law of large numbers has nothing to grip. The loss must be *definite and measurable*: provable in time, place, cause and amount. It must be *accidental* — fortuitous, outside the insured's control, which is why intentional losses are excluded everywhere. It must *not be catastrophic* to the pool: a peril that strikes all the exposures at once — war, or flood drowning a whole valley of policyholders together — breaks the independence the mathematics requires, which is why flood needed a federal program (Unit 6 tells that story). The chance of loss must be *calculable*, and the premium *affordable* — a coverage priced near the loss itself transfers nothing worth transferring.

One more enemy stalks every pool: **adverse selection**. Insurance looks most attractive exactly to those most likely to collect — the family in the floodplain, the man who has noticed his health failing — so left alone, a pool fills with the worst risks, losses outrun premiums, rates rise, the healthy leave, and the spiral tightens. The industry's answers are underwriting (selecting and classifying risks so each pays a premium matched to its true expected loss), waiting periods, exclusions — and

sound arithmetic. The arithmetic begins with **expected loss**: probability of loss times amount of loss. Spread over the exposures, that yields the **pure premium**, the raw cost of the promise; the insurer then loads on expenses, reserves and profit to reach the gross premium you are quoted. In this example: 1,000 similar homes, each with a 1-in-250 annual chance of a $150,000 fire — expect four fires, $600,000 in losses, a pure premium of $600 per home before loading. The quoted premium is higher; the logic is exactly this.

On the exam today. This lesson is bedrock for every state outline, and the questions are predictable. Pure versus speculative: insurance covers pure risk only — expect a scenario (a business venture, a lottery ticket) you must disqualify. Peril versus hazard: the fire is the peril; the oily rags are the hazard — and the three-way hazard sort is tested constantly, with *moral* (dishonesty) versus *morale* (carelessness) the single most-missed pair; anchor them as character versus attitude. The four risk-management techniques appear as match-the-scenario questions: the deductible is *retention*, the smoke alarm is *reduction*, insurance itself is *transfer*. The law of large numbers is tested as a definition — losses become more predictable as similar exposures increase; it does not make any individual loss less likely. And know adverse selection by name as the tendency of poorer-than-average risks to seek and keep insurance, with underwriting as its cure.

PICTURE STUDY



The Harvesters, Pieter Bruegel the Elder, 1565 · Oil on wood · The Metropolitan Museum of Art, New York

Image: Wikimedia Commons, public domain

Bruegel painted The Harvesters in 1565 as one of a series of the seasons, and it became one of the first great paintings whose true subject is ordinary work. Nothing here is heroic: men mow, women bind, the crew by the pear tree eats its midday bread. It opens this lesson because the harvest is mankind's oldest lesson in large numbers — no single stalk matters and no single stalk is certain, yet the field as a whole feeds the village — and because granaries, like insurance pools, are how the prudent carry this year's plenty against next year's want.

Look closely

- Count the kinds of work: mowing, binding, stacking, carrying, eating, sleeping. How many hands does one harvest take?
- Find the sheaves already stacked in stooks. Why gather grain into many small bundles rather than one great heap?
- Notice the half-cut field: so much standing, so much fallen. If hail came tonight, what would be lost, and what is already safe?
- Follow the path down to the village and the bay beyond. How much of this landscape depends on this one field coming in?

Talk about it

1. No farmer knows which seeds will fail, yet every farmer knows roughly what the field will yield. How is that the law of large numbers before mathematics — and what is the insurance pool's version of the granary?
2. The harvesters work as a crew and eat as a crew. Which of the four risk-management choices — avoid, retain, reduce, transfer — can you find hiding in village life like this?
3. Joseph in Egypt stored the seven fat years against the seven lean (Genesis 41). Is buying insurance an act of the same prudence, or can it become an excuse to stop being prudent — a morale hazard? Where is the line?

PROJECT

The Risk Map of Your Own House

You will apply the whole lesson to the risks of one real household — yours — and produce the one-page risk map that joins your Pathway File. This is the agent's first skill practiced on the family you know best: name the exposures, sort the perils and hazards, choose among the four techniques, and run the pool arithmetic once with honest numbers.

You will need

- One sheet of paper ruled into four columns (or a spreadsheet page)
- Your exam notebook and pen
- A calculator for the pool arithmetic

Steps

1. Head the four columns EXPOSURE, PERILS, HAZARDS, TECHNIQUE. Down the first column list eight real loss exposures of your household — the house or apartment, each vehicle, a parent's income, a musical instrument, the dog's teeth, whatever is truly yours.
2. For each exposure, write its chief perils (fire, collision, wind, theft, sickness…) in column two.
3. In column three, name one honest hazard per exposure and label it P, MOR or MLE (physical, moral, morale). Finding a morale hazard in your own household is the hard, useful part.
4. In column four, assign each risk one or more of the four techniques — avoid, retain, reduce, transfer — and underline every retention that is deliberate (an emergency fund or deductible) rather than accidental.
5. Below the table, work the pool problem: invent 1,000 households like yours, give the worst peril on your list a probability (say 1 in 200) and a loss amount, and compute expected losses, total expected cost and the pure premium each household would owe. Label it "in this example."
6. Write two sentences at the bottom: which single risk most needs transfer, and which hazard your family could reduce this week for free.

7. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for pure vs. speculative risk, peril, the three hazards, the four techniques, law of large numbers, adverse selection and pure premium.
2. Draw a two-panel sketch: one house alone under a question mark, then a grid of 1,000 tiny houses under a steady number — caption it "uncertainty moves to where it is tame."
3. Write a five-line trap list titled "Moral vs. morale," ending with: moral = dishonesty, morale = carelessness — character vs. attitude.

KEY FORMULAS

$$\text{Expected loss} = \text{probability of loss} \times \text{amount of loss}$$

$$\text{Pure premium} = \frac{\text{total expected losses}}{\text{number of exposure units}}$$

From history. Edmond Halley — the comet astronomer — built his 1693 life table from the meticulous birth and death registers of Breslau, sent to the Royal Society because the city kept better records than London. He then computed what a life annuity should cost at each age, and noted drily that the English government was selling annuities far too cheap — at the same price regardless of the buyer's age. Governments, it turned out, needed underwriting too.

WORKED EXAMPLES

Example 1. In this example, an insurer covers 2,000 similar houses. Each has a 1-in-500 chance of a total fire loss of $250,000 in a year. Find the expected number of losses, the total expected loss, and the pure premium per house.

Show solution

1. Expected number of losses: $2{,}000 \times \frac{1}{500} = 4$ houses.
2. Total expected loss: $4 \times \$250{,}000 = \$1{,}000{,}000$.
3. Pure premium: $\$1{,}000{,}000 \div 2{,}000 = \$500$ per house.
4. The quoted (gross) premium will be higher — expenses, reserves and profit are loaded on — but every honest premium starts with this arithmetic.

Answer: About 4 expected losses; $1,000,000 expected in total; pure premium $500 per house, before loading.

Example 2. Exam style. A homeowner stores oily rags beside a furnace, and a fire destroys the garage. Which identifies the peril and the hazard?

A. Peril: the rags; hazard: the fire

B. Peril: the fire; hazard: the oily rags near the furnace

C. Peril: the garage; hazard: the furnace

D. Both the fire and the rags are perils

Show solution

1. Apply the sorting sentence: the peril is what strikes; the hazard is why it was likelier here.
2. The cause of loss — what struck — is the fire: that is the peril.
3. The condition that made the loss more likely is the rags by the furnace: a physical hazard.
4. A reverses the pair, the standard trap; C mistakes the damaged property for a peril; D calls a condition a cause.

Answer: B. Fire is the peril (cause of loss); the stored rags are a physical hazard (condition increasing the chance of loss).

Example 3. Exam style. After buying a theft policy, a shop owner stops locking his storeroom, reasoning that "insurance will cover it." Separately, his competitor inflates an inventory claim after a genuine break-in. Classify the two hazards.

A. Both are moral hazards

B. Both are morale hazards

C. The unlocked storeroom is a morale hazard; the inflated claim is a moral hazard

D. The unlocked storeroom is a physical hazard; the inflated claim is a morale hazard

Show solution

1. Anchor the pair: moral = dishonesty (character); morale = carelessness (attitude).
2. Leaving the storeroom unlocked because coverage exists is indifference to loss — morale hazard.
3. Padding a claim is dishonesty — moral hazard, and fraud besides.
4. A and B each flatten the distinction; D misuses "physical," which means a tangible condition like broken locks, not a chosen behavior.

Answer: C. Carelessness bred by coverage is morale hazard; dishonesty for gain is moral hazard — the most-missed pair on the exam.

PRACTICE

1. Easy Which kind of risk does insurance cover — pure or speculative — and what is the difference?

   Show answer

   Insurance covers pure risk only: loss or no loss, with no possibility of gain. Speculative risk, like gambling or investing, includes a chance of gain and is not insurable.

2. Easy In one sentence each: what is a peril, and what is a hazard?

   Show answer

   A peril is the cause of a loss, like fire or theft; a hazard is a condition that makes loss from a peril more likely or more severe, like frayed wiring.

3. **Easy** Name the four risk-management techniques and give one everyday example of each.

Show answer

Avoid (don't buy the trampoline), retain (pay small losses from savings — a deductible is retention), reduce (install smoke alarms), transfer (buy insurance, which shifts the burden by contract).

4. **Medium** State the law of large numbers in your own words, and name the book and year in which Jacob Bernoulli's proof was published.

Show answer

As the number of similar, independent exposures grows, actual losses come ever closer to expected losses, so the group's results become predictable even though no individual's are. The proof appeared in Ars Conjectandi, published in 1713, after Bernoulli's death.

5. **Medium** A driver buys collision coverage and begins tailgating, figuring dents are "the insurer's problem." Which hazard is this?

A. Physical
B. Moral
C. Morale
D. Legal

Show answer

C. Carelessness or indifference bred by the existence of coverage is morale hazard. Moral hazard (B) would be dishonesty — staging or padding a claim; a physical hazard (A) is a tangible condition like bald tires.

6. **Medium** Each of 1,500 insured boats has a 1-in-300 chance of a $60,000 total loss this season in this example. Find the expected losses and the pure premium per boat.

Show answer

Expected losses: $1{,}500 \div 300 = 5$ boats, totaling $5 \times \$60{,}000 = \$300{,}000$. Pure premium: $\$300{,}000 \div 1{,}500 = \$200$ per boat, before expense loading.

7. Medium Which of the following is NOT a characteristic of an ideally insurable risk?

A. A large number of homogeneous exposure units
B. Loss that is definite and measurable
C. Loss that is catastrophic to the whole pool at once
D. Loss that is accidental from the insured's standpoint

Show answer

C. Catastrophic, all-at-once loss is the disqualifier, not a characteristic — a peril striking every exposure together (war, widespread flood) destroys the independence the law of large numbers needs. A, B and D belong on the checklist.

8. Hard Define adverse selection and name the industry's chief remedy for it.

Show answer

Adverse selection is the tendency of those most likely to suffer loss to seek and keep insurance most eagerly, tilting the pool toward bad risks. The chief remedy is underwriting — selecting and classifying applicants so each pays a premium matched to the risk actually presented.

9. Hard Why does an insurer with 100,000 similar policies face less uncertainty per policy than a family faces over its one house? Use the law of large numbers precisely — what becomes predictable, and what does not?

Show answer

The law of large numbers makes the group's total losses predictable: with 100,000 independent exposures, actual losses will land very near expected losses in percentage terms. Which particular house burns remains as unknowable as ever — prediction improves for the pool, never for the individual — which is exactly why transferring the risk to the pool is worth a premium.

10. Hard A seaside town asks one small insurer to write hurricane coverage on all 4,000 of its homes and nothing else. Using two characteristics of ideally insurable risk, explain the problem and one way insurers in fact handle such perils.

Show answer

The exposures are not independent — one hurricane strikes them all together, a catastrophic loss to the pool — and losses may outrun any affordable premium's capacity. Insurers handle such perils by spreading exposures across regions, buying reinsurance, or — where the private market cannot carry it, as with flood — through government programs like the NFIP (Unit 6).

11. Challenge In this example a pure premium works out to $500 per house, but the insurer quotes $740. A neighbor calls the difference "pure profit." In three sentences, correct him and defend the loading honestly.

Show answer

The gap funds the machinery that makes the promise good: underwriting, policy service, claims adjusters, reserves against worse-than-expected years, state premium taxes — and, yes, a margin of profit. A pool that charged only pure premium would fail its policyholders the first bad year, paying no one in full. The honest question is not whether there is loading but whether the price fairly matches the risk — which is what regulators (next lesson) and competition both police.

12. Challenge "Insurance is just gambling." Using pure vs. speculative risk and the direction of uncertainty, write three sentences refuting this — and one sentence conceding what the two have in common.

Show answer

A gambler starts with no risk and creates one for the chance of gain — speculative risk, manufactured on purpose. An insured starts with a risk he already owns — his house can already burn — and pays to transfer it, standing only to be restored, never enriched. Insurance destroys uncertainty for the family and tames it in the pool; gambling multiplies it. What they share is probability arithmetic — the same mathematics, pointed in opposite directions.

COMMON MISTAKES

- Confusing moral with morale hazard — moral is dishonesty (the padded claim), morale is carelessness because coverage exists (the unlocked door); the exam tests this pair relentlessly.
- Calling the damaged property or the dollar amount the peril; the peril is the cause of loss — fire, wind, theft — not the thing lost.
- Thinking the law of large numbers makes an individual's loss less likely; it only makes the group's total losses more predictable.
- Forgetting that a deductible is retention — a deliberate decision to self-bear small losses — and that choosing one is risk management, not negligence.
- Marking speculative risks insurable; any scenario with a chance of gain (a venture, a wager, a market position) is outside insurance by definition.
- Treating adverse selection as any bad luck; it is specifically the tilt of worse-than-average risks toward buying and keeping coverage, and underwriting is its named cure.

Make it a game · Peril! Hazard! Sort!. Write fifteen slips: five perils (fire, hail, theft, collision, sickness), five hazards (oily rags, bald tires, a padded claim, doors left unlocked "because we're covered," a rotted porch rail), and five risk-management moves (buying a policy, choosing a $1,000 deductible, installing smoke alarms, skipping the ski trip, keeping an emergency fund). A parent draws and reads; you have five seconds to call the category — and for hazards, physical, moral or morale; for techniques, avoid, retain, reduce or transfer. One point each, minus one for a miss. Fifteen straight wins the round; then swap, and write five trickier slips of your own.

Scripture. "Give a portion to seven, and also to eight; for thou knowest not what evil shall be upon the earth." (Ecclesiastes 11:2, KJV)

The Preacher's counsel is diversification born of humility: because you cannot know which evil will fall, divide what you have across many places. The insurance pool is the same humility organized at scale — no one knows whose house will burn, so many bear each, and none is ruined. Prudence begins where the pretense of knowing the future ends.

1.4 Fifty Regulators: Paul v. Virginia, SEUA and McCarran-Ferguson

OBJECTIVES

- Tell the regulation story in order: Paul v. Virginia (1869), United States v. South-Eastern Underwriters Association (1944) and the McCarran-Ferguson Act (1945), and state what each decided.
- Describe the state insurance commissioner and department, and the NAIC's role in making fifty state systems nearly uniform through model laws.
- Classify an insurer as domestic, foreign or alien by its state or country of domicile.
- Distinguish admitted (authorized) from non-admitted insurers and explain the certificate of authority.
- Explain what a state guaranty association does and why producers may not use it in selling or advertising.

> **Warm-up.** In five minutes, write your best guesses: who gives an insurance agent his license — the federal government, the state, or the insurance company? Who approves the policy forms your family signs? And if an insurer went broke mid-claim, who, if anyone, would step in? Keep the guesses; this lesson grades them.

WATCH

Regulation of Insurance: Module 1 of 5

LawShelf · 15:41

https://www.youtube.com/watch?v=9bhsZebG63A

> **WHEN TO WATCH**
> Watch after the story paragraphs; each time a case or statute is named, pause and write its year and its one-line holding — three entries will carry most of this lesson.

BACKUP VIDEO

The NAIC: Who We Are and What We Do

NAIC News · 3:22

https://www.youtube.com/watch?v=bYgX9_sDrx4

The regulators introduce themselves in three minutes; watch before the project so the directory you are about to open has faces and a purpose behind it.

KEY TERMS

Paul v. Virginia (1869)

The Supreme Court decision holding that issuing an insurance policy is not a transaction of interstate commerce — leaving insurance regulation to the states for 75 years.

United States v. South-Eastern Underwriters Association (1944)

The Supreme Court decision reversing Paul: insurance transacted across state lines is interstate commerce, subject to federal law including the Sherman Antitrust Act.

McCarran-Ferguson Act (1945)

The federal law declaring that state regulation and taxation of insurance is in the public interest, and that federal antitrust law applies to insurance only to the extent the states do not regulate it.

commissioner of insurance

The chief insurance regulator of a state — titled commissioner, director or superintendent — who licenses producers and insurers, approves forms and rates, examines companies and enforces the code.

NAIC

The National Association of Insurance Commissioners, founded 1871 — the regulators' own organization, whose model laws and accreditation standards make fifty separate systems workably uniform.

model law

A statute drafted by the NAIC for legislatures to adopt; it has no force until a state enacts it, which is how uniformity arrives without federal control.

domestic insurer

An insurer doing business in the state where it is incorporated — its home state.

foreign insurer

An insurer doing business in one state but incorporated in another state — foreign means out-of-state, not out-of-country.

alien insurer

An insurer doing business in a state but incorporated in another country.

admitted (authorized) insurer

An insurer granted a certificate of authority to transact insurance in a state; a non-admitted insurer holds no such certificate there.

certificate of authority

The state's license to an insurance company — the company-level counterpart of the producer's license.

guaranty association

The state-created safety net, funded by assessments on admitted insurers, that pays covered claims of insolvent insurers within statutory limits — and may not be used in advertising or selling.

CORE IDEAS

The story. In 1942 the Department of Justice indicted the **South-Eastern Underwriters Association** — a rating bureau of nearly two hundred stock fire insurers across six southern states — charging that the association fixed fire insurance rates and punished agents and insurers who dared sell below them, in violation of the Sherman Antitrust Act. The industry's defense was not that the facts were false. It was grander: federal antitrust law could not touch insurance at all, because the Supreme Court had said in 1869 that insurance was not commerce. For

75 years that had been the ground everyone stood on — states regulated insurance, and federal commerce powers stopped at the policy's edge. On June 5, 1944, the Supreme Court pulled the ground away. By 4 to 3, in *United States v. South-Eastern Underwriters Association,* Justice Hugo Black wrote that a business collecting premiums across state lines in the millions was interstate commerce like any other, and the Sherman Act applied. In one morning, every state insurance code in America stood on nothing, and the industry and its regulators faced the real possibility that Washington would take the whole field.

How they figured it out. To understand the earthquake, you need the 1869 bedrock. Virginia required insurance companies chartered elsewhere to post security deposits before selling in the state; a Petersburg agent named **Samuel Paul**, representing New York fire insurers that had not complied, sold a policy anyway, was convicted and fined fifty dollars, and appealed on the ground that insurance was interstate commerce only Congress could regulate. In *Paul v. Virginia* (1869) the Supreme Court disagreed: issuing a policy of insurance, it said, is not a transaction of commerce but a local contract. The ruling Paul lost built the system we have — free of federal interference, every state developed its own insurance code and its own regulator, and in **1871** those regulators organized what became the **NAIC**, the National Association of Insurance Commissioners, to coordinate fifty separate systems by drafting uniform forms and, later, **model laws**. So when SEUA struck in 1944, there was already a sturdy state apparatus worth saving — and the states, the industry and Congress moved fast to save it.

The big idea. Congress's answer, signed March 9, **1945**, was the **McCarran-Ferguson Act**, named for Senators Pat McCarran of Nevada and Homer Ferguson of Michigan, and its logic fits in three clauses you should be able to recite. First: the continued regulation and taxation of insurance *by the states* is in the public interest. Second: federal antitrust and most other federal laws apply to the business of insurance only *to the extent the states do not regulate it* — a standing invitation the states accepted by passing rating laws and unfair trade practices acts, which is why Unit 9 exists. Third: no exemption shields *boycott, coercion or intimidation* — the raw strong-arming charged in SEUA stays federally punishable no matter what. The result is the architecture you will work inside your whole career: insurance is regulated primarily by the fifty states, under a federal permission that the states keep by

actually regulating. Your license, your exam, your conduct rules and your discipline all flow from your state's code.

Meet, then, your actual regulator. Every state has a **commissioner** of insurance (some states say director or superintendent) heading an insurance department — appointed by the governor in most states, elected in about a dozen. The commissioner licenses producers and insurers, approves or reviews policy forms and rates, examines insurers' finances and market conduct, investigates complaints, holds hearings, and can fine, suspend or revoke — powers Unit 9 opens in full. What the commissioner does *not* do matters too: commissioners administer and enforce the insurance code; the state legislature writes it. And the **NAIC** binds the fifty systems together without ruling them: its model laws become law only when a legislature enacts one, its accreditation program audits each state's solvency regulation against national standards, and its databases track every licensed producer and company. Fifty regulators, one playbook — uniformity by persuasion rather than preemption.

The state system sorts every company you will ever represent with two classifications the exam tests constantly. First, by home: a **domestic** insurer operates in its own state of incorporation; a **foreign** insurer is incorporated in another *state*; an **alien** insurer is incorporated in another *country*. An insurer chartered in your state is domestic there and foreign in the other forty-nine — the words describe a relationship, not a company's nature. Second, by permission: an **admitted** (authorized) insurer holds the state's **certificate of authority** — the company-level license — while a **non-admitted** insurer holds none there. Producers place business with admitted insurers; the narrow exception, **surplus lines** — specially licensed brokers placing hard-to-insure risks with eligible non-admitted insurers — waits for Unit 8. For now, fix the pairing: producers have licenses; companies have certificates of authority.

One more institution completes the map: the **guaranty association**. Regulation watches insurer solvency precisely because an insurance promise can outlive the promisor, and when an admitted insurer fails anyway, every state has a guaranty association — created by law, funded by **assessments on the admitted insurers** in that state — that steps in to pay the failed company's covered claims up to statutory limits (commonly $300,000 of life insurance death benefit, in this example; your state's figures may differ). It is a safety net worth having and a dangerous thing to sell

with, which is why the law forbids producers to **advertise or invoke the guaranty association** to induce a sale. The reasoning is sound underwriting of the system itself: if every promise looks state-backed, no buyer or agent has reason to prefer sound insurers, and the careless drive out the careful at the careful companies' expense. Pick strong companies; never sell the net.

On the exam today. This lesson is pure exam territory. Keep the three milestones straight by what each *held*: Paul v. Virginia (1869) — insurance is not commerce, states regulate; SEUA (1944) — insurance is interstate commerce, federal law applies; McCarran-Ferguson (1945) — Congress returns primary regulation to the states, antitrust applies only where states do not regulate, boycott-coercion-intimidation always federal. The domestic/foreign/alien sort is a guaranteed question, and *foreign* is the trap: it means another state, never another country — that is *alien*. Match license to producer and certificate of authority to insurer. Expect a question on who heads the department (commissioner/director/superintendent) and one on the NAIC — an association of regulators whose model laws need state enactment, not a federal agency. And the guaranty-association advertising ban appears as a conduct question: mentioning it to close a sale is a violation, full stop.

PICTURE STUDY



The House of Representatives, Samuel F. B. Morse, 1822–1823 · Oil on canvas · National Gallery of Art, Washington (Corcoran Collection)

Image: Wikimedia Commons, public domain

Before he invented the telegraph, Samuel Morse was a painter, and in 1822 he spent months in the Capitol painting the House chamber at the quiet moment a clerk lights the chandelier for an evening session — eighty-odd portraits from life, and no hero in sight: the picture's subject is the institution itself, the machinery of lawmaking at rest before work. It opens this lesson because the story of insurance regulation runs through rooms like this one — a $50 fine argued up to the Supreme Court, a 1944 decision, and the Congress that answered it in 1945 by handing the pen back to fifty state legislatures.

Look closely

- Find the man on the ladder lighting the chandelier. Why might Morse put the picture's central action in a lamplighter instead of a lawmaker?
- Count the small working groups of congressmen. Lawmaking here looks like conversation, not oratory — what does that suggest about how rules actually get made?
- Notice the gallery of onlookers above. Who watches the lawmakers — and in insurance regulation, who watches the commissioner?
- Take in the scale: one room for a continent's laws. McCarran-Ferguson moved insurance lawmaking from this room to fifty smaller ones. What is

gained by fifty, and what is risked?

Talk about it

1. Paul v. Virginia left insurance to the states; SEUA federalized it; McCarran-Ferguson handed it back on condition that the states actually regulate. Which arrangement would you trust most with your own family's policies, and why?
2. Morse's chamber is lit by one chandelier being kindled as night falls. Regulation, too, is mostly unseen maintenance — solvency exams, form approvals — until a failure makes it visible. Why is boring, steady oversight worth more than dramatic rescue?
3. Scripture says that in the multitude of counsellors there is safety (Proverbs 11:14). Fifty commissioners sharing one NAIC playbook is a multitude of counsellors by design. When does counsel-taking become wisdom, and when does it become everyone copying everyone?

PROJECT

The Regulation Layer: Finishing the Timeline, Meeting Your Commissioner

You will finish the timeline you began in Lesson 1.2 by adding the regulation layer — 1869, 1871, 1944, 1945 — and then put a real name on the abstraction by looking up your own state's commissioner and department. The finished page is the historical spine of your Pathway File: how insurance began, and who governs it now.

You will need

- Your origins timeline from Lesson 1.2 and a contrasting ink color
- Your exam notebook
- The NAIC State Insurance Departments directory from the kit (content.naic.org/state-insurance-departments)

Steps

1. On the right third of your timeline, extend the line to 1950 (compressing the scale is fine — mark the break honestly with a zigzag).
2. Above the line, in the new color, add the regulation events: 1869 Paul v. Virginia (not commerce — states regulate); 1871 NAIC founded; 1944 SEUA (interstate commerce — federal law applies); 1945 McCarran-Ferguson (back to the states, so long as they regulate).
3. Under each event write its one-line holding from memory first, then check it against the lesson and correct in pencil.
4. Box the three-step pattern beneath: states rule → Court reverses → Congress restores, and add the standing exception: boycott, coercion, intimidation — always federal.
5. Now open the NAIC directory from the kit and find your state: write on the page your department's name, your commissioner's name and title (commissioner, director or superintendent?), whether the office is elected or appointed, and the department's consumer helpline or complaint page.
6. Add a four-line legend sorting insurers: domestic / foreign / alien (by home) and admitted / non-admitted (by certificate of authority), each with a six-

word definition.

7. Tell the whole timeline aloud — 1666 to 1945 — in under four minutes, then date the page and return it to your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the three milestones (case or act, year, one-line holding) and for domestic, foreign, alien, admitted, certificate of authority and guaranty association.
2. Draw the regulation see-saw: STATES on one end, FEDERAL on the other, with 1869 tipping it one way, 1944 the other, and 1945 balancing it with a note — "states keep it by using it."
3. Write a five-line trap list titled "Foreign ≠ foreign," ending with: another STATE is foreign; another COUNTRY is alien.

> **From history.** The regulators organized before the telephone: the National Insurance Convention — today's NAIC — first met in New York City in May 1871, with commissioners from 19 states, and its first great product was not a rule but a form: the uniform annual statement blank, so a company's finances could be read the same way in every capital. A century and a half later the annual statement is still the backbone of solvency regulation — proof that in oversight, as in underwriting, standardized information comes first.

Example 1. Exam style. An insurer incorporated in Toronto, Canada, is licensed and selling policies in Ohio. From Ohio's standpoint this insurer is:

A. Domestic and admitted

B. Foreign and admitted

C. Alien and admitted

D. Alien and non-admitted

Show solution

1. Sort by home first: incorporated in another country — Canada — so the insurer is alien in every U.S. state. Foreign would mean another state.
2. Sort by permission second: it is licensed in Ohio, meaning it holds an Ohio certificate of authority — admitted.
3. B is the classic trap, misreading foreign as foreign-country; D contradicts the stated licensing.

Answer: C. Another country makes it alien; the Ohio license (certificate of authority) makes it admitted there.

Example 2. Exam style. Under the McCarran-Ferguson Act, federal antitrust law applies to the business of insurance:

A. Fully, as it applies to any industry

B. Only to the extent the business is not regulated by state law

C. Not at all

D. Only to life insurance

Show solution

1. Recall the act's second clause: federal antitrust applies only to the extent the states do not regulate the business.
2. A states the SEUA world without McCarran-Ferguson; C overshoots — boycott, coercion and intimidation remain federally punishable regardless.
3. D invents a product-line distinction that exists nowhere in the act.
4. B is the act's own formula — and the reason states promptly passed rating and unfair-trade-practices laws.

Answer: B. McCarran-Ferguson leaves insurance to the states so long as they regulate; the federal antitrust laws stand ready where they do not, and boycott, coercion and intimidation are always reachable.

Example 3. A producer, closing a nervous client, says: "Even if this company ever failed, the state guaranty association would pay your claim, so you're guaranteed either way." Walk through what is true, what is false, and what the producer has done.

Show solution

1. True in substance: guaranty associations exist in every state and pay covered claims of insolvent admitted insurers within statutory limits.
2. False in impression: the limits are capped, recovery can be slow, and not every product or amount is covered — "guaranteed either way" overstates the net.
3. The violation: using the guaranty association in selling or advertising is prohibited by state law precisely because it erases the buyer's reason to prefer sound insurers.
4. The honest alternative: show the client the insurer's financial strength and the department's resources, and never sell the net.

Answer: The producer has committed a sales-conduct violation: guaranty associations may not be used to induce a sale, however soothing the sentence sounds. Teach the client to choose strong companies instead.

PRACTICE

1. Easy What did Paul v. Virginia (1869) hold, and what did that leave the states free to do?

   Show answer

   That issuing an insurance policy is not a transaction of interstate commerce — so federal commerce power did not reach insurance, and the states built and ran their own systems of insurance regulation for 75 years.

2. Easy From your state's standpoint, classify each: an insurer incorporated in your state; an insurer incorporated in a neighboring state; an insurer incorporated in London.

   Show answer

   Domestic; foreign (another state); alien (another country).

3. **Easy** What document authorizes an insurance company to transact business in a state, and what is the producer's counterpart?

Show answer

The certificate of authority admits the company; the producer's counterpart is the individual license (plus each insurer's appointment).

4. **Medium** Which of the following did United States v. South-Eastern Underwriters Association (1944) decide?

A. Insurance may never be regulated by the states

B. Insurance transacted across state lines is interstate commerce subject to federal law

C. Rate-fixing by insurers is always legal

D. The NAIC is unconstitutional

Show answer

B. SEUA reversed Paul's not-commerce doctrine, exposing insurance to the Sherman Act. It did not forbid state regulation (A) — McCarran-Ferguson soon re-centered it in the states; C reverses the case's thrust, and D confuses a private association with a statute.

5. **Medium** Recite McCarran-Ferguson's three working parts.

Show answer

State regulation and taxation of insurance is in the public interest; federal antitrust and most federal laws apply only to the extent the states do not regulate the business; and boycott, coercion and intimidation remain federally punishable regardless.

6. **Medium** Is the NAIC a federal agency? Explain what it is and how its model laws gain force.

Show answer

No. It is the private association of the state insurance commissioners, founded in 1871. Its model laws are drafts with no legal force until a state legislature enacts them — which most do, producing near-uniformity without federal control.

7. Medium Who funds a state guaranty association, and whom does it protect?

Show answer

Admitted insurers in the state fund it through assessments. It protects policyholders and claimants of insolvent insurers by paying covered claims within statutory limits — it is a safety net for promises, not a bailout for companies.

8. Hard A producer's mailer reads: "All our carriers are backed by the State Guaranty Fund — your coverage is safe no matter what." Name the violation and the reason the rule exists.

Show answer

Using the guaranty association in advertising or sales is prohibited. If every policy looks state-guaranteed, buyers and producers lose their reason to prefer financially sound insurers — the rule protects the market's incentive to choose carefully.

9. Hard Why did the SEUA decision, which the insurance industry lost, lead within a year to a statute the industry largely welcomed? Trace the logic in two or three sentences.

Show answer

SEUA made insurance federally regulable, threatening to displace 75 years of state codes and expose ordinary cooperative ratemaking to antitrust suits. The states and industry both preferred the devil they knew, and Congress agreed that working state regulation served the public. McCarran-Ferguson restored state primacy on the condition that states actually regulate — which they promptly did with rating and unfair-trade-practices laws.

10. Hard An insurer incorporated in your state sells only in two other states. A friend says, "It's a domestic insurer, so your commissioner has nothing to say about it." What is right and wrong in that sentence?

Show answer

Right: it is domestic in your state — classification follows the state of incorporation. Wrong: domicile is the strongest ground for oversight, not the weakest; the domestic regulator leads solvency examination of its own companies, while the states where it sells regulate it there as a foreign insurer.

11. **Challenge** McCarran-Ferguson's antitrust exemption lives only "to the extent" states regulate. Explain in three sentences how that single phrase disciplines fifty legislatures, using Unit 9's existence as evidence.

Show answer

The phrase makes state power conditional: any corner of the business a state leaves unregulated falls automatically under federal antitrust law. Legislatures therefore keep comprehensive codes — rating laws, unfair trade practices acts, claims-conduct rules — to keep the field occupied. Unit 9 of this course exists because every state answered the invitation with a thick book of producer law, which is what your exam tests.

12. **Challenge** Fifty regulators instead of one: give one real advantage and one real cost of the American arrangement, and say which the NAIC exists to soften.

Show answer

Advantage: a commissioner close to local markets can act quickly, and one state's mistake does not become everyone's — states also learn from each other's experiments. Cost: fifty sets of rules burden multistate insurers and producers with duplication. The NAIC exists to soften the cost — model laws, uniform filings and accreditation give the fifty systems one playbook while leaving the pen in each state's hand.

COMMON MISTAKES

- Reading "foreign insurer" as a company from another country — foreign means another state; another country is alien, and the exam will offer both.
- Swapping the holdings: Paul v. Virginia (1869) said insurance is NOT commerce; SEUA (1944) said it IS; McCarran-Ferguson (1945) returned primary regulation to the states.
- Calling the NAIC a federal agency or its model laws binding; it is the commissioners' association, and models bind only when a legislature enacts them.
- Forgetting the standing federal exception — boycott, coercion and intimidation are punishable under federal law no matter how thoroughly a state regulates.
- Matching the certificate of authority to the producer; producers hold licenses, companies hold certificates of authority.

- Mentioning the guaranty association to reassure a prospect — a prohibited sales practice even when every word is technically true.

Make it a game · Domestic, Foreign, Alien!. A parent names company homes and sales states in rapid fire — "incorporated in Texas, selling in Texas"; "incorporated in Ontario, selling in Montana"; "incorporated in Maine, selling in Georgia" — and you call DOMESTIC, FOREIGN or ALIEN before a three-count. Every third round, they swap in a milestone instead — "1869!", "1944!", "1945!" — and you answer with the case or act and its one-line holding. One point per correct call; first to twelve wins. Then reverse roles: inventing fair questions fixes the categories deeper than answering them.

Scripture. "Where no counsel is, the people fall: but in the multitude of counsellors there is safety." (Proverbs 11:14, KJV)

American insurance regulation is this proverb built into machinery: fifty commissioners counseling one another through the NAIC, legislatures checking regulators, and courts checking both. The agent stands at the end of all that counsel — and the proverb still applies at his desk, where the client deserves more than one opinion's worth of care.

1.5 The License: Lines, Exams and Your Study Plan

OBJECTIVES

- Name the major lines of authority and state which products require an additional securities registration.
- Recite the licensing steps in order, from choosing a line to carrier appointment.
- State the common exam and fee facts as of 2026 — question counts, time, passing scores, vendors — and label every changeable figure as an example to verify.
- Explain the federal felony-consent rule of 18 U.S.C. §1033 and the common fingerprint and background requirements.
- Build a dated state facts sheet from your own state's insurance department and candidate handbook, and lay out the 33-week study calendar this course follows.

> **Warm-up.** In five minutes, write the steps you would guess stand between you today and legally selling an auto policy — every exam, form, fee and permission you can imagine, in order. Keep the guess; by the end of this lesson you will rewrite it as a checklist accurate enough to follow for real.

WATCH

How to Become a Licensed Insurance Agent - A Step-by-Step Guide

State Requirement · 5:28

https://www.youtube.com/watch?v=vTBaEyI3ejM

> **WHEN TO WATCH**
> Watch after the big idea with your pencil on the seven-step list from this lesson; check off each step as the video reaches it, and note any figure it gives as an example to verify against your own state.

BACKUP VIDEO

How to Get Your Insurance License (Step-by-Step Guide)

Insurance Exam Prep by JustInsurance · 4:56

https://www.youtube.com/watch?v=Hk6GfSD_9To

A brisk second walk down the same seven steps from an exam-prep teacher; watch it after building your facts sheet and note any step where his generic figures differ from your state's verified ones.

KEY TERMS

line of authority

A category of insurance a producer license covers — commonly life; accident & health (sickness); property; casualty; and personal lines.

pre-licensing education

Classroom or online study hours some states require before a candidate may sit the exam; more than thirty states have eliminated the requirement, and states that keep it commonly require roughly 20–40 hours per line.

candidate handbook

The testing vendor's official booklet for your state: exam outlines, question counts, fees, scheduling rules and test-center procedures — the document your state facts sheet is built from.

testing vendor

The company that administers a state's licensing exams — for most states Pearson VUE, PSI or Prometric; Alabama tests through the University of Alabama, and Kentucky runs its own exams.

passing score

The minimum exam score a state requires — usually 70%, with a few states or lines using 60–65%.

fingerprinting and background check

The identity and criminal-history screening most states require of license applicants.

18 U.S.C. §1033

The federal law barring anyone convicted of a felony involving dishonesty or breach of trust from working in insurance without the regulator's written consent.

NIPR

The National Insurance Producer Registry (nipr.com), the electronic gateway through which most license applications and renewals flow to the states.

resident license

The producer license issued by your home state after you pass its exam; the foundation for licenses elsewhere.

non-resident license

A license another state grants a producer by reciprocity on the strength of his good-standing resident license, usually without another exam.

reciprocity

The state-to-state agreement to honor one another's producer licensing, which makes multi-state careers practical.

continuing education (CE)

Ongoing coursework required to renew a license — commonly 24 hours per two-year term including about 3 hours of ethics, varying by state.

CORE IDEAS

The story. For most of a century, an agent who wanted to work across a state line faced fifty gauntlets: separate applications, separate fees, sometimes separate exams, in every state — a maze that served no client. Congress lost patience on November 12, **1999**, when the Gramm-Leach-Bliley Act — the great financial-modernization law — included a quiet ultimatum: unless a majority of states enacted uniform or reciprocal producer-licensing laws within three years, a federal body, the National Association of Registered Agents and Brokers, would be created over their heads. The states heard it. The NAIC produced the **Producer Licensing Model Act** in 2000 — one license called *producer*, standard lines of authority, licenses honored state to state — and legislatures adopted it at a sprint; by 2002 well more than the required twenty-nine states were certified reciprocal, and the federal body was never seated. That race is why your path is plain today: one resident license, electronic applications through a single registry, and **non-resident licenses** by **reciprocity** almost everywhere. The door you are about to walk through was unjammed in a three-year hurry — because Washington credibly promised to remove it.

How they figured it out. The model act's cleanest gift is the menu of **lines of authority** — the categories a license covers, each with its own exam. The majors: **life** (policies on human lives, including annuities); **accident & health** (sickness, injury, disability); **property** (direct loss to homes, buildings, belongings); **casualty** (legal liability, with auto and workers' compensation in its family); and **personal lines**, a narrower P&C license for individual and family risks. States commonly pair them — life & health taken together, property & casualty together — which is why this course teaches both families. One flag matters early: **variable** life insurance and variable annuities are securities as well as insurance, so selling them requires FINRA registration (a Series 6 or 7) on top of a life license — the door School Launch's Series 65 course (at /courses/business/series-65/) opens from the investment side. Choose

your first line by the work you want: people and their incomes, or property and the liabilities around it — and remember that many agents eventually hold both.

The big idea. Here is the whole path, in order — memorize it as seven steps. *One:* choose your line of authority. *Two:* meet your state's **pre-licensing education** rule if it has one: as of 2026 more than thirty states have eliminated mandatory hours (Washington in 2023, Alabama in January 2024, Maryland in October 2024, Pennsylvania in April 2025, and California dropped its line-specific 20-hour courses effective January 1, 2026, keeping a 12-hour code-and-ethics course), while states that keep the requirement commonly ask roughly 20–40 hours per line. *Three:* schedule and pass the state exam with the **testing vendor**. *Four:* fingerprints and the background check, required by most states. *Five:* apply — through **NIPR** or the state directly — and pay the license fee, commonly $20–$200 in this example. *Six:* the state issues your resident license. *Seven:* an insurer **appoints** you, and only then are you its agent. For a working adult the whole road commonly runs about two to eight weeks — every figure in it set by your state, which is why this lesson ends with you building a facts sheet, not trusting mine.

Now the exam itself, stripped of mystery. Most states test through Pearson VUE, PSI or Prometric at proctored computer centers (Alabama uses the University of Alabama; Kentucky runs its own). Depending on state and line, exams run from about 50 to 150 scored questions — a combined life & health or property & casualty exam commonly runs about **150 questions in about two and a half hours** — all multiple choice, four answers, one best choice, no penalty for guessing. **Passing is usually 70%**, though a few states or lines set 60–65%; most centers show pass or fail on screen before you reach the parking lot. Exam fees commonly run $40–$150 per attempt in this example, and a failed exam can be retaken after a waiting period the candidate handbook states — so the cheapest exam is the one you only take once. Do the arithmetic that tames the beast: 150 questions in 150 minutes is one minute per question, and 70% of 150 is 105 — a careful candidate can miss 45 questions and pass. This course's practice sets, unit tests and full-length final all run on those numbers.

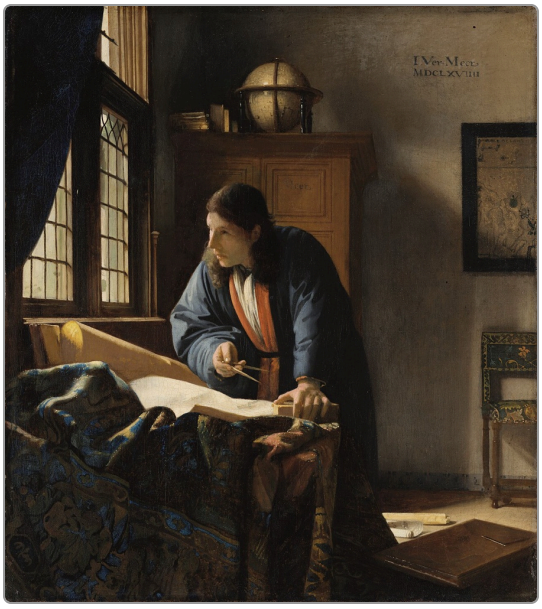
The licensing law also asks who you are, not only what you know. Most states require **fingerprinting and a background check**, and federal law stands behind them all: **18 U.S.C. §1033** makes it a crime for anyone convicted of a felony involving dishonesty or breach of trust to work in the business of insurance without the regulator's written consent — a waiver that exists but is never automatic. Applications also ask

about criminal history and license discipline in plain questions, and the one unforgivable answer is a false one: regulators routinely license people with imperfect pasts honestly disclosed, and routinely deny or revoke for lies about small things. The pattern runs through this whole profession — Unit 2 will show you that an insurance application works the same way — so learn it here first: in this business, concealment is always the greater offense. Tell the truth on forms; it is both the law and the trade's oldest habit.

Finally, your own plan — because you, a high-school student, hold one advantage and one constraint. The constraint: nearly every state requires a licensee to be 18, so your real exam likely waits until near or after graduation. The advantage: you have what adult candidates cramming in three weeks never have — **thirty-three weeks** — and mastery now makes the real exam a formality later. This course runs five sessions a week: three per lesson (teaching and worked examples; project and notebook; practice set with corrections), a test closing each unit, a 60-question midterm after Unit 5, and a full-length 150-question practice final, proctored by a parent, timed like test day. Your part is the craft of steady study: the exam notebook with its trap lists and corrected misses, the flashcard box that will reach about 400 cards, one timed drill every week — ten questions in ten minutes — and the dated **state facts sheet** you will build in this lesson's project and verify again before anyone pays a fee. Plans gain power when they are written, dated and witnessed; yours gets all three today.

On the exam today. Licensing mechanics appear on the real exam mostly as law questions you will deepen in Unit 9, but the staples start here. Know the **lines of authority** by name and scope, and that variable products additionally require FINRA securities registration — a favorite question. Know the order of the path: exam before application, license before appointment, appointment before selling — sequencing questions are common. Know **resident versus non-resident** licensing and that reciprocity, not re-examination, is the normal road to a second state. Know §1033's exact trigger — a felony involving *dishonesty or breach of trust*, cured only by the regulator's *written consent*. And treat every number in this lesson the way the course has trained you: question counts, fees, hours and waiting periods are examples that change by state and year, and the live figures sit in your state's candidate handbook — which the exam, helpfully, will never contradict.

PICTURE STUDY



The Geographer, Johannes Vermeer, 1669 · Oil on canvas · Städel Museum, Frankfurt

Image: Wikimedia Commons, public domain

Vermeer painted almost nothing but quiet rooms, and in 1669 he painted this one: a young geographer caught at the instant between measuring and understanding, dividers still in hand, eyes lifted to the light. The map on his table is only as good as the care behind it — and he is checking. It opens this lesson because you now become the geographer of your own route: a student with a chart to draw (the state facts sheet), instruments to master (the exam's arithmetic) and a journey measured in weeks that must first be measured on paper.

Look closely

- Find the dividers in his hand — a tool for measuring distances on a chart. What is this lesson's equivalent of the dividers?
- Notice that he has looked up from the map toward the window. Measurement has just become thought. When does studying feel like that?
- Find the globe and the rolled charts. The room holds the whole world, organized. What will your Pathway File hold by Unit 10?
- Look at the light from the window falling on the work. Vermeer gives ordinary diligence the lighting other painters saved for kings. Why?

Talk about it

1. A geographer's map must match the real coastline or ships are lost; your facts sheet must match your state's real rules or fees and months are lost. What does it mean to verify a fact rather than copy it?
2. Vermeer's scholar works alone, but his charts came from a thousand sailors' logs. Whose recorded experience are you inheriting when you study a candidate handbook or an exam outline?
3. Jesus asked which of you, intending to build a tower, does not first sit down and count the cost (Luke 14:28). What costs — money, weeks, discipline — does your 33-week plan honestly count, and what does counting them first protect you from?

PROJECT

The State Facts Sheet and the 33-Week Calendar

You will build the two most practical pages in your Pathway File: a one-page, dated sheet of your own state's licensing facts, each with its official source, and the 33-week study calendar you will actually follow — countersigned by a parent, because plans gain force when they are witnessed. The facts sheet is a living document: you will re-verify it before each exam in this course and before anyone ever pays a real fee.

You will need

- Two sheets of paper or two clean spreadsheet pages
- Your state insurance department's website (find it via the NAIC directory in the kit) and your state's exam candidate handbook, downloaded from its testing vendor
- Your exam notebook, and a parent to countersign the calendar

Steps

1. Head the first page (YOUR STATE) — LICENSING FACTS, AS OF (today's date), and rule three columns: FACT, ANSWER, SOURCE.
2. Fill these rows from the department site and candidate handbook, writing the exact source page for each: minimum age; pre-licensing hours required (possibly none) per line; testing vendor; question count and time for the line you expect to take; passing score; exam fee; retake waiting period; fingerprint/background requirement; application route (NIPR or state) and license fee; CE hours per renewal.
3. Check-mark at least five rows you verified directly in the candidate handbook itself, not from any summary site.
4. Add one row — FEDERAL — for 18 U.S.C. §1033: felony involving dishonesty or breach of trust bars insurance work without the regulator's written consent.
5. On the second page, draw the 33-week calendar: number the weeks, mark the ten units in order with their test days, the midterm after Unit 5, the final

in week 33, one fixed weekly review slot, and the weekly ten-questions-in-ten-minutes timed drill.

6. Write beneath it your target real-exam window (near or after your eighteenth birthday or graduation), then sign and date the calendar and have a parent countersign it.
7. Clip both pages into your Pathway File in front of the timeline.

EXAM NOTEBOOK

1. Make flashcards for the lines of authority, the seven licensing steps in order, §1033, NIPR, reciprocity and the renewability of your motivation — one card that says 105 OF 150 PASSES.
2. Draw the seven-step path as a road from CHOOSE YOUR LINE to APPOINTED, with a toll booth at each fee and a magnifying glass at the fingerprint step.
3. Write a four-line trap list titled “Variable means both,” ending with: variable products = state life license + FINRA registration.

> **From history.** The 1999 ultimatum had a sequel: Congress actually created the National Association of Registered Agents and Brokers on paper — “NARAB II,” signed in January 2015 — as a one-stop clearinghouse for non-resident licenses. A decade later its board had never been seated, and the state system kept doing the work through NIPR and reciprocity. The moral for your facts sheet: in producer licensing, the states move when pressed — and the paper federal alternative has twice proved pressure enough.

WORKED EXAMPLES

Example 1. Your state's combined property & casualty exam has 150 scored questions, 2½ hours, passing at 70% — in this example. How many questions must you answer correctly, how many can you miss, and what is your time budget per question with ten minutes reserved for review?

Show solution

1. Required correct: $0.70 \times 150 = 105$ questions.
2. Allowed misses: $150 - 105 = 45$ questions — nearly one in three, which should drain the terror from the thing.
3. Working time: $150 - 10 = 140$ minutes for 150 questions, about 56 seconds each.
4. Train at that pace from Unit 1: this course's weekly drill is ten questions in ten minutes, slightly generous on purpose.

Answer: 105 correct passes; 45 misses are survivable; budget just under a minute per question. Check your own state's counts and passing score in its candidate handbook.

Example 2. In this example, a candidate's state has no pre-licensing requirement. She buys an optional $80 study course, pays a $70 exam fee but fails once and pays it again, pays $48 for fingerprinting and a $100 license application fee through NIPR. What did licensing cost her, and what did the failed attempt cost beyond money?

Show solution

1. Add the outlays: $\$80 + \$70 + \$70 + \$48 + \$100 = \$368$.
2. The retake cost $70 cash — but also the vendor's waiting period before rescheduling, commonly days to weeks by state, delaying her license and every commission after it.
3. Compare: passing the first time would have brought the total to $298 and saved the wait.
4. Every figure here is an example; the real ones live at your state insurance department and in the candidate handbook.

Answer: $368 in this example — $70 and lost weeks traceable to one underprepared attempt. The cheapest exam is the one you take once.

Example 3. Exam style. A producer wants to sell variable annuities. Which credentials does she need?

A. A property & casualty license only

B. A life insurance license only

C. A life insurance license plus FINRA securities registration

D. No license, because annuities are investments, not insurance

Show solution

1. Classify the product: a variable annuity is both insurance (an annuity contract) and a security (values vary with separate-account investments).
2. Each nature demands its credential: the state life line of authority for the insurance, FINRA registration (Series 6 or 7) for the security.
3. B is the trap for half-remembered rules; A names the wrong family entirely; D is false in both directions.
4. Fixed annuities, by contrast, need only the life line — the word variable is what summons the securities regulator.

Answer: C. Variable products require both the state life license and FINRA securities registration — the course's standing cross-reference to the Series 65 pathway.

PRACTICE

1. Easy Name four major lines of authority a producer license may cover.

   Show answer

   Life; accident & health (sickness); property; casualty — with personal lines as a narrower P&C license. States commonly pair life with health and property with casualty.

2. Easy Put these in order: carrier appointment, state exam, license application, choosing a line of authority.

   Show answer

   Choose the line → pass the state exam → apply for the license (via NIPR or the state) → be appointed by a carrier. Exam before application; license before appointment; appointment before selling.

3. Easy What passing score do most states require on the licensing exam, and is there a penalty for guessing?

Show answer

Usually 70% — a few states or lines use 60–65% — and no, there is no guessing penalty, so a candidate answers every question.

4. Medium As of 2026, must every candidate complete classroom hours before sitting a licensing exam? Describe the national picture.

Show answer

No. More than thirty states have eliminated mandatory pre-licensing hours (Washington 2023, Alabama January 2024, Maryland October 2024, Pennsylvania April 2025, and California dropped its line-specific 20-hour courses effective January 1, 2026, keeping a 12-hour code-and-ethics course). States that keep the requirement commonly ask roughly 20–40 hours per line — your own state's rule is row one of your facts sheet.

5. Medium Which federal law restricts people with certain felony convictions from insurance work, and what exactly does it require?

Show answer

18 U.S.C. §1033: anyone convicted of a felony involving dishonesty or breach of trust may not work in the business of insurance without the insurance regulator's written consent.

6. Medium Who administers licensing exams, and through what does a license application usually travel to the state?

Show answer

Most states use Pearson VUE, PSI or Prometric (Alabama tests through the University of Alabama; Kentucky runs its own exams). Applications usually flow electronically through NIPR, the National Insurance Producer Registry, or directly to the state.

7. Medium A licensed producer in good standing moves her business across the state line. Must she retake a licensing exam there? Name the mechanism.

Show answer

Normally no: she applies for a non-resident license, which the second state grants by reciprocity on the strength of her resident license — the system the states built after Gramm-Leach-Bliley's 1999 ultimatum.

8. Hard Your exam has 100 scored questions, passing at 70%, in 2 hours — in this example. Compute the passing number, the allowable misses, and your per-question time budget leaving 8 minutes to review.

Show answer

$0.70 \times 100 = 70$ to pass; 30 misses allowed; $(120 - 8) \div 100 \approx 1.1$ minutes per question.

9. Hard An application asks about criminal history, and a candidate with an old misdemeanor is tempted to leave it blank, reasoning it may not even count. Advise him in two or three sentences using this lesson's pattern.

Show answer

Disclose it. Regulators routinely license applicants whose records are honestly explained — and routinely deny or revoke for concealment, because a false answer on the application is itself dishonesty in a profession built on utmost good faith. In insurance, from license forms to claim forms, the cover-up is always the greater offense.

10. Hard Why did Congress's 1999 threat to create a national licensing body produce faster uniformity than fifty years of polite coordination had? And what does the episode teach about how McCarran-Ferguson's bargain stays alive?

Show answer

Because the states' authority was suddenly conditional: reform or be preempted. Legislatures adopted the NAIC's Producer Licensing Model Act at speed, and the federal body was never seated. It is McCarran-Ferguson's logic replayed — the states keep the field by occupying it well, and credible federal alternatives are what keep the occupation honest.

11. **Challenge** Design the error-proofing for your own weakest habit: name the habit (cramming, skipping review, untimed practice, trusting summaries over sources), and write a three-part countermeasure using this course's tools — the notebook, the drill, the facts sheet or the calendar.

    Show answer

    Any honest answer earns credit. Example: habit — trusting summaries. Countermeasures: verify five facts-sheet rows in the candidate handbook itself each month; rewrite every missed practice question in the notebook with its source; have a parent spot-audit two facts monthly against the cited page. The pattern matters: name the weakness, then schedule its correction — willpower is not a plan.

12. **Challenge** A friend says: "Why study 33 weeks for an exam adults pass in three?" Answer in three sentences that distinguish passing the exam from entering the calling.

    Show answer

    Adults cram the vocabulary to clear a hurdle; you are learning the policies, the mathematics, the law and the ethics beneath them, so that the exam becomes a side effect of competence. The agent families deserve is not the one who scored 70% once but the one who understands what he sells and why. You have the one resource crammers lack — time — and stewardship of it is the first professional skill this course grades.

COMMON MISTAKES

- Memorizing one state's fees, hours and question counts as universal facts; every figure varies by state and year, and only your state's candidate handbook speaks with authority.
- Forgetting that variable life and variable annuities require FINRA securities registration in addition to the life license.
- Scrambling the sequence — the exam precedes the application, the license precedes appointment, and appointment precedes selling for that insurer.
- Reading §1033 too broadly or too narrowly: it targets felonies involving dishonesty or breach of trust, and its cure is the regulator's written consent, not the passage of time.

- Assuming a second state means a second exam; reciprocity normally grants non-resident licenses on the strength of a good-standing resident license.
- Planning to study without a calendar, a timer and a witness — the three things this lesson's project exists to install.

Make it a game · License Road Relay. Write the seven licensing steps on seven index cards and shuffle them with five decoy cards (college degree required; sponsoring company required; federal license; interview with the commissioner; notarized essay). Deal the twelve face down in a row. On GO, flip and race to lay the true seven in order, discarding decoys to a junk pile — under 45 seconds wins. A parent then taps any card in your line and you must state its key fact (the usual passing score, who runs the exam, what §1033 bars, what appointment is) in one sentence for a bonus point each. Three clean runs and the road is yours.

Scripture. "For which of you, intending to build a tower, sitteth not down first, and counteth the cost, whether he have sufficient to finish it?" (Luke 14:28, KJV)

Jesus commends the builder who counts before he builds — the unfinished tower, He says, earns mockery, not sympathy. Your facts sheet and countersigned calendar are the sitting down first: the cost of this license counted in weeks, fees and discipline before the first stone. Counting the cost is not doubt; it is how serious intentions prove themselves.

UNIT 1

The Calling and the Path

Before you memorize a single policy provision, you should meet the profession and hear where it came from. In this unit you will meet the **insurance agent** — the law calls him a **producer** — the licensed person who matches families with the coverage they need and then stands beside them when the loss comes. You will hear the cable Cuthbert Heath sent from London after the 1906 San Francisco earthquake — pay the policyholders in full — and learn why a business built on paper promises lives or dies by keeping them. Then you will walk back to the beginning: London burning in 1666, Nicholas Barbon's Fire Office of 1681, the sailors and merchants at Edward Lloyd's coffee house writing their names *under* the risks, Benjamin Franklin's Philadelphia Contributionship of 1752, and the Presbyterian Ministers' Fund of 1759 that became America's first life insurer.

From the stories you will draw the machinery: **pure risk**, perils and hazards, the four ways to manage a risk, and the **law of large numbers** that Jacob Bernoulli proved in a book published in 1713 — the mathematics that turns many small premiums into one kept promise. You will watch the Supreme Court hand insurance regulation to the states in *Paul v. Virginia* (1869), take it back in the *South-Eastern Underwriters* case (1944), and watch Congress return it by the McCarran-Ferguson Act (1945) — which is why fifty state regulators, not one federal agency, will license you. The unit ends at your own door: the lines of authority, the licensing steps in order, your state's actual rules on a dated facts sheet, and the 33-week study plan this course follows.

PREREQUISITES

- Can work comfortably with percents and decimals (find 70% of 150, multiply a probability by a dollar amount)
- Can read a timeline and keep a tidy, dated notebook
- Can look up a source online (naic.org, nipr.com, your state insurance department) and record what it says
- Has completed a basic personal-finance course or can define premium, policy and risk in one sentence each

MASTERY CHECKLIST

- ☐ I can define an insurance agent (producer) and a broker and state whom each one legally represents.
- ☐ I can describe an agent's working week — needs analysis, quoting, applications, service and claims advocacy — and contrast captive and independent agents.
- ☐ I can tell the story of insurance from the Great Fire of London (1666) through Lloyd's coffee house, Franklin's Contributionship (1752) and the Ministers' Fund (1759), and define underwriter, mutual and stock insurer.
- ☐ I can distinguish pure from speculative risk, a peril from a hazard, and physical, moral and morale hazards, and name the four risk-management choices.
- ☐ I can state the law of large numbers, list the characteristics of an ideally insurable risk, define adverse selection, and compute an expected loss and a simple pure premium.
- ☐ I can tell the regulation story — Paul v. Virginia (1869), South-Eastern Underwriters (1944), McCarran-Ferguson (1945) — and classify insurers as admitted or non-admitted and domestic, foreign or alien.
- ☐ I can name the major lines of authority and recite the licensing

steps in order, from choosing a line to carrier appointment, with the common figures as of 2026.

- ☐ I can build a dated state facts sheet from my own state's insurance department and candidate handbook, and lay out a 33-week study calendar with a weekly review habit.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: State Insurance Departments directory**: Free, official. The National Association of Insurance Commissioners' map of all fifty state departments — the front door to your state's licensing rules, candidate handbook and consumer services. Open it in Lesson 1.4 to find your commissioner, and again in Lesson 1.5 to build your state facts sheet. Ages 14 and up.
- **Insurance Information Institute (iii.org)**: Free. The industry's consumer-education site: plain-language explainers on how auto, home and life insurance work, with facts and statistics pages. Browse the basics articles alongside Lessons 1.1 and 1.3 to see how the ideas in this unit are explained to the public an agent serves. Ages 14 and up.
- **NIPR (National Insurance Producer Registry)**: Free to browse, official. The nonprofit registry through which most producer license applications actually flow, with state-by-state licensing requirements. Look up your state with Lesson 1.5 — this is the site you will use for real after you pass. Ages 15 and up.
- ***The Autobiography of Benjamin Franklin***: Free on the Internet Archive. Franklin tells in his own words how Philadelphia organized itself — the Junto, the Union Fire Company of 1736, the subscription projects that led to the Contributionship of 1752. Read a chapter with Lesson 1.2 for the flavor of organized neighborliness. Ages 14 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

1.1 The Insurance Agent: A Promise-Keeper's Calling

3 sessions of 50 minutes

1.2 The Great Fire and the Coffee House: How Insurance Began

3 sessions of 50 minutes

1.3 Spreading the Risk: The Law of Large Numbers 3 sessions of 50 minutes

1.4 Fifty Regulators: Paul v. Virginia, SEUA and McCarran-Ferguson

3 sessions of 50 minutes

1.5 The License: Lines, Exams and Your Study Plan 3 sessions of 50 minutes

Unit 1 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about a minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; there is no guessing penalty, so an unanswered question is simply wrong. Where a question says “in this example,” use the figures given, and remember that real fees, hours and question counts live at your state insurance department and in its candidate handbook. A state licensing exam would pass you at 70% — 14 of 20 — but aim higher. Choose the one BEST answer.

1. **5 pts**

   In a standard agency relationship, an insurance agent legally represents:

   A. The applicant

   B. The insurer that appointed him

   C. The state insurance department

   D. The testing vendor

2. **5 pts**

   Under modern state licensing law, a “producer” is best defined as:

   A. Any person licensed to sell, solicit or negotiate insurance

   B. Only an agent appointed by a single insurer

   C. Only a broker representing buyers

   D. An insurer’s home-office underwriter

3. 5 pts

Which statement about captive and independent agents is TRUE?

A. The captive agent typically owns his book of business

B. The independent agent may sell for only one insurer group

C. The captive agent represents the buyer

D. The independent agent typically holds appointments from several insurers and owns his book of business

4. 5 pts

A newly licensed producer may act as a particular insurer's agent only after:

A. Passing a second state exam

B. Joining the NAIC

C. That insurer appoints her, filing the appointment with the state

D. Five years of experience

5. 5 pts

The Great Fire of London, which exposed the need for fire insurance, occurred in:

A. 1666, beginning in a bakehouse on Pudding Lane

B. 1752, beginning in Independence Hall

C. 1906, beginning along a California fault line

D. 1681, beginning at the Royal Exchange

6. 5 pts

A mutual insurer is owned by:

A. Its stockholders

B. The state guaranty association

C. Its policyholders

D. Its appointed agents

7. 5 pts

The term “underwriter” comes from:

A. Clerks who copied policies by hand

B. Merchants at Lloyd’s coffee house who wrote their names under a described risk, accepting a share of it

C. Printers who set policy forms in type

D. Judges who signed insurance disputes into law

8. 5 pts

Which best describes Lloyd’s of London?

A. The world’s largest mutual insurance company

B. A stock insurer founded by Edward Lloyd

C. A British government agency

D. A marketplace where syndicates of underwriters accept shares of risks

9. 5 pts

The first life insurance corporation in America was:

A. The Philadelphia Contributionship (1752)

B. The Presbyterian Ministers’ Fund (1759)

C. Barbon’s Fire Office (1681)

D. The South-Eastern Underwriters Association (1944)

10. 5 pts

Which of the following risks is insurable?

A. A homeowner’s risk that fire will destroy her house

B. An investor’s risk that his stock will fall

C. A gambler’s risk of losing a wager

D. A merchant’s risk that a new product will not sell

11. 5 pts

Lightning strikes a house with an old wood-shingle roof, causing a fire. The lightning and the roof are, respectively:

A. Hazard and peril

B. Both perils

C. Peril and physical hazard

D. Both hazards

12. 5 pts

An insured leaves his car unlocked with the keys inside “because theft is covered,” while another insured stages a theft that never happened. These illustrate, respectively:

A. Moral hazard and morale hazard

B. Physical hazard and moral hazard

C. Morale hazard and physical hazard

D. Morale hazard and moral hazard

13. 5 pts

The law of large numbers allows an insurer to:

A. Prevent losses from occurring

B. Predict the group’s total losses more accurately as the number of similar exposures increases

C. Guarantee that no individual insured suffers a loss

D. Eliminate the need for underwriting

14. 5 pts

The tendency of persons most likely to suffer losses to seek and keep insurance most eagerly is called:

A. Adverse selection

B. Subrogation

C. Reciprocity

D. Indemnity

15. 5 pts

An insurer covers 1,000 similar houses, each with a 1-in-200 annual chance of a $180,000 total loss, in this example. The pure premium per house is:

A. $90

B. $180

C. $900

D. $1,800

16. 5 pts

Paul v. Virginia (1869) held that:

A. Insurance is interstate commerce subject to federal antitrust law

B. Congress must license all insurance agents

C. Rate-fixing by insurers violates the Sherman Act

D. Issuing an insurance policy is not a transaction of interstate commerce, leaving regulation to the states

17. 5 pts

Under the McCarran-Ferguson Act (1945), the business of insurance is regulated:

A. Exclusively by the federal government

B. Primarily by the states, with federal antitrust law applying only to the extent the states do not regulate it

C. By the NAIC directly

D. By no one, as a matter of contract freedom

18. 5 pts

An insurer incorporated in Iowa and licensed to sell in Nebraska is, from Nebraska's standpoint:

A. A foreign, admitted insurer

B. An alien, admitted insurer

C. A domestic, non-admitted insurer

D. A foreign, non-admitted insurer

19. 5 pts

A producer tells a hesitant prospect, "The state guaranty association will pay your claim even if this insurer fails, so there's no risk." This statement is:

A. Good practice, because it is substantially true

B. Required disclosure under state law

C. Permitted only in writing

D. A prohibited sales practice — the guaranty association may not be used to induce a sale

20. **5 pts**

A producer holding only a life line of authority wants to sell variable annuities and asks what more, if anything, she needs. The correct answer is:

A. Nothing; a life license covers all annuities

B. A property & casualty license

C. FINRA securities registration in addition to her life license

D. Written consent under 18 U.S.C. §1033

ANSWER KEY

1. B. The agent is the insurer's representative; the broker represents the buyer. A describes a broker — the exam's favorite reversal.
2. A. Producer is the umbrella licensing term covering agents and brokers alike. B and C each name only half of it, and D is a company employee role, not a producer.
3. D. Independence means multiple appointments and ownership of the book. A and B swap the models' traits, and C confuses agents with brokers — both kinds of agent represent insurers.
4. C. One license, but a separate appointment from each insurer represented. A applies only to a new line of authority, and B misunderstands the NAIC, which is the regulators' association.
5. A. September 2, 1666 — about 13,200 houses and old St. Paul's. 1681 is Barbon's Fire Office, 1752 the Philadelphia Contributionship, 1906 the San Francisco earthquake.
6. C. Policyholders own a mutual and may receive non-guaranteed policy dividends; stockholders (A) own a stock insurer.
7. B. Risk-takers signed beneath the risk on the broker's slip — wrote under it. Today the word also names the insurer's risk-selection professional.
8. D. Lloyd's is a market of underwriting syndicates, not an insurance company — the distinction exams test by listing "Lloyd's associations" as a separate insurer type.
9. B. Chartered in 1759 to provide for ministers' widows and orphans. The Contributionship (A) was earlier but insured houses; C is English fire insurance; D was a rating bureau.
10. A. Insurance covers pure risk only — loss or no loss, no chance of gain. B, C and D are speculative risks, which include the possibility of profit and are uninsurable.
11. C. The peril is the cause of loss — lightning (and the fire it starts); the shingle roof is a physical hazard, a condition making loss likelier or worse. A reverses the pair.
12. D. Carelessness bred by coverage is morale hazard; dishonesty is moral hazard. A reverses them — the single most-missed pairing on licensing exams.
13. B. Large numbers make group results predictable; they make no individual loss less likely (A, C) and underwriting is still needed against adverse selection (D).

14. A. Adverse selection tilts the pool toward poor risks; underwriting is its remedy. B, C and D are real terms from other lessons that do not describe the tilt.
15. C. Expected losses: $1{,}000 \div 200 = 5$; total $5 \times \$180{,}000 = \$900{,}000$; per house $\$900{,}000 \div 1{,}000 = \$900$. A and B come from skipping the loss amount or the pool division.
16. D. Paul kept insurance with the states for 75 years. A describes the SEUA decision of 1944 that reversed it; C describes SEUA's consequence; B happened in neither case.
17. B. The act restored state primacy on condition the states regulate — and boycott, coercion and intimidation remain federally punishable regardless. The NAIC (C) drafts models but regulates nothing directly.
18. A. Another state makes it foreign (another country would make it alien); its Nebraska certificate of authority makes it admitted there.
19. D. Advertising or invoking the guaranty association in selling is forbidden, even when technically accurate, because it erases the buyer's incentive to choose financially sound insurers.
20. C. Variable products are both insurance and securities, requiring FINRA registration (Series 6 or 7) on top of the life line. §1033 consent (D) concerns felony convictions, not product authority.

PORTFOLIO PIECE: MY PATHWAY FILE

Assemble the file that maps the profession and your road into it: the one-page profession map of agent, broker, captive and independent with the two product worlds (Lesson 1.1); the completed timeline from the Great Fire of 1666 through the Ministers' Fund of 1759 to the regulation layer of 1869, 1871, 1944 and 1945, with your state's commissioner and department named on the page (Lessons 1.2 and 1.4); the risk map of your own household with its peril-and-hazard columns and pool arithmetic (Lesson 1.3); and the dated state facts sheet with every row sourced, beside the 33-week study calendar countersigned by a parent (Lesson 1.5).

Close the file with a one-page cover letter addressed to your future first client, explaining in your own words what an insurance agent is, why the business began among neighbors bearing one another's burdens, and why — citing the Good Samaritan and Cuthbert Heath's 1906 cable — they will be able to trust you with their worst day. Date it; in Unit 10 you will read it again beside the full-length practice exam and see how far the file has come.

LOOK FOR	WHAT IT MEANS
Profession map	Agent and broker are correctly contrasted by whom each represents; captive and independent by companies, book ownership and support; the two license families are shown; and the dated BLS and reachability facts carry their sources.
Timeline	All anchor events are present, dated and correctly placed — 1666, 1681, c. 1688, 1736, 1752, 1759, 1869, 1871, 1944, 1945 — each regulation entry carries its one-line holding, and the student can narrate the whole line aloud in under four minutes without errors.
Risk map	Eight real exposures are listed with sensible perils; each hazard is correctly labeled physical, moral or morale; every risk is assigned a defensible technique; and the pool arithmetic (expected losses, total cost, pure premium) is computed correctly and labeled as an example.
State facts sheet and calendar	Every licensing fact carries an answer and an official source, at least five rows are check-marked as verified in the candidate handbook itself, the sheet is dated "as of," and the 33-week calendar shows unit tests, midterm, final, a weekly review slot, the timed drill and a parent's countersignature.

LOOK FOR	WHAT IT MEANS
Cover letter and reflection	The letter defines the agent's calling accurately, uses the 1906 story and the Scripture honestly rather than decoratively, names whom an agent represents without fudging, and connects the student's own study plan to the faithfulness the profession requires.

UNIT 2

The Contract and the Agent's Authority

Every policy you will ever sell is a contract — but a contract like no other. In this unit you will stand in Edward Lloyd's coffee house and watch merchants write their names under the terms on a slip of paper, and you will learn why the law calls the bargain they made **aleatory**, **unilateral**, **conditional**, **personal** and a **contract of adhesion** — five strange characters no ordinary contract shares. You will see Parliament shut down the ghoulish London fashion of betting on strangers' lives with the Life Assurance Act of 1774, and from that scandal learn the two principles that keep insurance honest: **insurable interest** and **indemnity** — restore, never enrich. You will sit in Lord Mansfield's courtroom in 1766 for *Carter v Boehm*, the case that named insurance a contract of **utmost good faith**, and learn the exam's careful ladder of representations, warranties, concealment and fraud.

Then the unit turns to you — the agent. Under the old law of agency you will learn the three kinds of authority you will someday carry: **express**, written in your contract; **implied**, read into it by custom; and **apparent**, created by the company's own conduct toward the public — and why the insurer is bound by what its agent does and knows. Finally you will do the work of the **underwriter**: take the application, meet the Medical Information Bureau and the Fair Credit Reporting Act, classify the risk, and build a premium from mortality, interest and expenses. By the end, the policy in your hand will no longer be fine print; it will be a promise whose every peculiar clause you can explain.

PREREQUISITES

- Has completed Unit 1 and can define risk, peril, hazard and the law of large numbers, and name the lines of authority
- Can work comfortably with percents, decimals and simple formulas (find 0.3% of a number, multiply a rate by thousands of face amount)
- Can keep a tidy, dated exam notebook with definitions, comparisons and corrected misses
- Can look up a source online (your state insurance department, naic.org, mib.com) and record what it says

MASTERY CHECKLIST

- ☐ I can name the four elements of a valid contract, say who usually makes the offer in insurance, and state what each party gives as consideration.
- ☐ I can define the five characteristics of an insurance contract — aleatory, adhesion, unilateral, conditional and personal — and apply each to a scenario.
- ☐ I can state when insurable interest must exist for life insurance and for property insurance, and name who has an insurable interest in a life.
- ☐ I can explain the principle of indemnity, contrast indemnity contracts with valued contracts, and say which kind a life policy is.
- ☐ I can tell representations from warranties by the truth each requires, and define misrepresentation, material misrepresentation, concealment and fraud.
- ☐ I can explain rescission, and state how the incontestability clause limits an insurer after two years.
- ☐ I can define express, implied and apparent authority with an example of each, and explain waiver, estoppel and why the agent's knowledge binds the insurer.

- ☐ I can walk an application through underwriting — receipts, the MIB, the Fair Credit Reporting Act, classification — and build a premium from mortality, interest and expenses in an example.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: How Does Insurance Work?**: Free, official. The association of all fifty state insurance regulators explains policies, premiums and deductibles in plain consumer language. Read it with Lesson 2.1 to see the contract described for the people who sign it. Ages 14 and up.
- **NAIC: State Insurance Departments directory**: Free, official. The map of every state insurance department — the regulator whose rules govern every contract and agent in this unit. Use it with Lessons 2.4 and 2.5 to find your own department and bookmark its consumer and licensing pages. Ages 14 and up.
- **MIB: Request Your MIB Consumer File**: Free, official. The Medical Information Bureau's own page for consumers who want to see and correct their file — the disclosure rights you will study in Lesson 2.5. Read it, do not submit anything; a student has no file to request. Ages 15 and up.
- **CFPB: Credit Reports and Scores**: Free, official. The federal consumer bureau's plain-language pages on consumer reports and the right to notice and dispute — the Fair Credit Reporting Act duties an underwriter owes every applicant. Read the overview with Lesson 2.5. Ages 15 and up.
- ***Handbook of the Law of Insurance*, by William R. Vance (1904)**: Free on the Internet Archive. A classic law-school handbook from 1904 — dip into its chapters on the making of the contract and on warranties with Lessons 2.1 and 2.3 to hear a great teacher of a century ago explain the same rules you are learning. Ages 16 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

2.1	**A Contract Like No Other: Elements and Characteristics**	3 sessions of 50 minutes
2.2	**Insurable Interest and Indemnity: No Betting Allowed**	3 sessions of 50 minutes

2.3 Utmost Good Faith: Representations, Warranties and Concealment

3 sessions of 50 minutes

2.4 The Agent's Three Authorities: Express, Implied and Apparent

3 sessions of 50 minutes

2.5 Underwriting: The Application, the MIB and the Price of Risk

3 sessions of 50 minutes

Unit 2 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Time yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says "in this example," use the figures given, and remember that real premiums, fees and clause periods vary by state and company — the live rules are at your state insurance department. Choose the one BEST answer.

1. **5 pts**

   Which of the following is NOT one of the four elements of a valid contract?

   A. Offer and acceptance

   B. Consideration

   C. Indemnity

   D. Legal purpose

2. **5 pts**

   In forming an insurance contract, the offer is usually made by:

   A. The applicant, submitting the application with the first premium

   B. The insurer, through its advertising

   C. The agent, by quoting a rate

   D. The state, by approving the policy form

3. 5 pts

A court reads an ambiguous policy term in favor of the insured because an insurance policy is:

A. An aleatory contract

B. A contract of adhesion

C. A conditional contract

D. A valued contract

4. 5 pts

A family pays a $700 annual premium in this example and later collects $250,000 . The unequal exchange illustrates which characteristic?

A. Unilateral

B. Personal

C. Conditional

D. Aleatory

5. 5 pts

For a life insurance policy, insurable interest must exist:

A. At the time of death

B. At the time of application

C. Continuously from application to death

D. Only when the beneficiary is changed

6. 5 pts

Harlan sold his cabin in April; in June it burned. His old policy was still paid up. His claim fails because:

A. The policy lapsed automatically at the sale

B. Fire was not a covered peril

C. He had no insurable interest at the time of loss

D. The new owner’s coverage is primary

7. 5 pts

A creditor owed $25,000 wants life insurance on the debtor. The creditor's insurable interest supports coverage of approximately:

A. $25,000

B. Any amount the debtor consents to

C. Ten times the debt

D. Nothing; creditors have no insurable interest

8. 5 pts

Life insurance pays its stated face amount without measuring the survivors' financial loss because it is:

A. An indemnity contract

B. An aleatory wager

C. A conditional receipt

D. A valued contract

9. 5 pts

Statements made by an applicant on a life insurance application are considered:

A. Warranties, which must be literally true

B. Representations, which must be substantially true

C. Concealments, unless notarized

D. Guarantees of insurability

10. 5 pts

A statement written into the contract itself and guaranteed to be strictly, literally true is:

A. A warranty

B. A representation

C. An estoppel

D. A rider

11. 5 pts

A misrepresentation is MATERIAL when:

A. It embarrasses the applicant

B. It appears in Part 2 of the application

C. The truth would have changed the insurer's underwriting decision

D. It relates to the cause of the loss

12. 5 pts

Three years into a life policy, the insurer discovers a material (but not fraudulent) misstatement in the application. Under the incontestability clause, the insurer:

A. May rescind and return premiums

B. May deduct the misstatement's cost from the benefit

C. May cancel at the next anniversary

D. May no longer contest the policy

13. 5 pts

An insurer leaves its signage, forms and rate books with an agent after terminating him, and he takes an application from an unknowing customer. The insurer may be bound under:

A. Express authority

B. Implied authority

C. Apparent authority

D. No authority; termination ends everything

14. 5 pts

An agency contract says only "solicit applications," yet the agent lawfully collects initial premiums with them because collection is usual and necessary to the task. This is:

A. Apparent authority

B. Implied authority

C. Express authority

D. Waiver

15. 5 pts

An applicant tells the agent about a heart condition; the agent writes “none” on the application and submits it. At claim time, the insurer’s rescission effort is weakest because:

A. The agent’s knowledge is imputed to the insurer, which may be estopped from rescinding

B. Heart conditions are never material

C. The incontestability clause applies from day one

D. Applications are not part of the contract

16. 5 pts

Which pairing is correct?

A. Agent — represents the buyer; broker — represents the insurer

B. Agent — binds all lines; broker — binds none

C. Both agent and broker legally represent the insurer

D. Agent — represents the insurer; broker — represents the buyer

17. 5 pts

Premium accompanies a life application and the agent issues a conditional receipt. The applicant dies before the policy is issued, and underwriting confirms he was insurable as applied for. The insurer:

A. Owes nothing; no policy was delivered

B. Owes the death benefit; coverage was effective from the receipt or exam date

C. Owes a premium refund only

D. Owes the benefit only if a binder existed

18. 5 pts

Which statement about the Medical Information Bureau is correct?

A. It is a government agency that approves applications

B. Insurers may decline applicants solely on an MIB code

C. Applicants may never see their MIB files

D. It is a member-owned bureau of coded information, requiring applicant authorization, and may not be the sole basis for declination

19. 5 pts

An insurer rates an applicant partly on a consumer report. Under the Fair Credit Reporting Act it must:

A. Keep the source confidential to protect the reporting agency

B. Offer the applicant a premium discount

C. Notify the applicant of the adverse action and identify the reporting agency

D. Destroy the report within thirty days

20. 5 pts

In this example, a $300,000 policy is priced with mortality of $2.50 per $1,000, a $80 expense load and a $110 interest credit. The annual premium is:

A. $720

B. $940

C. $750

D. $830

ANSWER KEY

1. C. Indemnity is a principle of insurance, not an element of a contract. The four elements are agreement (offer and acceptance), consideration, competent parties and legal purpose.
2. A. The applicant offers with application and premium; the insurer accepts by issuing as applied for. Advertising (B) is only an invitation to apply, and a quote (C) is not an offer.
3. B. The insurer drafted every word and offered the contract take-it-or-leave-it, so under contra proferentem ambiguities are construed against the drafter. Aleatory (A) describes unequal exchange, not drafting.
4. D. Aleatory contracts exchange unequal values depending on an uncertain event. Unilateral (A) is about who promises; conditional (C) is about duties that must be met before payment.
5. B. Life insurable interest is tested when the policy is issued — at application — and a validly formed policy survives later changes such as divorce. 'At the time of death' (A) is the exam's classic trap.
6. C. Property insurance requires insurable interest at the time of loss, and Harlan owned nothing that burned — paying premiums cannot create a loss where none was suffered.
7. A. A creditor's interest is limited to roughly the outstanding debt. Consent (B) is necessary but cannot enlarge an interest the law caps, and coverage far beyond the debt would be a wager.
8. D. A valued contract pays a stated sum on the insured event; no adjuster appraises a life. Property and casualty policies are the indemnity contracts (A), paying measured loss up to the limit.
9. B. Application answers are representations — true to the applicant's honest knowledge and belief. The strict literal-truth standard (A) belongs to warranties, which most states exclude from life and health applications absent fraud.
10. A. A warranty is part of the contract and guaranteed strictly true; a breach can void coverage regardless of materiality — which is why the standard is reserved mostly for commercial settings.
11. C. Materiality is measured against the underwriting decision — decline, exclude or reprice. It does not require any connection to the eventual loss (D), the distractor the exam plants most often.

12. D. After the contestable period — commonly two years — the insurer can no longer contest application misstatements. The time to investigate was the first two years, not the week of the claim.
13. C. Actual authority (express and implied) died with the contract, but the principal's own conduct — leaving the indicia of authority in place — created a reasonable public appearance, and apparent authority binds the careless principal.
14. B. Implied authority is unwritten but real — the customary, necessary powers that carry out the express grant. It is part of actual authority, unlike apparent authority (A), which rests on appearances.
15. A. Under Union Mutual v. Wilkinson, what the agent learns within his agency the insurer is deemed to know, and having issued through its own agent's falsification it may be estopped — while the agent faces discipline.
16. D. The agent acts for the insurer-principal; the broker shops for the buyer and generally cannot bind coverage. Most state codes license both under the single term producer.
17. B. The conditional receipt's condition — insurable as applied for — was met, so coverage took effect at the receipt or exam date. Refund-only (C) is the result when the condition fails; binders (D) belong to property insurance.
18. D. The MIB is the insurers' own cooperative bureau; inquiries require authorization and notice, applicants may request and correct their files, and a code is a lead to verify — never by itself a reason to decline.
19. C. Adverse action based on report information triggers the duty to tell the applicant and name the source, so she can obtain the file and dispute errors. Secrecy (A) is the opposite of the statute's design.
20. A. Mortality cost is $300 \times \$2.50 = \$750$; add \$80 expenses and subtract the \$110 interest credit: $\$750 + \$80 - \$110 = \$720$. Choice B adds the interest instead of subtracting it.

PORTFOLIO PIECE: MY PATHWAY FILE: THE CONTRACT CHAPTER

Assemble the chapter of your Pathway File that proves you understand the strange and wonderful contract at the heart of the profession: the Contract Anatomy Chart with its four elements and five characteristics (Lesson 2.1), the Insurable Interest Sorting Sheet with both clocks written large (Lesson 2.2), the banded deck of Good-Faith Case Cards sorted up the ladder from honest answer to fraud (Lesson 2.3), the Agent Authority Map with its principal–agent–public triangle and the Wilkinson chain (Lesson 2.4), and the three-applicant Pretend Underwriting File with its priced premium and its two letters (Lesson 2.5).

Close the chapter with a one-page letter addressed to a pretend first client, explaining in your own words why an insurance policy can be trusted even though the company wrote every word of it — naming at least three protections you learned in this unit (choose from contra proferentem, insurable interest, utmost good faith, incontestability, apparent authority and the underwriting rights of applicants) and ending with the standard of Matthew 5:37: a yes that means yes.

LOOK FOR	WHAT IT MEANS
Contract Anatomy Chart	All four elements and all five characteristics are present, correctly defined, each with a working example, and the offer–counteroffer–acceptance case is traced accurately.
Insurable Interest Sorting Sheet	All twelve cases are sorted correctly with the right family of interest, and both clocks — property at loss, life at application — are stated without error.
Good-Faith Case Cards	Every rung of the ladder appears at least once, each card names the doctrine and the remedy correctly, and the materiality test is quoted exactly on the banner card.
Agent Authority Map	The three authorities are classified with their true sources, all ten test acts are marked correctly, and the imputed knowledge–waiver–estoppel chain is in the right order.
Underwriting File	Classifications are defended, the premium arithmetic is complete and labeled with every figure marked as an example, and the two letters honor the MIB and FCRA rights they exist to serve.

LOOK FOR	WHAT IT MEANS
Client letter	The three protections are accurately explained in the student's own words, the Scripture is used honestly rather than decoratively, and the letter would genuinely reassure a careful reader.

2.1 A Contract Like No Other: Elements and Characteristics

OBJECTIVES

- Name the four elements of a valid contract — agreement, consideration, competent parties and legal purpose — and apply each to an insurance application.
- State who usually makes the offer in insurance and what each party gives as consideration.
- Define the five characteristics of an insurance contract: aleatory, adhesion, unilateral, conditional and personal.
- Explain why ambiguities in a policy are construed against the insurer.
- Explain the entire contract idea: the policy, the application and any riders are the whole agreement.

> **Warm-up.** In five minutes, write down the last promise-for-a-promise trade you made — chores for allowance, work for pay, anything. Label who offered, who accepted, and what each side gave up. Keep the paper: by the end of this lesson you will test whether an insurance policy fits your pattern, and discover three ways it does not.

WATCH

Aleatory, Adhesion and Unilateral Explained for the Insurance Exam

Insurance Exam Queen · 9:39

https://www.youtube.com/watch?v=u51BuTAPJQM

> **WHEN TO WATCH**
> Watch after reading the big idea; each time a characteristic is named, pause and write it in your notebook with a five-word example of your own.

BACKUP VIDEO

How To Get Your Insurance License: Contract Elements - Aleatory, Adhesion, Unilateral, & Conditional

Morton Schools · 13:56

https://www.youtube.com/watch?v=bUmLVWlknHo

A second, slower pass through both the elements and the characteristics; watch it before the project if any of the five characteristics still blur together.

KEY TERMS

offer and acceptance (agreement)

The meeting of the minds that begins a contract; in insurance the applicant usually makes the offer by submitting the application with the premium, and the insurer accepts by issuing the policy as applied for.

consideration

The value each party gives: the applicant's premium and statements in the application, exchanged for the insurer's promise to pay covered losses.

competent parties

Parties legally able to contract — of legal age, of sound mind, not under duress — with the insurer licensed to do business in the state.

legal purpose

The requirement that a contract not be against the law or public policy; insurable interest and consent keep an insurance contract from being a wager.

aleatory contract

A contract in which the values exchanged are unequal and depend on an uncertain event — a small premium may buy a large payment, or years of premiums may buy none.

contract of adhesion

A contract drafted entirely by one party and offered take-it-or-leave-it, so courts construe any ambiguity against the drafter — the insurer.

unilateral contract

A contract in which only one party — the insurer — makes a legally enforceable promise; the insured may stop paying at any time and cannot be sued for premiums.

conditional contract

A contract whose performance depends on conditions being met, such as paying the premium and giving timely proof of loss.

personal contract

A contract with a particular person rather than with property; a property policy does not follow a house or car to its buyer without the insurer's consent.

entire contract

The rule that the policy, the attached application and any riders or endorsements make up the whole agreement, and nothing outside it counts.

counteroffer

The insurer's response when it issues a policy on different terms than applied for — a new offer the applicant accepts by paying the premium.

CORE IDEAS

The story. In February 1689 a London newspaper, the *Gazette*, carried an advertisement directing readers to Edward Lloyd's coffee house on Tower Street — the first known mention of a little shop that would give its name to the most famous insurance market on earth. Lloyd served coffee to ship captains, merchants and men with money, and he served them something better: reliable shipping news. A custom grew up at his tables. A broker with a ship to insure wrote the particulars — vessel, master, voyage, cargo — across the top of a slip of paper. Men who were willing to carry a share of the risk wrote their names *under* the terms, each with the fraction he

would bear: and so they were called **underwriters**. No committee negotiated clause by clause; no signer could pay less than the loss demanded or owe more than his share. A few strokes of ink bound strangers to rebuild a merchant's fortune if the sea took it, and bound the merchant to nothing but his premium. The lawyers would spend the next three centuries explaining what kind of contract that could possibly be — and their answers are exactly what your licensing exam asks.

How they figured it out. Judges began with the ordinary law of contract, which demands four things of every enforceable bargain, and found that insurance has them all. There is **agreement** — an offer by one party and acceptance by the other. There is **consideration** — something of value from each side. There are **competent parties** and a **legal purpose**. But the courts also saw that the policy is one-sided in a way no horse trade is: the company writes every word, and the buyer can only take it or leave it. So they borrowed an old Latin rule, *contra proferentem* — "against the offeror" — and made it the first rule of insurance law: when a policy's words honestly carry two meanings, the court reads them against the party who drafted them, the insurer, and in favor of the insured. A company that wants the narrow meaning must write the narrow words. That single rule, born of fairness, is why policies grew long and precise — and why you must learn to read them.

The big idea. Fix the four elements first, in insurance dress. **Offer and acceptance:** the applicant usually makes the offer, by submitting the application with the first premium; the insurer accepts by issuing the policy as applied for. If the insurer issues something different — a higher premium, an added exclusion — that is not acceptance but a **counteroffer**, which the applicant accepts by paying for the changed policy. **Consideration:** the applicant's consideration is the premium *and* the statements in the application; the insurer's is its promise to pay covered losses. Notice the lopsidedness — money and words on one side, a conditional promise on the other. **Competent parties:** legal age, sound mind, no duress; the insurer must be licensed — the exam's word is *authorized* or *admitted* — in the state. **Legal purpose:** the contract must not offend law or public policy, which is why insurable interest and consent, next lesson's subject, are required at the start.

Now the five characteristics, the exam's favorite vocabulary in this unit. The contract is **aleatory**, from the Latin *alea*, dice: the values exchanged are unequal and hang on chance. A family pays $600 in this example and collects $250,000; a neighbor pays for thirty years and collects nothing — and both received exactly what they bought,

the carrying of a risk. It is a contract of **adhesion**: the insurer drafts it, the applicant adheres to it, and ambiguities cut against the drafter. It is **unilateral**: only the insurer makes an enforceable promise. The insured never promises to keep paying; he may walk away, and the company's only remedy is that coverage ends. One promise, not two — that is the heart of the word.

It is **conditional**: the insurer's duty to pay ripens only if conditions are met — the premium paid, the loss a covered one, notice given and proof of loss furnished in time. A policyholder who never files proof of loss has not triggered the promise, however real the fire. And it is **personal**: insurance follows the person, not the thing. If the Harmons sell their house in this example, their homeowners policy does not ride along to the buyer, because the company priced the Harmons — their care, their claims record — not the shingles. Property policies therefore cannot be assigned to a new owner without the insurer's written consent. (Life insurance is the gentle exception you will meet in Unit 4: a life policy is property of its owner and may be assigned, though the insured life never changes.)

Last, the **entire contract**: the policy, the application attached to it, and any riders or endorsements are the whole of the agreement. Neither side may point to a brochure, a lunch-table remark or a half-remembered phone call to add or subtract a term; and after issue, the insurer cannot quietly amend the contract — changes require an endorsement or rider, agreed to in writing, and only an executive officer of the company, not the agent, may alter the policy's terms. The rule protects both directions at once: the insured cannot be held to statements never made part of the file, and the insurer cannot be held to promises the policy never contained. When Unit 2.4 asks what an agent's word can and cannot bind, remember that the paper is the promise.

On the exam today. State exams drill this lesson as pure vocabulary with scenario dress. Know the four elements cold — and that *indemnity*, *insurable interest* and *good faith* are principles of insurance, not elements of a contract, a favorite wrong answer. Know who makes the offer: the applicant, with application and premium — and that issuing a changed policy is a counteroffer. Match each characteristic to its one-line cue: unequal exchange, aleatory; take it or leave it with ambiguities against the insurer, adhesion; only one enforceable promise, unilateral; duties that must be met before payment, conditional; coverage that does not follow sold property, personal.

The subtlest trap swaps unilateral and conditional: unilateral is about *who promises*, conditional about *what must happen* before the promise pays.

PICTURE STUDY



The Village Lawyer, Pieter Brueghel the Younger, 1621 · Oil on panel · Museum of Fine Arts, Ghent

Image: Wikimedia Commons, public domain

Pieter Brueghel the Younger painted the daily life his father had made famous, and in this scene from 1621 the whole village has crowded into a lawyer's office, paying in eggs and hens to have their bargains read, written and defended. The paper blizzard is the point: when neighbors stop trusting a handshake, every promise becomes a document someone must draft — and someone else must sign without fully understanding. It opens this lesson because insurance lives in exactly that room: a contract one party writes and the other adheres to, which is why the law reads every unclear word against the writer.

Look closely

- Count the kinds of payment the villagers have brought — eggs, a bird, bundles. Consideration does not have to be money; it has to be value.
- Find the papers: on the desk, the shelves, the walls, the floor. What does the painter think of a world that runs on documents?
- Look at the faces of the waiting peasants. Who in this room understands the words they are paying for?
- Notice the lawyer's concentration as he reads. The man who drafts the words holds the power — which is exactly why courts construe ambiguity against him.

Talk about it

1. The villagers cannot draft the documents they depend on. How does the rule of contra proferentem protect people in their position today?
2. Is a mountain of paper a sign of distrust, or a way of keeping promises honest? Can it be both?
3. An agent will someday read policies to families like these. What does this room teach about the duty to explain plainly what a signer cannot draft — and Who hears every promise, written or not?

PROJECT

The Contract Anatomy Chart

You will build a one-page anatomy of the insurance contract for your Pathway File: the four elements down one side, the five characteristics down the other, each tested against a pretend policy. Half the law questions in this unit's test begin by asking which element or characteristic a scenario shows, and a chart you drew yourself is the fastest memory there is.

You will need

- One sheet of unlined paper (or a single spreadsheet page), ruler and two ink colors
- Your exam notebook and pen
- This lesson's key terms and the NAIC "How Does Insurance Work?" page from the kit

Steps

1. Draw a line down the middle. Head the left column THE FOUR ELEMENTS and the right column THE FIVE CHARACTERISTICS.
2. Fill the left column: agreement (offer and acceptance — write WHO OFFERS: THE APPLICANT, WITH APP + PREMIUM), consideration (applicant: premium and statements; insurer: the promise), competent parties, legal purpose. Give each a ten-word pretend example.
3. Fill the right column: aleatory, adhesion, unilateral, conditional, personal — each with its one-line cue (unequal exchange; ambiguities against the insurer; one promise; duties before payment; follows the person, not the property).
4. Across the bottom, write a three-line case: "The Ortiz family applies for a homeowners policy with the first premium. The insurer issues it with a higher wind deductible. The Ortizes pay." Mark the offer, the counteroffer and the acceptance with arrows.
5. Add a banner across the top: THE POLICY, THE APPLICATION AND THE RIDERS ARE THE ENTIRE CONTRACT.

6. Test yourself: cover the right column and recite all five characteristics with their cues; cover the left and recite the four elements.
7. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make a flashcard for each key term in this lesson, term on the front, one-sentence definition on the back, and add them to your course box.
2. Draw a two-panel diagram: panel one, a balanced scale labeled ORDINARY CONTRACT (promise for promise); panel two, a tilted scale labeled ALEATORY (small premium, large promise, chance decides) — and under both write UNILATERAL: ONLY THE INSURER PROMISES.
3. Write a five-line trap list titled "Elements vs. characteristics," ending with: INDEMNITY AND GOOD FAITH ARE PRINCIPLES, NOT ELEMENTS.

> **From history.** The slip was only the beginning of Lloyd's standardization. In 1779 the underwriters adopted a single printed wording for marine risks — the "SG" policy, for Ship and Goods — and it proved so durable that Parliament attached it as a schedule to the Marine Insurance Act of 1906, and it remained in general use until 1982: more than two centuries of commerce carried on one form. Standard wording is why thousands of strangers can share one risk — and why a single ambiguous word, once found, matters in every policy that carries it.

Example 1. Exam style. Marta submits an application for a life policy with her first premium. The insurer issues the policy exactly as applied for. Which is true of offer and acceptance?

A. The insurer made the offer by advertising; Marta accepted by applying

B. Marta made the offer; the insurer accepted by issuing the policy as applied for

C. No contract exists until Marta reaffirms after delivery

D. The agent made the offer on the insurer's behalf

Show solution

1. Identify the offer: an application submitted with the premium is the applicant's offer — advertising is only an invitation to apply.
2. Identify the acceptance: issuing the policy exactly as applied for is the insurer's acceptance.
3. Test the traps: A reverses the parties; C invents an extra step the law does not require; D confuses soliciting with offering — the agent carries the offer, he does not make it.
4. Had the insurer issued the policy at a higher premium, it would have made a counteroffer, which Marta would accept by paying.

Answer: B. The applicant offers with application and premium; the insurer accepts by issuing as applied for — and a changed policy would be a counteroffer instead.

Example 2. A homeowners policy covers “collapse” but nowhere defines it. The Doyles’ sagging porch has dropped eight inches without falling. The insurer reads collapse to mean a complete falling down; the Doyles read it to include serious structural caving. Both readings are honest. Applying the rules of this lesson, who wins, and why?

Show solution

1. Name the characteristic: a policy is a contract of adhesion — drafted entirely by the insurer, offered take-it-or-leave-it.
2. Apply the rule for ambiguity: contra proferentem — an ambiguous term is construed against the drafter.
3. Both meanings are reasonable, so the ambiguity is real, and it is resolved in favor of the insured.
4. Note the lesson for the insurer: the cure was available at the drafting table — define the word. Many modern policies now define collapse for exactly this reason.

Answer: The Doyles. An honest ambiguity in a contract of adhesion is read against the insurer who drafted it; if the company wanted the narrow meaning, it had to write the narrow words.

Example 3. Exam style. Harold stops paying premiums on his policy in the third year. The insurer sues him for the remaining premiums he "promised" to pay. What result, and which characteristic decides it?

A. The insurer wins; contracts bind both parties

B. The insurer wins if the policy was aleatory

C. Harold wins; the contract is unilateral and he made no enforceable promise to keep paying

D. Harold wins only if he proves a hardship

Show solution

1. Name the characteristic in play: unilateral — only the insurer made a legally enforceable promise.
2. Apply it: the insured may stop paying at any time; the company's remedy is that coverage lapses, not a lawsuit for premiums.
3. Strike the traps: A states the rule for ordinary bilateral contracts, which insurance is not; B misuses aleatory, which describes unequal exchange, not who promises; D invents a hardship test.
4. Connect to conditional: by not paying, Harold simply failed a condition, so the insurer's promise never ripens again after lapse.

Answer: C. Insurance is unilateral: the insured never promises to continue paying, so the insurer cannot sue for premiums — it can only let the policy lapse.

PRACTICE

1. Easy Name the four elements of a valid contract.

   Show answer

   Agreement (offer and acceptance), consideration, competent parties and legal purpose.

2. Easy In insurance, who usually makes the offer, and how?

   Show answer

   The applicant, by submitting the application with the first premium; the insurer accepts by issuing the policy as applied for.

3. Easy What is the applicant's consideration, and what is the insurer's?

Show answer

The applicant gives the premium and the statements in the application; the insurer gives its promise to pay covered losses.

4. Medium An insurance contract is called aleatory because:

A. Only one party makes an enforceable promise

B. The values exchanged are unequal and depend on an uncertain event

C. The insurer drafts all the terms

D. Payment depends on conditions being met

Show answer

B. Aleatory, from the Latin for dice, means unequal exchange hanging on chance. A is unilateral, C is adhesion, D is conditional — the exam loves to shuffle these four.

5. Medium A policy term honestly carries two meanings. Under which characteristic is it construed, and in whose favor?

Show answer

Under adhesion — the insurer drafted the contract, so the rule of contra proferentem reads the ambiguity against the insurer and in favor of the insured.

6. Medium Why is an insurance contract called unilateral when two parties sign it?

Show answer

Because only the insurer makes a legally enforceable promise. The insured never promises to keep paying premiums; if he stops, the insurer's only remedy is to let the coverage lapse.

7. Medium The Nguyens sell their insured boat to a neighbor. Does the policy go with the boat? Which characteristic answers the question?

Show answer

No. Insurance is a personal contract — the insurer priced the Nguyens, not the boat — so a property policy cannot be assigned to the buyer without the insurer's consent.

8. Hard An insurer receives an application with the premium, but issues the policy with a smoker rate instead of the nonsmoker rate applied for. The applicant pays the higher premium. Trace offer, counteroffer and acceptance.

Show answer

The applicant's submission was the offer; the insurer's issuing on different terms was a counteroffer, not an acceptance; the applicant accepted the counteroffer by paying the higher premium. The contract formed on the insurer's terms.

9. Hard A claimant suffered a genuine covered fire loss but never filed the required proof of loss. The insurer declines to pay. Which characteristic supports the insurer, and why does the unilateral characteristic not help the claimant?

Show answer

Conditional: the insurer's promise ripens only when the conditions — including proof of loss — are met. Unilateral describes who made an enforceable promise, not whether its conditions were satisfied; a one-sided promise can still be a conditional one.

10. Hard An agent tells a buyer at the kitchen table, "Don't worry, flood is covered." The policy excludes flood. Under the entire-contract idea, what governs, and what should the buyer have done?

Show answer

The written policy governs: the policy, attached application and riders are the whole agreement, and an agent cannot alter its terms by a kitchen-table remark. The buyer should have read the exclusions and demanded any promised coverage in writing as an endorsement. (Lesson 2.4 explains when an agent's conduct can still bind the insurer.)

11. **Challenge** A family pays $750 a year for a homeowners policy for twenty years with no claims — $15,000 in all. Their neighbor pays one $750 premium and collects $240,000 after a fire. Write three sentences explaining, with the word aleatory, why both families received exactly what they paid for.

    Show answer

    Insurance is aleatory: the values exchanged are deliberately unequal and turn on chance. Both families bought the same thing — a year of the insurer carrying a risk neither family could carry alone — and both received it in full every year, claim or no claim. The premium buys the promise, not a refund; the family with no fire bought twenty years of protection, not nothing.

12. **Challenge** Lloyd's underwriters wrote their names under terms they did not draft; a modern applicant signs a policy she did not draft. Write three sentences on how the law balances a contract that only one side writes, naming contra proferentem and the entire contract rule.

    Show answer

    The law accepts one-party drafting as the price of standardized, affordable insurance, then disciplines the drafter: under contra proferentem, every honest ambiguity is read against the insurer, so precision is the company's own burden. The entire contract rule disciplines both sides, confining the bargain to the policy, application and riders so neither party can smuggle in unwritten promises. Between the two rules, the writer must write carefully and the signer can trust that what is written is all there is.

COMMON MISTAKES

- Listing indemnity, insurable interest or good faith among the four elements of a contract — those are principles of insurance; the elements are agreement, consideration, competent parties and legal purpose.
- Saying the insurer makes the offer by advertising — the applicant makes the offer with the application and premium; ads only invite applications.
- Confusing unilateral (only one enforceable promise) with conditional (duties that must be met before the promise pays).
- Forgetting that a policy issued on different terms than applied for is a counteroffer, accepted when the applicant pays.

- Thinking a property policy follows the property to a buyer — insurance is personal and assignment requires the insurer's consent.
- Claiming the applicant's consideration is only the premium — it is the premium plus the statements made in the application.

Make it a game · Name That Character. Write the five characteristics — ALEATORY, ADHESION, UNILATERAL, CONDITIONAL, PERSONAL — on five cards laid face up on the table. A parent or sibling reads scenarios aloud from a list you write first (a family pays $500 and collects $200,000; a court reads a vague word against the company; a man stops paying and cannot be sued; a claim fails for missing proof of loss; a sold car's policy stays behind…). First player to slap the right card gets a point; a wrong slap costs one. Add two trick scenarios about the four ELEMENTS — anyone who slaps a characteristic card on an element loses a point and must name all four elements aloud. Best of fifteen wins.

Scripture. "But let your communication be, Yea, yea; Nay, nay: for whatsoever is more than these cometh of evil." (Matthew 5:37, KJV)

Christ's standard for speech is the standard the law labors to enforce with its elements and doctrines: say plainly what you will do, and do it. An agent whose yes means yes needs no fine print to hide behind — and reads the fine print honestly to every family who cannot draft it.

2.2 Insurable Interest and Indemnity: No Betting Allowed

OBJECTIVES

- Explain the principle of indemnity: insurance restores the insured to his financial position before the loss, and must not enrich him.
- State when insurable interest must exist for property insurance (at the time of loss) and for life insurance (at the time of application).
- Name who holds an insurable interest in a life: the person himself without limit, close family, business partners and key employees, and creditors to the extent of the debt.
- Tell the story of the Life Assurance Act of 1774 and why the law refuses to insure a stranger's life.
- Contrast indemnity contracts with valued contracts and classify a life policy correctly.

> **Warm-up.** In five minutes, answer with pencil and paper: your family's car is worth $9,000 and is destroyed. An insurer offers to pay $25,000. List two bad things that could start happening in a town where wrecked cars pay out almost three times their value. You have just discovered why insurance has an indemnity principle — and what it is guarding against.

WATCH

Insurable Interest - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 5:44

https://www.youtube.com/watch?v=jwj0ZcvtoRE

> **WHEN TO WATCH**
> Watch after the big idea; each time a relationship is named, write it under LOVE AND BLOOD, BUSINESS, or CREDITOR in your notebook, and star the timing rule when it is stated.

BACKUP VIDEO

Free P&C Exam Prep Class: Indemnity and Insurable Interest

P&CP · 6:30

https://www.youtube.com/watch?v=mS6GaqVrcFc

A second pass from the property-and-casualty side; watch it before the project to hear the time-of-loss rule and indemnity taught together, then say both clocks aloud from memory.

KEY TERMS

principle of indemnity

The rule that insurance restores the insured to approximately the financial condition he enjoyed before the loss — making him whole, never better off.

insurable interest

A genuine financial or relational stake in the person or property insured, such that the insured's loss is the policyholder's loss.

time-of-loss rule (property)

In property and casualty insurance, insurable interest must exist at the time of the loss; without it, nothing of the claimant's was lost.

time-of-application rule (life)

In life insurance, insurable interest must exist when the policy is issued — at application — and need not exist at the time of death.

love and blood

The exam's shorthand for relationships close enough to create insurable interest in a life without proof of financial loss — oneself, a spouse and close family.

creditor interest

A creditor's insurable interest in a debtor's life, limited to roughly the amount of the outstanding debt.

valued contract

A contract that pays a stated amount on the insured event regardless of measured loss — a life policy pays its face amount.

indemnity contract

A contract that pays the amount of the actual loss up to the policy limit — the pattern of property and casualty insurance.

wagering (gambling) contract

A contract that creates a new risk for the chance of gain rather than transferring an existing one; insurance without insurable interest is a void wager.

stranger-originated life insurance (STOLI)

An arrangement in which investors with no insurable interest induce a person to take out a policy intending to transfer it to them — prohibited today as the old wager in modern dress.

CORE IDEAS

The story. In the London of the 1760s you could walk into certain coffee houses and insure the life of a man you had never met. Newspapers printed the names of public figures — elderly statesmen, admirals on campaign, celebrated beauties — and the smart money took out "policies" on whether they would live out the year, with the going odds moving like stock prices on every rumor of illness. When a famous man fell sick, speculators who held policies on his life had reasons no Christian should have for following the bulletins. The scandal became impossible to ignore: insurance offices were functioning as betting shops, and a betting slip on a stranger's death gives its holder an interest in the funeral. In 1774 Parliament acted. The **Life Assurance Act** — known ever since as the Gambling Act — declared void every policy on a life "wherein the person or persons for whose use, benefit, or on whose account such policy or policies shall be made, shall have no interest." No interest, no insurance. With one sentence, the law drew the line your exam still tests: insurance transfers a real risk; it must never manufacture one.

How they figured it out. The lawmakers of 1774 were following the sea. Parliament had already voided "interest or no interest" marine policies in 1745, because a merchant who could insure a cargo he did not own had bought a lottery ticket on a shipwreck — and a reason to help the wreck along. The underlying insight is the **principle of indemnity**: insurance exists to *restore*, not to enrich. If a loss can leave the claimant better off than before, the contract has created a brand-new risk — the moral hazard of a policyholder who profits by disaster — instead of transferring an old one. Requiring an **insurable interest**, a real stake in the thing or the life insured, is how the law guarantees that the person collecting after a loss is a person who genuinely lost. The gambler wants the ship to sink; the owner prays it home. Insurance is for owners.

The big idea. Two rules, and above all their two different clocks. In **property and casualty** insurance, insurable interest must exist **at the time of the loss.** If the Veras sell their house in March and it burns in May, they cannot collect on their old policy, because nothing of theirs burned; if they still owned it, their interest at the moment of the fire is what the claim rests on. In **life** insurance, insurable interest must exist **at the time of application** — when the policy is issued — and need *not* exist at death. A wife insures her husband; years later they divorce and she keeps paying the premiums on the policy she owns; when he dies, she collects. The interest was real when the contract began, and the contract, once validly made, stands. The exam asks this clock question constantly, in both directions.

Who has an insurable interest in a life? First, **yourself**: every person has an unlimited insurable interest in his own life and may name any beneficiary he chooses — the insurable-interest question is asked about the *policyowner*, not the beneficiary, when a person insures himself. Second, **love and blood**: a spouse and close family, where the relationship itself is the stake and no ledger is demanded. Third, **business**: partners in a buy-sell arrangement, and an employer in a key employee whose death would genuinely cost the firm. Fourth, a **creditor** in a debtor — but only to roughly the extent of the debt. A lender owed $40,000 in this example has an insurable interest near that figure, not a license to write $400,000 on the borrower's life; tenfold coverage would make the lender a bettor, not a creditor.

Now distinguish the two shapes a policy's payment can take. An **indemnity contract** pays the measured loss, up to the limit: a $300,000 homeowners policy pays a $47,000 kitchen-fire claim, not the limit — property and casualty insurance works

this way, and Units 6 and 7 will teach its measuring rules. A **valued contract** pays a stated sum when the event occurs, with no appraisal of the loss: a $250,000 life policy pays $250,000, because no adjuster can price a father. Life insurance is the great valued contract. The law keeps even valued contracts honest at the door rather than at the claim: insurable interest and underwriting limit the face amount to a reasonable relation to the life's economic value when the contract is made.

The old wager still tries to come back wearing a suit. In **stranger-originated life insurance** — STOLI, sometimes IOLI for investor-originated — promoters find an older person, pay or induce him to apply for a large policy on his own life, and arrange from the start to have the policy end up owned by investors who have no interest in his life except its ending. The paperwork looks like a man insuring himself; the substance is 1774's coffee-house bet, and state laws prohibit it. Distinguish the legitimate transaction it impersonates: a policyowner who later, for his own reasons, sells or assigns a policy he honestly bought is exercising ownership rights — the sin of STOLI is the *original intent* to manufacture a policy for strangers. An agent is the first line against it, because the agent sees the kitchen table where the scheme is born.

On the exam today. The clock questions lead: property interest at the time of *loss*; life interest at the time of *application* — and the statement "insurable interest must exist at the time of death" is false, a trap set on nearly every form. Know the three families of life interest — love and blood, business, creditor — and that the creditor's interest is capped near the debt. Know that a person's interest in his own life is unlimited and that a beneficiary named by the insured-owner needs no interest of her own. Match contract to shape: life is valued, property and casualty are indemnity. And when a scenario smells like betting — coverage wildly beyond any loss, or strangers steering the application — the answer will turn on the principle this whole lesson serves: insurance restores; it must never pay anyone to hope for harm.

PICTURE STUDY



The Cardsharps, Caravaggio, c. 1595 · Oil on canvas · Kimbell Art Museum, Fort Worth

Image: Wikimedia Commons, public domain

Caravaggio painted this scene as a young man in Rome around 1595, and it made his name: a trusting boy absorbed in his cards while two confederates — one signaling, one drawing a hidden card from his belt — prepare to take everything he has. It opens this lesson because the gambling den is exactly what insurance becomes when insurable interest is removed: a game where someone profits by another's loss, and where the man with the hidden advantage wants the worst to happen. The Act of 1774 exists to keep this table out of the insurance office.

Look closely

- Find the hidden card tucked in the far player's belt, and the dagger beside it. Where gambling leads, worse follows.
- Watch the older man's gloved hand signaling his partner. The victim thinks he is in a game of chance; he is in a game of design.
- Study the boy's face. He suspects nothing — what in the picture should have warned him?
- Notice that the stakes on the table are small, but the machinery of cheating is elaborate. What does that say about where appetite for easy gain ends?

Talk about it

1. A wagering policy gives its holder a stake in another man's misfortune. How is that like the loaded game in this painting?
2. Insurable interest requires that the person who collects is a person who truly lost. How does that one rule empty this table?
3. The cheaters see the boy only as a mark. What does it do to a soul to profit by a neighbor's loss — and why does honest insurance, where many bear one family's burden, point the opposite way?

PROJECT

The Insurable Interest Sorting Sheet

You will build a one-page sorting sheet of twelve pretend cases — who may insure whom or what, for how much, and under which clock — for your Pathway File. The exam tests insurable interest almost entirely through little cases like these, and writing your own is the surest way to stop being fooled by theirs.

You will need

- One sheet of paper ruled into a 12-row, 4-column table (or a spreadsheet page)
- Your exam notebook and pen
- This lesson's key terms and core ideas

Steps

1. Head the four columns: THE CASE, INTEREST? (YES/NO), WHY (love and blood / business / creditor / owner / none), and WHICH CLOCK (life: application; property: loss).
2. Write twelve pretend cases, covering every family of interest: a wife insuring her husband; a man insuring himself for any beneficiary he names; a partner in a buy-sell; an employer and a key employee; a lender owed $20,000 seeking $20,000; the same lender seeking $200,000; a fan insuring a famous athlete; a homeowner after selling the house; a renter insuring her own belongings; an ex-wife collecting on a policy she bought during the marriage; investors steering a stranger's application (STOLI); a neighbor insuring your family's car.
3. Fill all four columns for each case, in pencil first.
4. Check your answers against the core ideas, then ink the corrected rows.
5. Across the bottom, write the two clocks in large letters: PROPERTY — AT THE TIME OF LOSS; LIFE — AT THE TIME OF APPLICATION.
6. Add one sentence under the table in your own words: why the law refuses to let anyone profit by a loss he did not suffer.

7. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for indemnity, insurable interest, valued contract and STOLI, and one card with nothing but the two clocks on it: property — loss; life — application.
2. Draw a two-door diagram: one door labeled OWNER (prays the ship comes home) and one labeled GAMBLER (wants the ship to sink), with INSURABLE INTEREST as the doorkeeper letting only the owner in.
3. Write a five-line trap list titled "The clocks," ending with: 'AT THE TIME OF DEATH' IS ALWAYS THE WRONG ANSWER.

> **From history.** The Life Assurance Act of 1774 had a second, less famous requirement: the name of the person for whose benefit a life policy was made had to be written into it, so wagers could not hide behind blanks and nominees. The Act is still in force in Britain today, two and a half centuries on — one of the shortest and longest-lived insurance statutes ever written. American states never copied its text, but every state's insurable-interest doctrine is its descendant, carried over in the common law the colonies inherited.

Example 1. Exam style. Dana sold her bakery building on June 1 but forgot to cancel her property policy. On July 10 the building burned. Can Dana collect?

A. Yes; the policy was in force and premiums were paid

B. Yes, but only half, shared with the new owner

C. No; she had no insurable interest at the time of loss

D. No, unless the buyer had no insurance of his own

Show solution

1. State the rule: property insurance requires insurable interest at the time of the loss.
2. Apply it: on July 10 Dana owned nothing that burned; she suffered no financial loss.
3. Strike the traps: A confuses a paid-up policy with a payable claim — premiums do not create interest; B invents a sharing rule; D makes her claim depend on someone else's coverage, which is irrelevant.
4. Note the principle underneath: paying Dana would enrich her, not restore her — a wager's payout, which indemnity forbids.

Answer: C. Without ownership at the moment of the fire, Dana lost nothing, and a policy cannot pay a person who suffered no loss.

Example 2. Exam style. Rosa insured her husband Mateo's life in 2019. They divorced in 2023; Rosa owns the policy and kept paying premiums. Mateo died in 2026. The insurer claims Rosa lacks insurable interest. What result?

A. Rosa collects; insurable interest was required only at application

B. Rosa collects half as a former spouse

C. The claim fails; interest must exist at death

D. The claim fails unless Mateo consented again after the divorce

Show solution

1. State the rule: life insurance requires insurable interest when the policy is issued — at application — not at death.
2. Apply it: in 2019 Rosa was Mateo's wife — love and blood — so the contract was validly formed, and a valid life contract survives later changes in the relationship.
3. Strike the traps: C states the false clock the exam loves; B invents a divorce formula; D confuses the consent given at application, which was complete, with a renewal requirement that does not exist.
4. Remember whose interest is tested: the policyowner's, at the start.

Answer: A. Interest existed at application, so the policy stands and pays its owner — the time-of-death version of the rule is the classic wrong answer.

Example 3. Exam style. A lender is owed $35,000 by a borrower and applies for a $350,000 policy on the borrower's life, naming itself beneficiary. The underwriter should recognize this as:

A. Proper; creditors have unlimited interest in debtors

B. Proper, if the borrower signs the application

C. Improper; a creditor's interest is limited to approximately the debt

D. Improper; creditors never have insurable interest

Show solution

1. State the rule: a creditor has an insurable interest in a debtor, limited to roughly the outstanding debt.
2. Compare: $350,000 of coverage against a $35,000 debt is ten times the stake — the excess is a bet on the borrower's death, not protection of the loan.
3. Strike the traps: A overshoots the rule; D erases a legitimate interest the law does allow; B mistakes consent, which is necessary, for sufficiency — consent cannot manufacture an interest the law caps.
4. Underwriting's role: face amounts are kept in reasonable relation to the interest when the contract is made.

Answer: C. The creditor's interest supports coverage near $35,000; tenfold coverage turns a lender into a gambler, which insurable interest exists to prevent.

PRACTICE

1. Easy State the principle of indemnity in one sentence.

   Show answer

   Insurance restores the insured to approximately his financial condition before the loss — it makes him whole, never better off.

2. Easy When must insurable interest exist for a property policy, and when for a life policy?

   Show answer

   Property: at the time of the loss. Life: at the time of application (when the policy is issued) — not at death.

3. **Easy** Name the three families of insurable interest in another person's life.

Show answer

Love and blood (spouse and close family), business (partners and key employees) and creditor (limited to about the debt). A person also has unlimited interest in his own life.

4. **Medium** A life insurance policy is best described as:

A. An indemnity contract, paying the measured loss

B. A valued contract, paying a stated face amount

C. A wagering contract permitted by statute

D. An open contract, paying whatever a court sets

Show answer

B. Life insurance pays its stated face amount without measuring the loss, because a life cannot be appraised after the fact. Property and casualty policies are the indemnity contracts (A).

5. **Medium** Why did Parliament pass the Life Assurance Act of 1774?

Show answer

Because Londoners were taking out policies on strangers' lives as pure bets, giving policyholders a stake in other men's deaths; the Act voided any life policy whose holder had no insurable interest.

6. **Medium** Theo insures his own life for $500,000 and names his church as beneficiary. The church has no financial stake in Theo. Is the policy valid?

Show answer

Yes. A person has an unlimited insurable interest in his own life and may name any beneficiary he chooses; when the insured is the applicant-owner, the beneficiary needs no insurable interest of her own.

7. Medium A business partner wants to insure her co-partner's life to fund a buy-sell agreement. Which family of insurable interest applies, and what makes the interest genuine?

Show answer

Business interest: each partner would suffer a real financial loss at the other's death, because the survivor must buy out the deceased partner's share to keep the firm alive — the policy funds that obligation rather than betting on a life.

8. Hard An insurer pays a homeowner $52,000 for fire damage measured at $52,000, though the policy limit was $300,000. The homeowner complains he should receive the limit. Answer him in two sentences using this lesson's vocabulary.

Show answer

A homeowners policy is an indemnity contract: it pays the measured loss up to the limit, and the limit is a ceiling, not a promise. Paying $300,000 for a $52,000 loss would enrich rather than restore — the very thing the principle of indemnity forbids, because profitable losses invite manufactured ones.

9. Hard Investors offer a 78-year-old man cash to apply for a $2,000,000 policy on his life, planning from the outset that ownership will pass to them. The paperwork shows a man insuring himself. What is this scheme called, and why does it fail the law even though self-insurance needs no proof of interest?

Show answer

Stranger-originated life insurance (STOLI). The law looks at substance, not paperwork: the policy was manufactured from the start for investors with no insurable interest, so it is the 1774 wager in modern dress, and state laws prohibit it. A genuine self-purchased policy later sold by its owner is different because no stranger originated it.

10. Hard Explain in two or three sentences why the law uses different clocks for property (time of loss) and life (time of application).

Show answer

A property claim pays a measured loss, so the question is whether the claimant actually lost anything when the peril struck — interest is tested at the loss. A life policy is a valued, long-term contract validly formed once, and relationships lawfully change afterward; testing interest at death would let insurers escape old contracts whenever a marriage or partnership had ended. The wager is prevented at the door, when the contract is made.

11. Challenge A lender is owed $18,000. In this example, what face amount could a credit life policy on the borrower reasonably carry, and what is wrong — name two distinct harms — with the lender instead carrying $180,000?

Show answer

Coverage near $18,000, declining as the debt is repaid. At $180,000 the lender first holds a $162,000 bet on the borrower's death — a wagering interest the law forbids — and second gains a perverse incentive against the borrower's welfare: the loan is better repaid by the funeral than by the payments. Indemnity caps the creditor at restoration of what he is actually owed.

12. Challenge Exodus 22:6 makes the man who kindled a fire 'surely make restitution' for the stacks it consumed. Write three sentences connecting restitution to the principle of indemnity, including why neither one pays the victim more than he lost.

Show answer

Restitution and indemnity share one aim: the person who suffered the loss is made whole — the burned stacks are replaced, no more and no less. Paying more than the loss would turn the victim into a profiteer and make fires worth having, corrupting the remedy into a temptation. Insurance organizes restitution among many neighbors in advance, but it keeps the biblical measure: restore what was lost, and let no one be enriched by harm.

COMMON MISTAKES

- Writing that insurable interest in life insurance must exist at the time of death — it must exist at application, and a validly formed policy survives divorce or a dissolved partnership.

- Testing the beneficiary for insurable interest when a person insures his own life — the owner-applicant's unlimited interest in himself is what counts, and he may name anyone.
- Letting a creditor insure a debtor for many times the debt — the creditor's interest is capped at roughly the outstanding balance.
- Calling life insurance an indemnity contract — it is a valued contract that pays its face amount; property and casualty policies are the indemnity contracts.
- Assuming a paid-up premium guarantees a property claim — without insurable interest at the time of loss, there is no claim, because nothing of the claimant's was lost.
- Treating every later sale of a life policy as STOLI — the prohibited scheme is one originated by strangers from the start, not an owner's honest later decision about property he truly bought.

Make it a game · Interest or Wager?. Write fifteen relationships on slips (a wife and husband; a fan and a quarterback; a lender owed $10,000 seeking $10,000; the same lender seeking $100,000; business partners; a man and himself; investors and a stranger's policy; a homeowner after the sale closed…). A parent draws and reads each slip; players race to call INTEREST or WAGER, then — for one bonus point — name the family of interest (love and blood, business, creditor, owner) or the rule that kills it (wrong clock, capped creditor, STOLI). One point per correct call, minus one for a wrong one. Best of fifteen wins; the loser must recite both clocks twice without error.

Scripture. "If fire break out, and catch in thorns, so that the stacks of corn, or the standing corn, or the field, be consumed therewith; he that kindled the fire shall surely make restitution." (Exodus 22:6, KJV)

The law of Moses measured the remedy by the loss: the field's owner was restored, not enriched, and the restorer paid what was consumed, not a penalty invented after the fact. Indemnity is this old justice organized among neighbors in advance — and it fails the moment anyone is allowed to profit by a fire.

2.3 Utmost Good Faith: Representations, Warranties and Concealment

OBJECTIVES

- Tell the story of Carter v Boehm (1766) and define uberrimae fidei, utmost good faith.
- Distinguish representations (must be substantially true) from warranties (must be strictly true).
- Define misrepresentation, material misrepresentation, concealment and fraud, and state the insurer's remedy of rescission.
- Explain what makes a misstatement material: it would have changed the underwriting decision.
- State how the incontestability clause limits a life insurer after two years, and why the clause exists.

> **Warm-up.** In five minutes, write two short answers a seller of a used bicycle might give to the question "Anything wrong with it?" — one answer honest but imperfect (he forgot a worn brake pad), one deliberately hiding a cracked frame. Which seller would you trade with again, and what is the difference between an honest mistake and a hidden truth? Keep the paper; this lesson gives both answers their legal names.

WATCH

Representations and Warranties - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 5:39

https://www.youtube.com/watch?v=KhV0NcM2zPI

> **WHEN TO WATCH**
> Watch after the big idea; write the two standards of truth side by side as the teacher states them — substantially true for representations, strictly true for warranties — and star which one applications use.

BACKUP VIDEO

Insurance Exam Help: Representation, Misrepresentation, and Material Misrepresentation Explained

Insurance Exam Queen · 4:35

https://www.youtube.com/watch?v=Rv9dwicgNZQ

A quick second pass up the first rungs of the ladder; watch it before the case-card project and say the materiality test aloud each time it appears.

KEY TERMS

utmost good faith (uberrimae fidei)

The doctrine that both parties to an insurance contract must deal with complete honesty, disclosing material facts, because each must rely on the other's word.

representation

A statement by the applicant believed to be true, used to induce the insurer to issue the policy; it need only be substantially true.

misrepresentation

A false statement in an application; it affects the contract only if material.

material misrepresentation

A false statement that would have changed the insurer's underwriting decision — declining the risk or charging differently — had the truth been known; grounds for rescission.

warranty

A statement or promise made part of the contract itself and guaranteed to be strictly, literally true; a breach can void the contract regardless of materiality.

concealment

The applicant's failure to disclose a known material fact the insurer had no way to discover.

fraud

An intentional misrepresentation or concealment of a material fact, made to deceive and relied upon by the other party to its injury.

rescission

The insurer's remedy of canceling the contract from its beginning and returning premiums, as though the policy had never existed.

void vs. voidable

A void contract never legally existed (no insurable interest); a voidable contract stands unless the injured party elects to cancel it (material misrepresentation).

incontestability clause

The life policy provision barring the insurer from contesting the contract for misstatements after it has been in force, commonly two years.

CORE IDEAS

The story. In 1759 George Carter, governor of Fort Marlborough — a British East India Company trading post on the coast of Sumatra — bought a one-year policy from a London underwriter named Charles Boehm, insuring against the fort's capture by a foreign enemy. In 1760 a French naval force under the Comte d'Estaing took the fort, and Carter claimed. Boehm refused to pay: the governor, he argued, had concealed what he knew — that the fort was a trading post built to resist local raids, not a European siege, and that the French were likely to come. The case, *Carter v Boehm*, reached Lord Mansfield, the greatest commercial judge England ever produced, in 1766. Mansfield used it to lay down a principle for all insurance: it is a contract upon speculation, in which "the special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only." Good faith therefore forbids either party to conceal what he privately knows. And then Mansfield ruled — for *Carter*. The underwriter in London knew, or ought to have known, the state of war and the condition of such forts as well as the governor did; what a party could learn for himself, silence does not conceal. The case gave insurance both its great duty and its limit, in one judgment.

How they figured it out. Mansfield's label stuck: insurance is a contract *uberrimae fidei*, of **utmost good faith** — a higher candor than the buyer-beware standard of the marketplace, because the underwriter prices a risk he cannot inspect and the insured buys a promise he cannot test until the worst day of his life. Each must rely on the other's word, so the law polices the words. Over two centuries, American statutes and courts built a careful ladder of them: statements the applicant *believes* true, statements *guaranteed* true, truths withheld, and lies told on purpose — each rung with its own name and its own consequence. The engineering goal never changed from 1766: keep the bargain honest in both directions without letting either side spring a trap of technicalities on the other.

The big idea. Climb the ladder. A **representation** is a statement made to induce the insurer to issue the policy — the answers on an application — and the applicant vouches that it is true to the best of his knowledge and belief. The law requires representations to be **substantially true**, not perfect: an applicant who honestly reports his last doctor visit as March when it was February has not broken the contract. A **misrepresentation** is a false statement — and by itself, an immaterial one changes nothing. The hinge of the whole lesson is **materiality**: a misrepresentation is **material** when the truth would have changed the underwriting decision — the insurer would have declined the risk, excluded something or charged a different premium. Material misrepresentation gives the insurer the remedy of **rescission**: cancel the contract back to its beginning and return the premiums, as though it had never been. The test is never how embarrassing the lie is; it is whether the truth would have changed the decision.

A **warranty** stands on the rung above. It is a statement or promise written into the contract itself and guaranteed to be **strictly, literally true** — and in strict law, a breached warranty can void the contract whether or not the breach mattered to the loss. Warranties are the old marine tradition: a ship warranted to sail with convoy, a warehouse warranted to keep a watchman, a sprinkler system warranted operational in a commercial policy. Because the strict rule is harsh on ordinary families, most states have pulled life and health insurance down the ladder by statute: answers on a life or health application are deemed **representations, not warranties**, in the absence of fraud. Learn both halves, because the exam asks both: the definitions in their strict contrast, and the modern rule that an application's answers are representations.

Now the dark rungs. **Concealment** is silence where good faith required speech: the applicant's failure to disclose a material fact he knew and the insurer had no fair way to discover — Mansfield's own doctrine, with his own limit, since what the insurer knows or ought to know cannot be concealed from it. **Fraud** is the summit of bad faith: an intentional misrepresentation or concealment of a material fact, made to deceive, relied on by the other party to its injury. Fraud is grounds for rescission and, unlike honest misstatement, carries penalties beyond the contract — Unit 9 walks through them. Keep the distinctions in a line you can recite: a representation is an honest answer; a misrepresentation is a false one; a material misrepresentation is a false one that would have changed the decision; concealment hides the truth; fraud hides it on purpose, to deceive.

The law then built one counterweight into every life policy, and you must know it as well as the doctrines it limits: the **incontestability clause**. After a life policy has been in force for a stated period — commonly **two years** — the insurer may no longer contest the contract on the basis of misstatements in the application. The insurer gets a full contestable period to investigate and rescind; after it closes, the family's protection is safe from an archaeology of the application conducted at the widow's expense, decades after everyone who could explain an answer is gone. The clause is the industry's self-imposed answer to a trust problem: a promise that might be unwound at the moment of claim is a promise no one can rest on. (States recognize narrow limits — and misstatement of age is handled separately, by adjusting the benefit to the true age, as Unit 4 will show — but the exam's rule of thumb is clean: after two years, the life policy stands.)

On the exam today. The two standards of truth are the lesson's spine, tested as vocabulary and in scenarios: representations, **substantially true**; warranties, **strictly true** — and statements on life and health applications are representations. Materiality has one definition to memorize: it would have **changed the underwriting decision**; a question describing an immaterial fib wants the answer that the policy stands. Match remedy to rung: material misrepresentation, concealment and fraud support rescission with return of premium, and rescission must come inside the contestable period for a life policy — after two years the incontestability clause bars the contest. Watch two traps above all: "all statements on an application are warranties" is false in the life and health setting, and "any false statement voids the policy" ignores the materiality hinge the whole doctrine turns on.

PICTURE STUDY



The Fortune Teller, Georges de La Tour, probably 1630s · Oil on canvas · The Metropolitan Museum of Art, New York

Image: Wikimedia Commons, public domain

Georges de La Tour of Lorraine painted candlelit saints and, now and then, scenes like this one: a young man having his fortune told while the teller's accomplices quietly strip him of medallion and purse. Nothing in the picture shouts; every theft happens in plain sight, behind composed faces, while the victim's attention is held exactly where the troupe wants it. It opens this lesson because concealment works the same way — not a dramatic lie, but a truth withheld while the other party looks where he is directed. Utmost good faith exists because an underwriter, like this young man, must deal with people who know things he cannot see.

Look closely

- Follow the young man's eyes to the fortune teller, then find what each pair of hands in the picture is actually doing.
- Find the medallion leaving on its chain and the purse being cut. How many thefts proceed at once while one story is being told?
- Study the faces: no one looks guilty. What does that say about how little dishonesty announces itself?
- Notice that the young man is paying — the coin in the old woman's hand — for the very performance that covers the theft.

Talk about it

1. Concealment is a truth withheld while attention is held elsewhere. Where is the ‘withheld truth’ in this painting, and who controls where everyone looks?
2. Lord Mansfield said the facts of a risk ‘lie most commonly in the knowledge of the insured only.’ How is an underwriter like this young man — and when, as in Carter v Boehm, is he not entitled to that excuse?
3. Proverbs says lying lips are an abomination, but they that deal truly are the Lord’s delight. Why must an agent be the person in the room whose hands and face tell the same story?

PROJECT

The Good-Faith Case Cards

You will write ten little cases on index cards — one honest answer, three shades of misstatement, truths withheld and one outright fraud — and build the answer key that sorts them onto the ladder with the insurer's remedy for each. Exam questions on this lesson are nothing but cases like these; after you have written your own, theirs will look familiar.

You will need

- Ten index cards and a pen
- Your exam notebook
- This lesson's key terms and the ladder from the core ideas

Steps

1. On each card's front, write one pretend case, covering the whole ladder at least once: an honest, slightly imperfect application answer; an immaterial fib; a false answer that would have doubled the premium; a warranted sprinkler system shut off; a known heart condition never mentioned and undiscoverable by the insurer; a deliberate lie told to get coverage; a misstatement discovered one year into a life policy; the same misstatement discovered three years in; a fact the insurer's own records already showed; an agent advising an applicant to 'leave that answer blank.'
2. On each card's back, write three lines: the NAME (representation / misrepresentation / material misrepresentation / warranty breach / concealment / fraud / barred by incontestability), the WHY in one sentence, and the REMEDY (policy stands / rescission within the contestable period / void / none — insurer knew or should have known).
3. Shuffle and sort the cards onto a ladder you draw in your notebook, from honest answer at the bottom to fraud at the top.
4. Have a parent draw five cards and quiz you cold; correct any miss on the card itself in a second color.
5. Write the materiality test on a banner card in large letters: WOULD THE TRUTH HAVE CHANGED THE DECISION?

6. Date the banner card and clip the deck into your Pathway File with a rubber band.

EXAM NOTEBOOK

1. Make flashcards: representation / substantially true; warranty / strictly true; materiality / would have changed the decision; concealment; fraud; rescission; incontestability / two years.
2. Draw the ladder of statements from honest answer to fraud, with the remedy written beside each rung and a two-year gate drawn across the whole ladder labeled INCONTESTABILITY.
3. Write a five-line trap list titled "Truth standards," ending with: LIFE AND HEALTH APPLICATION ANSWERS ARE REPRESENTATIONS, NOT WARRANTIES.

> **From history.** The incontestability clause began as a marketing promise before it was ever a law. British offices experimented with "indisputable" policies in the mid-1800s — one company, founded in 1848, put the word in its name, the London Indisputable Life Policy Company — and American insurers followed, with Manhattan Life offering an incontestable clause in 1864. Companies adopted it to answer a public that had watched too many claims fought over old application answers; state legislatures later made mandatory the promise that competition had already invented.

Example 1. Exam style. On a life application, Noel honestly wrote that he visits a doctor "about once a year"; records later show some years had two visits. He also wrote "never used tobacco" while smoking daily — and the insurer's rules would have doubled his premium as a smoker. Noel dies in the contestable period. Which statement is correct?

A. Both errors void the policy; applications demand literal truth

B. Neither error matters; applications are mere formalities

C. The doctor-visit answer is a substantially true representation, but the tobacco answer is a material misrepresentation supporting rescission

D. The tobacco answer matters only if smoking caused the death

Show solution

1. Classify the statements: application answers are representations, required to be substantially true, not literally perfect.
2. Apply to the doctor visits: the answer was true to his honest belief and close to the records — substantially true, no breach.
3. Apply to tobacco: the truth would have changed the underwriting decision (double premium), so the false answer is material — rescission is available within the contestable period.
4. Strike the traps: A states the warranty standard, which applications do not carry; D is a favorite distractor — materiality is tested against the underwriting decision, not against the cause of death.

Answer: C. Representations need only be substantially true, but a lie that would have changed the decision is material — and materiality does not require any connection to how the loss happened.

Example 2. A commercial policy contains a warranty that the warehouse's automatic sprinkler system will be maintained in working order. An inspection after a theft loss finds the sprinklers had been shut off for months. The theft had nothing to do with sprinklers. Walk the strict-law analysis, then state how this differs if the same fact had been a mere representation.

Show solution

1. Classify: the sprinkler promise is a warranty — written into the contract and guaranteed strictly true.
2. Apply the strict rule: a breached warranty can void coverage regardless of materiality to the particular loss; the insurer did not get the risk it priced.
3. Contrast the representation analysis: a representation question would ask whether the falsehood was material to the underwriting decision — here it plainly was (sprinklers affect the rate), so even that path likely supports rescission, but the reasoning differs.
4. Note the policy behind the harshness: commercial warranties let insurers price safety measures; the strict rule is why they are written as warranties and not left as representations.

Answer: Under the warranty, the insurer may void coverage for the breach even though sprinklers had nothing to do with a theft — strict truth was guaranteed. As a representation, the same fact would be tested for materiality to the underwriting decision instead.

Example 3. Exam style. A life insurer discovers, three years after issue, that the insured materially misrepresented his health history in the application. There was no fraud finding; premiums are current. The insurer seeks to rescind. What result?

A. Rescission granted; material misrepresentation always supports rescission

B. Rescission denied; the incontestability clause bars the contest after two years

C. Rescission granted if the misrepresented condition caused the death

D. The policy converts to a reduced paid-up amount

Show solution

1. Identify the governing provision: the incontestability clause — commonly two years in force.
2. Apply the clock: three years exceeds the contestable period, so the insurer may no longer contest the policy for misstatements in the application.
3. Strike the traps: A ignores the clause that exists precisely to limit that rule; C smuggles in a causation test that belongs to neither doctrine; D invents a nonforfeiture remedy from a different lesson.
4. Remember the clause's purpose: after the insurer's full investigation window closes, the promise becomes safe to rest on.

Answer: B. After the contestable period — commonly two years — the life policy stands despite material misstatements; the time to investigate was the insurer's first two years, not the family's worst week.

PRACTICE

1. Easy What standard of truth must a representation meet, and what standard must a warranty meet?

   Show answer

   A representation must be substantially true — true to the applicant's honest knowledge and belief. A warranty is guaranteed strictly, literally true, and a breach can void the contract regardless of materiality.

2. **Easy** What makes a misrepresentation material?

Show answer

The truth would have changed the insurer's underwriting decision — it would have declined the risk, added an exclusion or charged a different premium.

3. **Easy** What is rescission?

Show answer

The insurer cancels the contract from its beginning and returns the premiums, as though the policy had never existed — the remedy for material misrepresentation, concealment or fraud.

4. **Medium** Concealment is best defined as:

A. Any wrong answer on an application

B. The failure to disclose a known material fact the insurer had no way to discover

C. A guaranteed statement that proves false

D. An agent withholding a commission disclosure

Show answer

B. Concealment is silence about a known material fact — and under Carter v Boehm, facts the insurer knows or ought to know cannot be concealed from it. A describes misrepresentation, C a warranty breach.

5. **Medium** In Carter v Boehm, the underwriter proved the governor had not described the fort's weakness — yet the governor won. Why?

Show answer

Because Lord Mansfield held that good faith forbids concealing only what lies privately in one party's knowledge; the London underwriter knew or ought to have known the state of war and the nature of such trading forts, so silence about what he could learn himself concealed nothing.

6. Medium An applicant honestly misremembers the year of an old, minor surgery. The insurer later seeks rescission. What result, and why?

Show answer

The policy stands. Application answers are representations requiring only substantial truth, and an honest, immaterial error would not have changed the underwriting decision — the materiality hinge fails.

7. Medium Distinguish a void contract from a voidable one, with an insurance example of each.

Show answer

A void contract never legally existed — a life policy bought by a stranger with no insurable interest is void as a wager. A voidable contract stands unless the injured party cancels it — a policy obtained by material misrepresentation is voidable by the insurer through rescission within the contestable period.

8. Hard A health applicant conceals a diagnosed heart condition. Eight months after issue, he claims for an unrelated broken leg, and the insurer discovers the concealment. May it rescind, even though the concealed fact had nothing to do with the claim? Explain.

Show answer

Yes. Materiality is measured against the underwriting decision — a diagnosed heart condition would plainly have changed it — not against the particular loss. Within the contestable period the insurer may rescind the whole contract and return premiums; the broken leg's innocence does not cure the application's silence.

9. Hard Why do most states provide that statements on life and health applications are representations and not warranties? Answer in two or three sentences.

Show answer

The strict warranty rule voids coverage for any literal falsehood, however innocent or trivial — a trap when applications ask ordinary families dozens of memory questions. Deeming the answers representations means honest, substantially true answers hold the contract, and only material falsehoods endanger it. The warranty standard survives mainly in commercial settings, where promised safety measures are deliberately priced into the contract.

10. Hard The incontestability clause rewards some people who lied on applications. Give the two-sentence argument for why life insurers adopted it anyway.

Show answer

A promise that can be unwound at claim time, decades later, when the insured can no longer explain his answers, is a promise no family can rest on — and a product fewer people would buy. The clause forces the insurer to do its investigating within the contestable period and then be bound, trading a few successful cheats for the trustworthiness of every honest policy.

11. Challenge An agent, eager for a sale, tells an applicant with a known liver condition: "Leave question 9 blank — they never check." The applicant obeys and the policy issues. Name every rung of the ladder this scene touches, and say who has failed whom.

Show answer

The blank conceals a known material fact — concealment by the applicant, and because it was deliberate and intended to deceive, it approaches fraud. The agent has corrupted his own duty of utmost good faith to the insurer he represents, inducing the concealment; his knowledge of the condition may also be imputed to the insurer, complicating rescission (Lesson 2.4). The agent failed the insurer, the applicant and himself: the policy he 'won' is voidable in the contestable period, likely to fail the family exactly when it is needed.

12. **Challenge** Utmost good faith binds the insurer too. Write three sentences on what uberrimae fidei requires of the company and its agent toward an applicant, naming one practice from each that would violate it.

Show answer

> The company must describe its promise truthfully — a policy summary that hides an exclusion, or claim-time conduct that denies what the contract plainly covers, is the insurer's own bad faith (Unit 9 gives these practices their legal names). The agent must present coverage honestly, complete applications with the applicant's true answers, and never coach silence or misstatement. Good faith is a two-way contract term, not a burden carried only by the family signing the form.

COMMON MISTAKES

- Saying application answers must be literally true — they are representations, requiring substantial truth; warranties carry the strict-truth standard.
- Forgetting the materiality hinge: an immaterial misrepresentation does not support rescission; the test is whether the truth would have changed the underwriting decision.
- Testing materiality against the cause of the loss — a concealed heart condition supports rescission even when the claim is a broken leg.
- Confusing concealment (silence about a known material fact) with misrepresentation (a false statement).
- Ignoring the incontestability clock: after a life policy's contestable period — commonly two years — the insurer can no longer contest application misstatements.
- Treating utmost good faith as the applicant's duty only — it binds the insurer and its agent with equal force.

Make it a game · Strictly or Substantially?. Players split the deck of case cards from this lesson's project (or improvise new one-line cases). The reader calls each case; players race to shout the rung — REPRESENTATION, MISREPRESENTATION, MATERIAL, WARRANTY BREACH, CONCEALMENT, FRAUD — and the remedy, STANDS or RESCIND. One point for the rung, one for the remedy, minus one for calling rescission on anything outside the two-year window when the reader adds a date. Every third round, the reader instead calls a standard — 'strictly true!' or 'substantially true!' — and players must answer WARRANTY or REPRESENTATION before a count of three. First to twelve points wins.

Scripture. "Lying lips are abomination to the LORD: but they that deal truly are his delight." (Proverbs 12:22, KJV)

The proverb grades words the way this lesson does — not by how clever they are but by whether they deal truly. An application signed in utmost good faith, an agent who never coaches silence, a company whose policy means what its agent said: all of it is simply dealing truly, and the verse says plainly what God thinks of both columns.

2.4 The Agent's Three Authorities: Express, Implied and Apparent

OBJECTIVES

- Define the law of agency — principal and agent — and explain why an insurer is bound by its agent's acts within his authority.
- Define express, implied and apparent authority, and classify examples of each.
- Explain waiver and estoppel, and why the agent's knowledge is imputed to the insurer.
- Distinguish an agent, who represents the insurer, from a broker, who represents the buyer.
- Explain what errors and omissions insurance covers and why every agent carries it.

> **Warm-up.** In five minutes, write down a time someone was allowed to act for your family — a sibling sent to buy groceries with a list, a neighbor asked to sign for a package. List one thing they were told to do, one thing nobody said but the errand obviously required, and one thing a stranger would reasonably assume they could do. You have just discovered all three authorities in this lesson.

WATCH

Express, Implied, & Apparent Authority: Definitions, Differences, Examples

Insurance Prescription · 11:27

https://www.youtube.com/watch?v=I0O-BSyob0I

> **WHEN TO WATCH**
> Watch after the big idea; for each of the three authorities, pause and write the teacher's example in one column and an example of your own in a second column.

BACKUP VIDEO

Agent Authority-Express, Implied, and Apparent

MMC University | Financial Licensing Made Simple · 13:21

https://www.youtube.com/watch?v=ccRCOdr404Y

A second pass through all three authorities with fresh examples; watch it before the project and sort each of the teacher's examples onto your triangle as it is given.

KEY TERMS

law of agency

The body of law under which one person, the agent, is authorized to act on behalf of another, the principal, whose legal position the agent's authorized acts bind.

agent (producer)

A licensed individual authorized to act for an insurer in soliciting, negotiating and servicing insurance; many state codes call agents and brokers alike producers.

principal

The party on whose behalf an agent acts — in insurance, the insurer.

express authority

Authority explicitly granted to the agent in writing, usually in the agency (agent's) contract with the insurer.

implied authority

Authority not written anywhere but reasonably necessary, usual and customary for carrying out the express authority — such as collecting the initial premium with applications.

apparent authority

Authority the agent does not actually have, but which a reasonable member of the public believes he has because of the principal's own conduct — its stationery, signage, forms and tolerated practices.

waiver

The voluntary and intentional giving up of a known right — as when an insurer, knowing a condition was unmet, acts as though it does not care.

estoppel

A legal bar preventing a party from asserting a right after its own conduct led another to rely to his detriment on the opposite.

imputed knowledge

The rule that what the agent learns within the scope of his agency, the insurer is deemed to know.

broker

A licensed individual who represents the insurance buyer, shopping among insurers; a broker generally cannot bind coverage.

errors and omissions (E&O) insurance

Professional liability insurance covering an agent's own negligent mistakes — wrong advice, failures to procure or renew coverage — not his dishonest acts.

CORE IDEAS

The story. In the late 1860s an agent of the Union Mutual Life Insurance Company sat at a kitchen table in Iowa, selling a policy on the life of Mrs. Wilkinson. The application asked hard family-history questions, and on one of them — about her mother — the family answered honestly that they lacked firsthand knowledge. The agent, wanting his sale, wrote in an answer anyway, assuring them it would do, and the family signed what the company's own man had composed. Mrs. Wilkinson died; the company refused to pay, pointing triumphantly to the false answer on "her" application. In 1871 the Supreme Court of the United States, in *Union Mutual Life*

Insurance Co. v. Wilkinson, sided with the family. Justice Samuel Miller wrote that the agent who fills the application is the company's hand, not the applicant's: an agent's powers are, on their face, co-extensive with the business entrusted to his care, and the company cannot arm a man with its forms and its name, profit by his salesmanship, and then disown his pen the day the claim arrives. The decision planted the law of agency squarely inside American insurance — where your exam still finds it.

How they figured it out. The court was applying a doctrine older than insurance itself. A company is a legal person with no hands; it can only act through agents, and the common law had long since worked out the consequences in a Latin maxim: *qui facit per alium facit per se* — he who acts through another, acts himself. The **principal** appoints the **agent**; within the scope of the authority given, the agent's acts *are* the principal's acts, the agent's contracts the principal's contracts, and — the sharp edge from *Wilkinson* — the agent's knowledge the principal's knowledge. The whole structure runs on a simple fairness: the party who chose the agent, trained him, equipped him and profits by him is the party who should bear the risk of what he does with the trust, as against an innocent member of the public who dealt with him in good faith.

The big idea. The exam sorts an agent's authority into three kinds, and you must be able to classify any scene instantly. **Express authority** is what the agency contract says in words: solicit applications for these lines, in this territory, at these commission rates, deliver policies, collect initial premiums. It is the authority the insurer intended and wrote down. **Implied authority** is not written anywhere, yet is real: the authority reasonably necessary, usual and customary to carry out the express grant. A contract that says "solicit applications" implies the authority to use the company's application forms, explain its products, quote its published rates and take the first premium with the application — nobody lists these because custom already has. Express and implied authority together make up the agent's *actual* authority: what the principal, expressly or by fair implication, truly granted.

Apparent authority is the strange and important third kind: authority the agent does *not* actually have, which the law nonetheless enforces against the insurer because the insurer's own conduct created the appearance of it. The company's name is on the office door; its logo is on the business card and the rate book; it supplied the forms; it accepted, month after month, the premiums this agent collected late

without a word of protest. A reasonable member of the public, seeing all this, believes the man is empowered — and the law protects that reasonable belief *against the party who created it*. Mark the definition's anchor, because the exam tests it precisely: apparent authority arises from the **principal's** conduct toward third parties — never from the agent's own boasting, and never from what the agent privately believes. A company that lets appearances stand is choosing to be bound by them.

Two doctrines travel with agency and finish the *Wilkinson* story. **Waiver** is the voluntary, intentional relinquishment of a known right: an insurer that issues a policy knowing an answer is incomplete, or keeps accepting late premiums without objection, can be held to have waived its right to insist. **Estoppel** is waiver's enforcement arm: a party whose conduct led another to rely in good faith is barred — estopped — from turning around and asserting the right its conduct denied. And because the agent's knowledge is **imputed** to the insurer, what the agent learned at the kitchen table, the company knew: in *Wilkinson*, the company "knew" the family had disclaimed knowledge, because its own agent heard them say it, and it was estopped from rescinding on the answer its agent invented. The practical lesson for your career is double-edged: your knowledge binds your company, so your company will rightly insist you transmit the truth — all of it, in writing, every time.

Know the cast around the agent. The **agent** represents the insurer; the **broker** represents the buyer, shopping among companies, and generally cannot bind an insurer to coverage — though most modern state codes license both under the single title **producer**. Binding itself divides by line: property and casualty agents commonly hold authority to bind temporary coverage (the binder you will meet in Lesson 2.5), while life agents do not bind the insurer — underwriting decides. Last, the agent's own safety net: **errors and omissions insurance**, the professional liability policy for the agent himself. E&O responds when a client is harmed by the agent's negligent mistake — coverage requested but never placed, a renewal missed, advice carelessly wrong. It does not cover dishonesty, and no E&O policy has ever been cheaper than the habits that make claims rare: write things down, confirm in writing, promise nothing the policy does not say.

On the exam today. Classification questions lead: the agency contract's words are **express**; the unwritten-but-customary acts that carry them out — forms, explanations, collecting the initial premium — are **implied**; the authority conjured

by signage, stationery, supplied forms and tolerated practice is **apparent**, and its source is the *principal's* conduct, the trap most often set. Expect a *Wilkinson*-shaped scenario: the agent completes the application or learns a disqualifying fact, and the credited answer runs through imputed knowledge to waiver or estoppel against the insurer. Keep the directions straight — the agent represents the insurer, the broker the buyer — and keep E&O in its lane: the agent's own negligence, not the insurer's claims and not the agent's fraud. When a question asks whom the agent legally serves during a sale, the answer is the insurer, however warmly he serves the family across the table.

PICTURE STUDY



The Syndics of the Drapers' Guild, Rembrandt van Rijn, 1662 · Oil on canvas · Rijksmuseum, Amsterdam

Image: Wikimedia Commons, public domain

Rembrandt painted the sampling officials of Amsterdam's drapers' guild in 1662 — the board elected each year to inspect dyed cloth and stamp it with the city's seal of quality. Every man at that table acts for someone else: the guild, the city, and every buyer in Europe who trusted Amsterdam cloth because these five men's stamp stood behind it. Their authority was granted, bounded and audited — the open ledger is on the table, and their frank outward gaze has been read for centuries as men answerable to the public walking in. It opens this lesson because an insurance agent holds exactly such a trust: authority that is real because a principal granted it, and binding because the public reasonably relies on it.

Look closely

- Find the open ledger. Delegated authority keeps records, because it must answer to the one who granted it.
- Count the gazes aimed out of the frame at you. These are men used to being watched while they decide for others.
- Notice the identical sober dress. The stamp mattered because the office, not the man, carried the authority — any syndic's seal bound the guild.

- Look for the one bare-headed figure, the servant. Even the room's small acts of service happen under the board's authority.

Talk about it

1. Each syndic's stamp bound the whole guild to a stranger who never met the board. How is that like apparent authority binding an insurer to a customer who never read the agency contract?
2. The ledger lies open on the table. Why do principals audit their agents — and why should an honest agent want to be audited?
3. The syndics' seal was trusted across Europe because it was never sold cheaply. What would it take for your signature on an application to be worth that kind of trust — and before Whom is every stewardship finally audited?

PROJECT

The Agent Authority Map

You will draw the one-page map of agency law for your Pathway File: the principal–agent–public triangle, the three authorities sorted with ten test acts, and the Wilkinson doctrines — imputed knowledge, waiver, estoppel — tied to the corner where they live. Exam questions on this lesson are classification drills, and a map you drew is a classifier you own.

You will need

- One sheet of unlined paper, ruler and two ink colors
- Your exam notebook and pen
- This lesson's key terms and worked examples

Steps

1. Draw a large triangle. Label the top corner PRINCIPAL (THE INSURER), the bottom left AGENT, the bottom right THE PUBLIC.
2. On the principal–agent side, write EXPRESS (the written contract) and IMPLIED (unwritten, necessary, customary), bracketed together as ACTUAL AUTHORITY.
3. On the principal–public side, write APPARENT — CREATED BY THE PRINCIPAL'S CONDUCT, with three examples: signage, supplied forms, tolerated practice.
4. On the agent–public side, write the flow of trust: the public reasonably relies on what the principal lets it see.
5. Below the triangle, list these ten acts and mark each E, I or A: the contract's stated commission terms; using company application forms; explaining a policy's published features; collecting the initial premium; a terminated agent with the company sign still up; quoting from the supplied rate book; a business card with the company logo; delivering issued policies; accepting late premiums month after month without protest; an agent's own boast that he can waive exclusions (mark this one NONE — an agent's boasting creates nothing).

6. In a box beside the triangle, write the Wilkinson chain: AGENT LEARNS → INSURER KNOWS (imputed) → INSURER ACTS ANYWAY (waiver) → INSURER IS BARRED (estoppel), and under it one line: THE AGENT REPRESENTS THE INSURER; THE BROKER REPRESENTS THE BUYER.
7. Add a small shield in the corner labeled E&O: COVERS MY NEGLIGENT MISTAKES, NEVER MY DISHONESTY, then date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the three authorities — express, implied, apparent — each with its source on the back (contract words; necessity and custom; the principal's conduct toward the public).
2. Draw the principal–agent–public triangle small and from memory, once a day for three days, timing yourself to under a minute.
3. Write a five-line trap list titled "Agency," ending with: APPARENT AUTHORITY COMES FROM THE PRINCIPAL'S CONDUCT, NEVER THE AGENT'S CLAIMS.

> **From history.** Justice Samuel Miller, who wrote Wilkinson, knew both sides of a kitchen-table profession: he had practiced medicine in Kentucky for a decade — riding to farmhouses the way agents did — before teaching himself law and becoming, by the 1870s, the most influential member of the Supreme Court. His insurance opinions kept a country doctor's view of the business: the company is present in the parlor in the person of its agent, and the farm family that trusted the company's man is entitled to have trusted the company.

Example 1. Exam style. An agency contract authorizes Lena to solicit applications for Pine State Mutual. Nothing in it mentions collecting money, but like every agent of the company she routinely collects the first premium with each application, using company receipt books Pine State supplies. Her authority to collect that first premium is:

A. Express

B. Implied

C. Apparent

D. Nonexistent, so the insurer may disclaim the payments

Show solution

1. Start from the express grant: solicit applications — written in the contract.
2. Ask what is reasonably necessary, usual and customary to carry that out: taking the initial premium with the application is the custom of the business, and the company even supplies receipt books.
3. Classify: unwritten but customary and necessary to the written grant — implied authority, part of her actual authority.
4. Strike the traps: A requires words in the contract that are not there; C would apply if she lacked actual authority and only appearances bound the company; D fails because implied authority is real authority — the insurer is bound and the premiums are received.

Answer: B. Collecting the initial premium is implied authority — never written, but usual, customary and necessary to the express power to solicit, and therefore fully binding on the insurer.

Example 2. Exam style. Whitfield Insurance terminated agent Dunn on March 1 but let him keep the company-branded office sign, application stock and rate books for months. On April 10, a customer with no knowledge of the termination applied through Dunn and paid a premium, receiving a company receipt. The customer's coverage position rests on:

A. Express authority, since the contract once existed

B. Implied authority, since collecting premiums was customary

C. Apparent authority created by Whitfield leaving its indicia with Dunn

D. Nothing; a terminated agent can never bind the company

Show solution

1. Fix the date: after March 1, Dunn has no actual authority — express and implied both died with the contract, striking A and B.
2. Ask what the public could reasonably believe: sign, forms, rate books and receipts all shout that Dunn still represents Whitfield.
3. Trace the appearance to its source: Whitfield's own failure to retrieve its indicia of authority — the principal's conduct — created the reasonable belief.
4. Conclude: apparent authority binds the company to the innocent customer; D states the rule backwards, and it is precisely why insurers collect signs, forms and licenses on the day of termination.

Answer: C. With actual authority ended, the company is still bound by the appearance its own neglect maintained — apparent authority protects the reasonable public, not the careless principal.

Example 3. Exam style. Taking an application, agent Ruiz hears the applicant describe occasional chest pains and a cardiologist referral. Ruiz, hungry for the commission, writes "no known heart issues" and submits it. The insurer issues the policy. At claim time the insurer seeks rescission for misrepresentation, still within the contestable period. The family's strongest argument is:

A. The incontestability clause has already run

B. Ruiz's knowledge is imputed to the insurer, which is estopped from rescinding on an answer its own agent falsified

C. Chest pains are never material

D. The application was a warranty, so only literal falsity matters

Show solution

1. Spot the Wilkinson pattern: the company's agent, acting within the scope of taking applications, learned the truth and wrote the falsehood himself.
2. Apply imputed knowledge: what Ruiz learned, the insurer is deemed to know — so the insurer 'knew' of the chest pains when it issued.
3. Apply estoppel: having issued with imputed knowledge, through its own agent's act, the insurer is barred from rescinding against the innocent family on the answer it effectively wrote.
4. Strike the traps: A fails on the stated timeline; C is false — chest pains are plainly material; D misstates the standard and would hurt, not help, the family.

Answer: B. Under the rule of Union Mutual v. Wilkinson, the agent's knowledge and the agent's pen are the company's own, and estoppel keeps the insurer from profiting by its agent's falsification — while Ruiz himself faces license discipline and worse.

PRACTICE

1. Easy In insurance, who is the principal and who is the agent, and whom does a broker represent?

   Show answer

   The insurer is the principal and the agent acts on its behalf; a broker represents the insurance buyer. Most state codes license both as producers.

2. Easy Define express authority and give one example.

Show answer

Authority explicitly granted in the written agency contract — for example, authority to solicit applications for the insurer's life products in a stated territory.

3. Easy What is implied authority?

Show answer

Authority not written in the contract but reasonably necessary, usual and customary to carry out the express authority — such as using company forms or collecting the initial premium with an application.

4. Medium Apparent authority is created by:

A. The agent's belief that he has authority

B. The agent's statements to the customer

C. The principal's conduct that leads the public reasonably to believe authority exists

D. The customer's hopes about coverage

Show answer

C. Apparent authority flows from the principal — signage, supplied forms, tolerated practices. The agent's own beliefs or boasts (A, B) create nothing, which is the exam's favorite wrong answer here.

5. Medium Distinguish waiver from estoppel in one sentence each.

Show answer

Waiver is a party's voluntary, intentional giving up of a known right, as when an insurer knowingly overlooks an unmet condition; estoppel is the legal bar that then prevents the party from asserting the right after others relied in good faith on its conduct.

6. Medium An insurer accepts an agent-collected premium ten days late every month for two years, then denies a claim for late payment in month twenty-five. What doctrines does the policyholder invoke?

Show answer

Waiver and estoppel: by knowingly accepting late payments without protest, the insurer waived strict timeliness, and having induced reliance on that course of conduct it is estopped from suddenly enforcing the right without warning.

7. Medium Why does the law impute the agent's knowledge to the insurer?

Show answer

Because a company can know things only through its people: the agent is the insurer's eyes and ears within the scope of his agency, so what he learns taking an application, the insurer is deemed to know — the rule of Union Mutual v. Wilkinson.

8. Hard A life agent tells a buyer, "I'm binding your coverage right now, effective today," though his company grants life agents no binding authority and nothing the company did suggested otherwise. The applicant is declined and a loss follows. Is the insurer bound? Explain by elimination of all three authorities.

Show answer

No. Express authority: the contract grants none. Implied: binding is not necessary or customary for life agents — underwriting decides. Apparent: the appearance came only from the agent's own boast, not from any conduct of the principal, and an agent's claims cannot manufacture apparent authority. The agent, however, faces discipline and an E&O claim for the harm his promise caused.

9. Hard Why do insurers make terminated agents return signs, forms, rate books and receipt stock on the day of termination? Name the doctrine and the cost of neglecting it.

Show answer

Because those indicia of authority are the principal's conduct toward the public: left in a terminated agent's hands, they keep apparent authority alive, and the insurer can be bound by applications and premiums the ex-agent takes from innocent customers who reasonably believed the appearance.

10. Hard An agent fails to submit a completed homeowners application before a family's closing date; the house burns uninsured. The family sues the agent. Which policy responds, what does it cover here, and name one thing it would never cover.

Show answer

The agent's errors and omissions policy — professional liability for his negligent failure to procure the coverage he undertook to place. E&O pays the client's resulting loss and defense costs, but it would never cover the agent's dishonest or fraudulent acts, such as pocketing a premium.

11. Challenge In Union Mutual v. Wilkinson the company argued it should be able to rely on the signed application's false answer. Write three sentences on why the Supreme Court refused, naming imputed knowledge and estoppel, and one sentence on what the case demands of you as a future agent.

Show answer

The agent who composed the false answer was the company's own hand, hired, trained and equipped by it, so what he heard at the kitchen table was knowledge imputed to the company when it issued the policy. Having taken the premium with that imputed knowledge, the company was estopped from rescinding against the innocent family on an answer its agent invented. The risk of a faithless agent properly falls on the principal who chose him, not on the public who trusted the company's name. For you: write only what the applicant actually says, and transmit all of it — your pen is the company's pen.

12. **Challenge** Proverbs 25:13 praises the faithful messenger who ‘refresheth the soul of his masters.’ An agent serves a principal yet sits at the family’s kitchen table. Write three sentences on how one person honestly serves both — and what he must never do for either.

Show answer

> The agent serves the insurer by transmitting the whole truth — accurate applications, disclosed facts, premiums delivered intact — and serves the family by explaining honestly what the policy does and does not promise. The two services are one service, because both parties need the same thing from him: the truth carried faithfully in each direction. What he must never do is bend the message for either master — coach an answer to win a commission, or promise coverage the contract does not give.

COMMON MISTAKES

- Saying apparent authority arises from the agent’s own statements or beliefs — it is created only by the principal’s conduct toward the public.
- Forgetting that implied authority is real, binding authority even though it is written nowhere — custom and necessity supply it.
- Missing the imputed-knowledge rule: what the agent learns within the scope of the agency, the insurer is deemed to know, even if the agent never passes it on.
- Reversing the loyalties: the agent represents the insurer; the broker represents the buyer — however warmly the agent serves the family.
- Assuming any agent can bind coverage — property and casualty agents commonly can issue binders; life agents cannot bind the insurer.
- Thinking E&O insurance covers an agent’s dishonesty — it covers negligent errors and omissions, never fraud or theft.

> **Make it a game · Whose Authority?.** Write E, I, A and N (none) on four cards per player. The reader calls out acts from a list you write first — the contract says ‘solicit life applications’; the agent explains a brochure; collects the first premium; keeps the company sign after termination and takes an application; boasts he can waive exclusions; quotes the supplied rate book; accepts late premiums for a year… Players throw a card face down on a count of three, then flip together: one point for each correct throw, and the first correct player explains the why for a bonus point. Anyone who throws A for the agent’s boast loses two — apparent authority never comes from the agent’s own mouth. Best of fifteen rounds wins.

> **Scripture.** “As the cold of snow in the time of harvest, so is a faithful messenger to them that send him: for he refresheth the soul of his masters.” (Proverbs 25:13, KJV)
>
> Agency law in a proverb: the messenger’s worth is faithfulness to the one who sent him, and the whole economy of trust — principal, agent, public — rests on messages carried without bending. An agent who reports the kitchen table exactly as he found it refreshes everyone who must rely on him, and the law’s doctrines exist for the messengers who do not.

2.5 Underwriting: The Application, the MIB and the Price of Risk

OBJECTIVES

- Describe the agent's role as field underwriter and the parts, signatures and correction rules of the application.
- Distinguish a conditional receipt from a binding receipt in life and health, and both from a property binder.
- State what the MIB is and the limits on its use, and the applicant-rights duties the Fair Credit Reporting Act imposes.
- Classify risks as preferred, standard, substandard (rated) or declined.
- Build a simple annual premium from mortality cost, expenses and interest in an example, and name the parallel pieces for health and property rates.

> **Warm-up.** In five minutes, imagine you run the neighborhood lawn-care pool from Unit 1, and two new families apply: one with a flat quarter-acre yard, one with a steep two-acre yard full of stumps. Write two lines: what you would want to know about each yard before quoting, and whether both should pay the same. You have just done field underwriting and classification — this lesson gives your instincts their professional names.

WATCH

Life Insurance Training - Chapter 1: Completing the App., Underwriting and Delivering the Policy

E. H. Howard Wealth Management · 17:52

https://www.youtube.com/watch?v=mdMqv40vRQQ

> **WHEN TO WATCH**
> Watch after the big idea; list every information source the teacher names — application, MIB, medical records, consumer reports — and star the two receipts when they are compared.

BACKUP VIDEO

Life Insurance Exam [National] 24 – Life Insurance Underwriting Process Explained

Open Exam Prep · 3:56

https://www.youtube.com/watch?v=24ui-pXMxhM

A four-minute review of the whole pipeline; listen the day after the lesson with your pipeline diagram in front of you and check off each stage as it is named.

KEY TERMS

underwriting

The insurer's process of evaluating, selecting, classifying and pricing risks so that each class pays premiums matching the losses it brings to the pool.

field underwriter

The agent, as the first underwriter: the only company representative who sees the applicant, asks the questions and observes what paper cannot show.

adverse selection

The tendency of those most likely to suffer loss to be most eager to buy insurance — the force underwriting exists to balance.

application

The applicant's signed statements — commonly Part 1 general information and Part 2 medical information — that begin underwriting and attach to the policy as part of the entire contract.

conditional receipt

A receipt given when premium accompanies a life or health application, making coverage effective as of the receipt (or medical exam) date only if the applicant proves insurable as applied for.

binding receipt

A less common receipt under which temporary coverage begins immediately upon receipt, regardless of insurability, until the insurer declines.

binder

Temporary property or casualty coverage, written or oral, in force until the policy issues or the binder is canceled — authority life agents do not have.

Medical Information Bureau (MIB)

A member-owned bureau through which life and health insurers exchange coded underwriting information to deter omission and fraud; a report requires the applicant's authorization and may not be the sole basis for declining.

attending physician's statement (APS)

A report the underwriter requests, with authorization, from the applicant's own doctor about a condition disclosed in underwriting.

Fair Credit Reporting Act (FCRA)

The federal law requiring notice to applicants when consumer reports are used, consent for investigative reports, and disclosure and dispute rights when information causes adverse action.

risk classification

Underwriting's sorting of accepted applicants into preferred, standard and substandard (rated) classes, with the remainder declined.

mortality and morbidity

The statistical rates of death (mortality) and of sickness and disability (morbidity) by class — the loss ingredient of life and health premiums.

CORE IDEAS

The story. By 1902 the medical directors of America's life insurers had learned an expensive lesson in human nature. A man declined by one company for a weak heart did not give up; he simply applied to a second company and left the heart out of his story. Each insurer examined applicants as if it were the first ever to see them, and the dishonest applicant could shop his silence from office to office until someone

issued. That year, the physicians of the industry's medical-director association founded the **Medical Information Bureau** — a cooperative bureau through which member companies reported, in confidential codes, the medical impairments their underwriting had turned up. An applicant's file at the MIB did not say yes or no; it said, in effect, *ask again here*. A company seeing a code that contradicted a clean application knew to order records and look closer. The bureau still operates on the same logic today, and your exam tests its rules precisely because it sits where underwriting meets an applicant's privacy: the pool must be protected from hidden risk, and the applicant must be protected from hidden files.

How they figured it out. The MIB answers the oldest force in the business: **adverse selection**. The family that suspects trouble — the cough that will not quit, the wiring that sparks — wants insurance most urgently and volunteers the least. Left unchecked, eager bad risks fill the pool, premiums priced for average risks fall short, honest customers' rates climb, and the soundest customers leave: the pool unravels. **Underwriting** is the gate that keeps the law of large numbers honest — not by refusing the sick and the risky everything, but by seeing clearly and pricing truly, so each class of risk pays its own way. And the gate has a human face: the **agent as field underwriter**, the only person in the whole company who actually sits in the kitchen, sees the applicant, hears the hesitation before an answer. The company's first and best information is the agent's honest eyes.

The big idea. Underwriting begins with the **application** — commonly Part 1, general: name, age, occupation, income, other insurance; and Part 2, medical: history, physicians, habits. The applicant signs it; the agent signs as witness; and because the application attaches to the policy as part of the entire contract, its care matters. Mistakes are corrected by the **applicant initialing the change** — never by erasure or white-out, which turn an honest slip into a suspicious document. Incomplete applications go back for completion; an insurer that issues a policy despite an unanswered question is generally held to have waived the answer — Lesson 2.4's doctrine working in the applicant's favor. The agent's duties are plain: ask every question aloud, record the words actually said, and submit the whole truth. Every rule in Lessons 2.3 and 2.4 converges on this form.

When the first premium accompanies a life or health application, the agent issues a receipt, and the exam loves the difference between the two kinds. Under a **conditional receipt** — by far the more common — coverage is effective as of the date

of the receipt (or the medical exam, if one is required) *on the condition* that underwriting finds the applicant insurable as applied for. An applicant who dies in week two and would have been issued standard is covered; one who would have been declined is not — the condition failed. Under a rare **binding receipt**, temporary coverage begins immediately regardless of insurability and lasts until the company declines. Without any premium, there is no receipt and no coverage: the application is a naked offer, and delivery rules finish the story in Unit 4. Property and casualty runs on a different instrument entirely: the **binder**, true temporary coverage a P&C agent commonly has authority to grant on the spot, written or even oral, in force until the policy issues or the binder is canceled. Life agents issue receipts; property agents issue binders; no life agent binds.

Beyond the application, the underwriter may draw on ordered sources, each wrapped in applicant rights. The **MIB:** member insurers check applications against coded reports; the applicant authorizes the inquiry, is notified of the bureau's existence, may request and correct his file — and no insurer may decline *solely* on an MIB code; codes are leads to verify, not verdicts. The **attending physician's statement** fills in disclosed conditions from the applicant's own doctor, with authorization. Medical exams and lab work may be ordered — paid by the insurer, not the applicant. And consumer reports bring in the **Fair Credit Reporting Act**: the applicant must be told a report may be ordered; an *investigative* consumer report — interviews with neighbors and associates about character and habits — requires advance disclosure; and if the insurer declines or rates on the strength of report information, it must say so and name the reporting agency, so the applicant can obtain the file and dispute errors. In this course's plain words: the company may look, the applicant must know, and the file must answer to the person it describes.

Underwriting ends in a **classification**, and classification sets the price. **Preferred** risks — better-than-average health and habits — earn the lowest rates; **standard** risks pay the table rate the mortality assumptions contemplate; **substandard** risks are accepted *rated* — a higher premium by table rating or a flat extra per thousand — because a risk worth accepting is not always a risk priced like the average; and some risks are **declined**. The premium itself is built from three ingredients. For life: **mortality** — the expected death cost for the class, from tables sharpened by two centuries of experience; minus **interest** — the earnings the insurer expects on premiums held in reserve; plus **expense** — the loading for operations. Health

substitutes **morbidity** — rates of sickness and disability — for mortality; property and casualty builds from **loss costs** plus expenses the same way. In this example: a $250,000 policy at a mortality rate of $2.40 per $1,000 carries $600 of mortality cost; add a $70 expense load, credit $90 of expected interest, and the annual premium is $580. Real rates vary by company, class and year — the method is the lesson.

On the exam today. The receipts are the classic question: a **conditional** receipt covers from the receipt or exam date *only if* the applicant proves insurable as applied for; a **binding** receipt covers immediately until declined; a **binder** is property-casualty's temporary contract, oral or written — and matching the wrong instrument to the wrong line is the planted error. MIB questions reward exact knowledge: member-owned, coded information, applicant authorization and notice, file access and correction rights, and never the sole basis for declination. FCRA questions turn on notice, advance disclosure for investigative reports, and adverse-action rights. Expect one arithmetic item shaped like our example — mortality cost plus expenses minus interest — and vocabulary checks on adverse selection, field underwriter and the classes: preferred, standard, substandard-rated, declined. The correction rule is tested as written: changes are initialed by the applicant; white-out is the wrong answer every time it appears.

PICTURE STUDY



The Doctor, Luke Fildes, 1891 · Oil on canvas · Tate Britain, London

Image: Wikimedia Commons, public domain

Luke Fildes painted this cottage vigil in 1891, remembering the doctor who had attended his own small son, and it became one of the most beloved pictures of its century. Nothing in the room is modern; everything in it is attention — the physician watching one child by lamplight with the patience of a man who will not leave until the fever turns. It opens the underwriting lesson because the whole machinery you are learning — Part 2 of the application, the APS from the attending physician, the medical exam — exists to bring this room's honest knowledge to the pricing of a promise, and because the agent, like this doctor, is the professional the family actually sees.

Look closely

- Find the makeshift bed — two chairs pushed together. The family's means are small, which is exactly why the promise they buy must be priced honestly.
- Watch the doctor's posture: leaning in, chin on hand. Assessment is attention before it is paperwork.
- Find the parents in the shadows — the father's hand on the mother's shoulder, her head bowed at the table. The ones who wait are the policy's real beneficiaries.

- Notice the dawn beginning at the window. The vigil has lasted all night; some knowledge cannot be hurried.

Talk about it

1. The attending physician knows what no form can ask. Why does underwriting seek his statement — and why only with the applicant's authorization?
2. An underwriter never meets the family; the agent and the doctor do. What does each owe the other in the chain that prices this child's father's policy truly?
3. Fildes's doctor can do little but watch, yet the picture honors him. What does faithful attention to one household teach an agent whose work is also kitchens and bedsides — and Who keeps the longer vigil over every house?

PROJECT

The Pretend Underwriting File

You will sit in the underwriter's chair for an afternoon and work three pretend applications from receipt to decision — classifying each risk, pricing one premium with this lesson's formula, and writing the letters the law requires. The finished folder is the Pathway File's proof that you can see both sides of the desk you will someday sit beside.

You will need

- Three sheets of paper (one per applicant) plus a folder or large clip
- Your exam notebook, pencil and calculator
- This lesson's formulas and the MIB and CFPB pages from the kit

Steps

1. Invent three pretend applicants and write a half-page file summary for each: (1) Marisol, 28, nonsmoking teacher, excellent checkup, applying for $250,000; (2) Ray, 45, smoker with controlled high blood pressure disclosed on Part 2, applying for $250,000; (3) Vern, 52, whose clean application contradicts an MIB code suggesting an undisclosed heart consultation.
2. For each file, list the information sources you may use and the permission or notice each requires: application, medical exam, APS with authorization, MIB with authorization and notice, consumer report with FCRA notice.
3. Classify Marisol and Ray (preferred, standard, substandard-rated, declined) and defend each classification in two sentences.
4. For Vern, write the next-step memo an honest underwriter would write — order the APS and records, verify the code, decide on evidence — and note why declining on the code alone is forbidden.
5. Price Marisol's policy with the lesson's formula, in this example: mortality $2.10 per $1,000 on $250,000, expenses $65, interest credit $85. Show mortality cost, then premium, with every step labeled.
6. Write Ray a one-paragraph rated-offer letter (his premium carries a flat extra in this example) and Vern a one-paragraph adverse-action letter that names

the information source and his rights to the file — the FCRA letter an applicant is owed.

7. Label the folder UNDERWRITING FILE — PRETEND FAMILIES, PRETEND NUMBERS, date it, and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for conditional receipt, binding receipt, binder, MIB, APS, FCRA, adverse selection and the four classifications — the receipt cards get the condition written out in full on the back.
2. Draw the underwriting pipeline as a diagram: APPLICATION (Part 1, Part 2, signatures, initialed changes) → SOURCES (MIB, APS, exam, consumer report — each with its permission slip) → CLASSIFICATION (preferred / standard / rated / declined) → PRICE (mortality + expenses − interest).
3. Write a five-line trap list titled “Receipts and binders,” ending with: LIFE AGENTS ISSUE RECEIPTS; PROPERTY AGENTS ISSUE BINDERS; NO LIFE AGENT BINDS.

KEY FORMULAS

$$\text{Mortality cost} = \frac{\text{face amount}}{1{,}000} \times \text{mortality rate per \$1,000}$$

$$\text{Annual premium} = \text{mortality cost} + \text{expense load} - \text{interest credit}$$

From history. Underwriting’s arithmetic got its modern gears in 1919, when two medical directors at New York Life, Dr. Oscar Rogers and the actuary Arthur Hunter, published the numerical rating system: start every applicant at 100, add debits for each impairment, subtract credits for favorable findings, and read the classification off the final score. The method let companies underwrite consistently across thousands of files and train underwriters who were neither physicians nor actuaries — and descendants of that debit-and-credit scoring still sort applications a century later.

Example 1. In this example, an insurer prices a $250,000 standard-class life policy with a mortality rate of $2.40 per $1,000, an expense load of $70, and an interest credit of $90. Find the annual premium.

Show solution

1. Mortality cost: $\frac{\$250{,}000}{1{,}000} = 250$ thousands of face, so $250 \times \$2.40 = \$600$.
2. Add the expense load: $\$600 + \$70 = \$670$.
3. Subtract the interest credit the insurer expects to earn on reserves: $\$670 - \$90 = \$580$.
4. Check the logic of each ingredient: mortality pays the class's expected claims, expense runs the company, and interest — money working while it waits — is the customer's discount.

Answer: $580 a year in this example. Real rates differ by company, class and year; the three-ingredient method is what the exam tests.

Example 2. Exam style. On May 1, Jonas applies for life insurance, pays the first premium and receives a conditional receipt; his medical exam is May 4. Underwriting would have classified him standard, exactly as applied for. He dies in an accident on May 10, before the policy is issued. What does the insurer owe?

A. Nothing; no policy was ever issued

B. A refund of premium only

C. The death benefit; the conditional receipt's condition was met, so coverage was effective from the exam date

D. The death benefit, but only if a binder was also signed

Show solution

1. Identify the instrument: premium paid with a life application and a conditional receipt given.
2. State the condition: coverage effective as of the receipt or exam date if the applicant proves insurable as applied for.
3. Apply it: underwriting would have issued standard — the condition is satisfied — so coverage was in force from May 4, before the accident.
4. Strike the traps: A ignores the receipt's whole purpose; B is the answer only when the condition fails (an uninsurable applicant); D imports a property-casualty instrument no life agent can issue.

Answer: C. Because Jonas was insurable as applied for, the conditional receipt made coverage effective at the May 4 exam, and the death benefit is payable though no policy ever reached him.

Example 3. Exam style. An underwriter sees an MIB code inconsistent with Dara's clean application, orders no records, requests no APS, and simply declines her, telling her nothing. Name every rule broken, and what Dara is entitled to.

Show solution

1. MIB rule one: a code may prompt investigation but may not be the sole basis for declination — the underwriter declined on the code alone.
2. MIB rule two: Dara authorized the inquiry and is entitled to know the bureau exists, to request her file and to correct errors in it.
3. FCRA layer: adverse action based on report information requires telling the applicant and naming the source, so she can obtain and dispute the file.
4. The cure: order the records or an APS with authorization, verify the code against facts, and decide on evidence — then classify preferred, standard, rated or declined on what is true.

Answer: The declination violated the MIB's sole-basis rule and the applicant's notice and disclosure rights. Dara is entitled to know why she was declined and where the information came from, to obtain her file, and to have errors corrected — underwriting may be firm, but it may not be secret.

PRACTICE

1. Easy What is underwriting, and what force does it exist to balance?

   Show answer

   The insurer's process of evaluating, selecting, classifying and pricing risks. It balances adverse selection — the tendency of those most likely to suffer loss to be the most eager buyers.

2. Easy Who is the field underwriter, and why?

   Show answer

   The agent — the only company representative who actually sees the applicant, asks the questions aloud and observes what the paperwork cannot show. His honest eyes are the company's first information.

3. Easy How is a mistake on an application corrected?

Show answer

The applicant initials the change. Erasures and white-out are never used — they make an honest slip look like tampering on a document that becomes part of the entire contract.

4. Medium Premium accompanies a life application and the agent issues a conditional receipt. Coverage is effective:
A. Immediately, regardless of insurability, until declined
B. As of the receipt or medical exam date, if the applicant proves insurable as applied for
C. Only when the policy is delivered
D. Retroactive to the applicant's last birthday

Show answer

B. That is the condition in a conditional receipt. A describes the rarer binding receipt; C describes an application submitted without premium; D confuses this with age-based premium calculations.

5. Medium Name three facts about the MIB the exam expects, including the rule about declinations.

Show answer

It is a member-owned bureau through which life and health insurers exchange coded impairment information; the applicant must authorize the inquiry and is entitled to notice, file access and correction; and no insurer may decline an applicant solely on an MIB code — codes are leads to verify, not verdicts.

6. Medium An insurer orders an investigative consumer report — interviews about an applicant's character and habits — and later rates the applicant partly on it. Name two FCRA duties it owed along the way.

Show answer

Advance disclosure that an investigative report might be made, and, upon the adverse action, notice to the applicant naming the reporting agency so she can obtain the file and dispute errors. (Ordinary consumer reports also require notice that a report may be ordered.)

7. Medium Sort the four risk classifications and state what happens to the premium in each.

Show answer

Preferred pays less than the table rate; standard pays the table rate the mortality assumptions contemplate; substandard is accepted rated — a higher premium through table rating or a flat extra; declined is not accepted at any price.

8. Hard In this example, a $400,000 policy is priced at a mortality rate of $3.10 per $1,000, with a $95 expense load and a $130 interest credit. Compute the annual premium, showing each step.

Show answer

Mortality cost: $400 \times \$3.10 = \$1{,}240$. Add expenses: $\$1{,}240 + \$95 = \$1{,}335$. Subtract interest: $\$1{,}335 - \$130 = \$1{,}205$ a year in this example.

9. Hard A P&C agent says over the phone, "You're covered as of now," to a shop owner whose policy will issue next week; a life agent says the identical words to a life applicant whose premium hasn't been paid. Analyze both sentences.

Show answer

The P&C agent has issued an oral binder — temporary coverage he commonly has authority to grant, in force until the policy issues or the binder is canceled. The life agent has promised what he cannot give: life agents have no binding authority, and with no premium there is not even a conditional receipt, so no coverage exists — and his words invite an E&O claim and discipline.

10. Hard Explain in two or three sentences why interest is subtracted in the premium formula rather than added.

Show answer

Premiums are paid before claims are, so the insurer holds and invests the money in reserves during the wait. The earnings it expects reduce what it must collect from the policyholder to fund the same promised claims. Interest is the customer's discount for prepayment — which is why eras of strong interest earnings are kind to premium rates.

11. **Challenge** Underwriting charges a substandard applicant more than his healthy neighbor for the same face amount. Write three sentences defending classification as fairness rather than unkindness, using adverse selection and the Unit 1 idea of the pool.

Show answer

Every premium is other families' money held in trust, and a class that pays average rates while bringing above-average risk is quietly subsidized by every other household in the pool. Unchecked, that subsidy invites adverse selection — the costliest risks crowd in at a bargain, rates climb, and the healthiest leave until the pool fails everyone, including the substandard applicant. Rating each class to carry its own expected losses keeps the promise affordable and honest for all of them; the unkind act would be pricing that eventually pays nobody.

12. **Challenge** Christ asks which builder does not first sit down and count the cost. Write three sentences connecting Luke 14:28 to the underwriter's desk and to the agent's field underwriting, including what happens to towers — and insurers — that skip the counting.

Show answer

Underwriting is the insurer sitting down before it builds: counting mortality, morbidity and expenses so the promise it sells can actually be finished — paid in full on the day it is claimed. The agent counts first in the field, asking true questions and transmitting true answers, because a tower is already leaning when its foundation is measured wrong. Companies that skip the counting make cheap promises and unfinished towers; the counted cost is what makes the promise kind.

COMMON MISTAKES

- Confusing the receipts: a conditional receipt covers from the receipt or exam date only if the applicant proves insurable as applied for; a binding receipt covers immediately until declined.
- Giving a life agent a binder — binders are property and casualty instruments; life agents cannot bind the insurer.
- Treating an MIB code as a verdict — it requires the applicant's authorization, carries notice and correction rights, and may never be the sole basis for declining.

- Forgetting the FCRA's adverse-action duty: an applicant declined or rated on report information must be told and given the source, so she can obtain and dispute the file.
- Correcting an application with white-out — changes are initialed by the applicant, always.
- Adding interest in the premium formula — interest earnings reduce the premium; the build is mortality (or morbidity) plus expenses minus interest.

Make it a game · Rate the Risk. Deal each player four cards labeled PREFERRED, STANDARD, RATED, DECLINE. A parent reads pretend applicant profiles you write together first (a 30-year-old marathoner; a 50-year-old smoker with controlled blood pressure; an applicant whose application contradicts an MIB code — careful: the right call is INVESTIGATE, said aloud, not a card; a skydiving instructor; a healthy teacher…). On a count of three, everyone throws a card; matching the group's best-defended answer scores one, defending it with a rule from the lesson scores two. Then one lightning round: the reader calls CONDITIONAL, BINDING or BINDER and players shout life-or-property and when coverage starts. First to ten points wins.

Scripture. "For which of you, intending to build a tower, sitteth not down first, and counteth the cost, whether he have sufficient to finish it?" (Luke 14:28, KJV)

Christ commends the builder who counts before he builds, because an unfinished tower mocks its maker and fails all who counted on it. Underwriting is the counting that lets an insurer finish what it starts — pay every claim it promised — and the agent who field-underwrites honestly is the first man at the table doing the arithmetic.

UNIT 2

The Contract and the Agent's Authority

Every policy you will ever sell is a contract — but a contract like no other. In this unit you will stand in Edward Lloyd's coffee house and watch merchants write their names under the terms on a slip of paper, and you will learn why the law calls the bargain they made **aleatory**, **unilateral**, **conditional**, **personal** and a **contract of adhesion** — five strange characters no ordinary contract shares. You will see Parliament shut down the ghoulish London fashion of betting on strangers' lives with the Life Assurance Act of 1774, and from that scandal learn the two principles that keep insurance honest: **insurable interest** and **indemnity** — restore, never enrich. You will sit in Lord Mansfield's courtroom in 1766 for *Carter v Boehm*, the case that named insurance a contract of **utmost good faith**, and learn the exam's careful ladder of representations, warranties, concealment and fraud.

Then the unit turns to you — the agent. Under the old law of agency you will learn the three kinds of authority you will someday carry: **express**, written in your contract; **implied**, read into it by custom; and **apparent**, created by the company's own conduct toward the public — and why the insurer is bound by what its agent does and knows. Finally you will do the work of the **underwriter**: take the application, meet the Medical Information Bureau and the Fair Credit Reporting Act, classify the risk, and build a premium from mortality, interest and expenses. By the end, the policy in your hand will no longer be fine print; it will be a promise whose every peculiar clause you can explain.

PREREQUISITES

- Has completed Unit 1 and can define risk, peril, hazard and the law of large numbers, and name the lines of authority
- Can work comfortably with percents, decimals and simple formulas (find 0.3% of a number, multiply a rate by thousands of face amount)
- Can keep a tidy, dated exam notebook with definitions, comparisons and corrected misses
- Can look up a source online (your state insurance department, naic.org, mib.com) and record what it says

MASTERY CHECKLIST

- ☐ I can name the four elements of a valid contract, say who usually makes the offer in insurance, and state what each party gives as consideration.
- ☐ I can define the five characteristics of an insurance contract — aleatory, adhesion, unilateral, conditional and personal — and apply each to a scenario.
- ☐ I can state when insurable interest must exist for life insurance and for property insurance, and name who has an insurable interest in a life.
- ☐ I can explain the principle of indemnity, contrast indemnity contracts with valued contracts, and say which kind a life policy is.
- ☐ I can tell representations from warranties by the truth each requires, and define misrepresentation, material misrepresentation, concealment and fraud.
- ☐ I can explain rescission, and state how the incontestability clause limits an insurer after two years.
- ☐ I can define express, implied and apparent authority with an example of each, and explain waiver, estoppel and why the agent's knowledge binds the insurer.

- ☐ I can walk an application through underwriting — receipts, the MIB, the Fair Credit Reporting Act, classification — and build a premium from mortality, interest and expenses in an example.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: How Does Insurance Work?**: Free, official. The association of all fifty state insurance regulators explains policies, premiums and deductibles in plain consumer language. Read it with Lesson 2.1 to see the contract described for the people who sign it. Ages 14 and up.
- **NAIC: State Insurance Departments directory**: Free, official. The map of every state insurance department — the regulator whose rules govern every contract and agent in this unit. Use it with Lessons 2.4 and 2.5 to find your own department and bookmark its consumer and licensing pages. Ages 14 and up.
- **MIB: Request Your MIB Consumer File**: Free, official. The Medical Information Bureau's own page for consumers who want to see and correct their file — the disclosure rights you will study in Lesson 2.5. Read it, do not submit anything; a student has no file to request. Ages 15 and up.
- **CFPB: Credit Reports and Scores**: Free, official. The federal consumer bureau's plain-language pages on consumer reports and the right to notice and dispute — the Fair Credit Reporting Act duties an underwriter owes every applicant. Read the overview with Lesson 2.5. Ages 15 and up.
- ***Handbook of the Law of Insurance*, by William R. Vance (1904)**: Free on the Internet Archive. A classic law-school handbook from 1904 — dip into its chapters on the making of the contract and on warranties with Lessons 2.1 and 2.3 to hear a great teacher of a century ago explain the same rules you are learning. Ages 16 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

2.1	**A Contract Like No Other: Elements and Characteristics**	3 sessions of 50 minutes
2.2	**Insurable Interest and Indemnity: No Betting Allowed**	3 sessions of 50 minutes

2.3 Utmost Good Faith: Representations, Warranties and Concealment

3 sessions of 50 minutes

2.4 The Agent's Three Authorities: Express, Implied and Apparent

3 sessions of 50 minutes

2.5 Underwriting: The Application, the MIB and the Price of Risk

3 sessions of 50 minutes

Unit 2 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Time yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says "in this example," use the figures given, and remember that real premiums, fees and clause periods vary by state and company — the live rules are at your state insurance department. Choose the one BEST answer.

1. **5 pts**

   Which of the following is NOT one of the four elements of a valid contract?

   A. Offer and acceptance

   B. Consideration

   C. Indemnity

   D. Legal purpose

2. **5 pts**

   In forming an insurance contract, the offer is usually made by:

   A. The applicant, submitting the application with the first premium

   B. The insurer, through its advertising

   C. The agent, by quoting a rate

   D. The state, by approving the policy form

3. 5 pts

A court reads an ambiguous policy term in favor of the insured because an insurance policy is:

A. An aleatory contract

B. A contract of adhesion

C. A conditional contract

D. A valued contract

4. 5 pts

A family pays a $700 annual premium in this example and later collects $250,000 . The unequal exchange illustrates which characteristic?

A. Unilateral

B. Personal

C. Conditional

D. Aleatory

5. 5 pts

For a life insurance policy, insurable interest must exist:

A. At the time of death

B. At the time of application

C. Continuously from application to death

D. Only when the beneficiary is changed

6. 5 pts

Harlan sold his cabin in April; in June it burned. His old policy was still paid up. His claim fails because:

A. The policy lapsed automatically at the sale

B. Fire was not a covered peril

C. He had no insurable interest at the time of loss

D. The new owner’s coverage is primary

7. 5 pts

A creditor owed $25,000 wants life insurance on the debtor. The creditor's insurable interest supports coverage of approximately:

A. $25,000

B. Any amount the debtor consents to

C. Ten times the debt

D. Nothing; creditors have no insurable interest

8. 5 pts

Life insurance pays its stated face amount without measuring the survivors' financial loss because it is:

A. An indemnity contract

B. An aleatory wager

C. A conditional receipt

D. A valued contract

9. 5 pts

Statements made by an applicant on a life insurance application are considered:

A. Warranties, which must be literally true

B. Representations, which must be substantially true

C. Concealments, unless notarized

D. Guarantees of insurability

10. 5 pts

A statement written into the contract itself and guaranteed to be strictly, literally true is:

A. A warranty

B. A representation

C. An estoppel

D. A rider

11. 5 pts

A misrepresentation is MATERIAL when:

A. It embarrasses the applicant

B. It appears in Part 2 of the application

C. The truth would have changed the insurer's underwriting decision

D. It relates to the cause of the loss

12. 5 pts

Three years into a life policy, the insurer discovers a material (but not fraudulent) misstatement in the application. Under the incontestability clause, the insurer:

A. May rescind and return premiums

B. May deduct the misstatement's cost from the benefit

C. May cancel at the next anniversary

D. May no longer contest the policy

13. 5 pts

An insurer leaves its signage, forms and rate books with an agent after terminating him, and he takes an application from an unknowing customer. The insurer may be bound under:

A. Express authority

B. Implied authority

C. Apparent authority

D. No authority; termination ends everything

14. 5 pts

An agency contract says only "solicit applications," yet the agent lawfully collects initial premiums with them because collection is usual and necessary to the task. This is:

A. Apparent authority

B. Implied authority

C. Express authority

D. Waiver

15. 5 pts

An applicant tells the agent about a heart condition; the agent writes “none” on the application and submits it. At claim time, the insurer’s rescission effort is weakest because:

A. The agent’s knowledge is imputed to the insurer, which may be estopped from rescinding

B. Heart conditions are never material

C. The incontestability clause applies from day one

D. Applications are not part of the contract

16. 5 pts

Which pairing is correct?

A. Agent — represents the buyer; broker — represents the insurer

B. Agent — binds all lines; broker — binds none

C. Both agent and broker legally represent the insurer

D. Agent — represents the insurer; broker — represents the buyer

17. 5 pts

Premium accompanies a life application and the agent issues a conditional receipt. The applicant dies before the policy is issued, and underwriting confirms he was insurable as applied for. The insurer:

A. Owes nothing; no policy was delivered

B. Owes the death benefit; coverage was effective from the receipt or exam date

C. Owes a premium refund only

D. Owes the benefit only if a binder existed

18. 5 pts

Which statement about the Medical Information Bureau is correct?

A. It is a government agency that approves applications

B. Insurers may decline applicants solely on an MIB code

C. Applicants may never see their MIB files

D. It is a member-owned bureau of coded information, requiring applicant authorization, and may not be the sole basis for declination

19. 5 pts

An insurer rates an applicant partly on a consumer report. Under the Fair Credit Reporting Act it must:

A. Keep the source confidential to protect the reporting agency

B. Offer the applicant a premium discount

C. Notify the applicant of the adverse action and identify the reporting agency

D. Destroy the report within thirty days

20. 5 pts

In this example, a $300,000 policy is priced with mortality of $2.50 per $1,000, a $80 expense load and a $110 interest credit. The annual premium is:

A. $720

B. $940

C. $750

D. $830

ANSWER KEY

1. C. Indemnity is a principle of insurance, not an element of a contract. The four elements are agreement (offer and acceptance), consideration, competent parties and legal purpose.
2. A. The applicant offers with application and premium; the insurer accepts by issuing as applied for. Advertising (B) is only an invitation to apply, and a quote (C) is not an offer.
3. B. The insurer drafted every word and offered the contract take-it-or-leave-it, so under contra proferentem ambiguities are construed against the drafter. Aleatory (A) describes unequal exchange, not drafting.
4. D. Aleatory contracts exchange unequal values depending on an uncertain event. Unilateral (A) is about who promises; conditional (C) is about duties that must be met before payment.
5. B. Life insurable interest is tested when the policy is issued — at application — and a validly formed policy survives later changes such as divorce. 'At the time of death' (A) is the exam's classic trap.
6. C. Property insurance requires insurable interest at the time of loss, and Harlan owned nothing that burned — paying premiums cannot create a loss where none was suffered.
7. A. A creditor's interest is limited to roughly the outstanding debt. Consent (B) is necessary but cannot enlarge an interest the law caps, and coverage far beyond the debt would be a wager.
8. D. A valued contract pays a stated sum on the insured event; no adjuster appraises a life. Property and casualty policies are the indemnity contracts (A), paying measured loss up to the limit.
9. B. Application answers are representations — true to the applicant's honest knowledge and belief. The strict literal-truth standard (A) belongs to warranties, which most states exclude from life and health applications absent fraud.
10. A. A warranty is part of the contract and guaranteed strictly true; a breach can void coverage regardless of materiality — which is why the standard is reserved mostly for commercial settings.
11. C. Materiality is measured against the underwriting decision — decline, exclude or reprice. It does not require any connection to the eventual loss (D), the distractor the exam plants most often.

12. D. After the contestable period — commonly two years — the insurer can no longer contest application misstatements. The time to investigate was the first two years, not the week of the claim.
13. C. Actual authority (express and implied) died with the contract, but the principal's own conduct — leaving the indicia of authority in place — created a reasonable public appearance, and apparent authority binds the careless principal.
14. B. Implied authority is unwritten but real — the customary, necessary powers that carry out the express grant. It is part of actual authority, unlike apparent authority (A), which rests on appearances.
15. A. Under Union Mutual v. Wilkinson, what the agent learns within his agency the insurer is deemed to know, and having issued through its own agent's falsification it may be estopped — while the agent faces discipline.
16. D. The agent acts for the insurer-principal; the broker shops for the buyer and generally cannot bind coverage. Most state codes license both under the single term producer.
17. B. The conditional receipt's condition — insurable as applied for — was met, so coverage took effect at the receipt or exam date. Refund-only (C) is the result when the condition fails; binders (D) belong to property insurance.
18. D. The MIB is the insurers' own cooperative bureau; inquiries require authorization and notice, applicants may request and correct their files, and a code is a lead to verify — never by itself a reason to decline.
19. C. Adverse action based on report information triggers the duty to tell the applicant and name the source, so she can obtain the file and dispute errors. Secrecy (A) is the opposite of the statute's design.
20. A. Mortality cost is $300 \times \$2.50 = \$750$; add \$80 expenses and subtract the \$110 interest credit: $\$750 + \$80 - \$110 = \$720$. Choice B adds the interest instead of subtracting it.

PORTFOLIO PIECE: MY PATHWAY FILE: THE CONTRACT CHAPTER

Assemble the chapter of your Pathway File that proves you understand the strange and wonderful contract at the heart of the profession: the Contract Anatomy Chart with its four elements and five characteristics (Lesson 2.1), the Insurable Interest Sorting Sheet with both clocks written large (Lesson 2.2), the banded deck of Good-Faith Case Cards sorted up the ladder from honest answer to fraud (Lesson 2.3), the Agent Authority Map with its principal–agent–public triangle and the Wilkinson chain (Lesson 2.4), and the three-applicant Pretend Underwriting File with its priced premium and its two letters (Lesson 2.5).

Close the chapter with a one-page letter addressed to a pretend first client, explaining in your own words why an insurance policy can be trusted even though the company wrote every word of it — naming at least three protections you learned in this unit (choose from contra proferentem, insurable interest, utmost good faith, incontestability, apparent authority and the underwriting rights of applicants) and ending with the standard of Matthew 5:37: a yes that means yes.

LOOK FOR	WHAT IT MEANS
Contract Anatomy Chart	All four elements and all five characteristics are present, correctly defined, each with a working example, and the offer–counteroffer–acceptance case is traced accurately.
Insurable Interest Sorting Sheet	All twelve cases are sorted correctly with the right family of interest, and both clocks — property at loss, life at application — are stated without error.
Good-Faith Case Cards	Every rung of the ladder appears at least once, each card names the doctrine and the remedy correctly, and the materiality test is quoted exactly on the banner card.
Agent Authority Map	The three authorities are classified with their true sources, all ten test acts are marked correctly, and the imputed knowledge–waiver–estoppel chain is in the right order.
Underwriting File	Classifications are defended, the premium arithmetic is complete and labeled with every figure marked as an example, and the two letters honor the MIB and FCRA rights they exist to serve.

LOOK FOR	WHAT IT MEANS
Client letter	The three protections are accurately explained in the student's own words, the Scripture is used honestly rather than decoratively, and the letter would genuinely reassure a careful reader.

UNIT 3

Life Insurance: The Policies

In 1759 a group of Philadelphia ministers did something no Americans had done before: they chartered a corporation whose whole business was a promise to widows and orphans. From that **Ministers' Fund** grew everything this unit studies — the products an agent spends most of a life-license exam proving he understands. You will begin with the question underneath every sale: *why* a family buys life insurance at all, and how an agent measures the need, by the **needs approach** and by the **human life value** a Wharton professor taught America to calculate in the 1920s. Then you will meet the policies themselves: **term life**, the pure, inexpensive, expiring promise; **whole life**, the level-premium promise that endures to the end and builds guaranteed **cash value** along the way; and the flexible designs of the last fifty years — **universal**, **indexed** and **variable** life — that unbundled the old contract and, in the variable forms, crossed into securities law.

The unit closes with the policies that cover people in bundles and in special situations: **group life** with its master policy and 31-day conversion right, **credit life**, juvenile and family coverage, joint and survivorship designs, and the old door-to-door **industrial insurance** that built one of the tallest buildings in the world out of nickels and dimes. Licensing exams draw more questions from these policy types than from almost any other topic, and they test by contrast: term against whole life, Option A against Option B, first-to-die against second-to-die. Learn each policy by the need it answers and the comparisons will keep themselves straight.

PREREQUISITES

- Has completed Units 1–2 and can define premium, insurer, insured, policyowner and beneficiary without looking
- Can explain insurable interest and indemnity from Lesson 2.2 — why life insurance is organized provision, not a wager
- Can work comfortably with percents and simple formulas (multiply a salary by a number of years, total a four-line worksheet)
- Has the exam notebook habit running: definitions and comparisons on left pages, corrected practice misses on right pages

MASTERY CHECKLIST

- ☐ I can explain the four jobs of a death benefit — income replacement, debts, final expenses and legacy — and tell the story of the Ministers' Fund of 1759.
- ☐ I can calculate a family's coverage need by the DIME method and by the human life value method, and say how the two approaches differ.
- ☐ I can describe level, decreasing and annually renewable term, and state exactly what the renewable and convertible features each guarantee.
- ☐ I can explain how level-premium whole life builds guaranteed cash value, and compare ordinary, limited-pay and single-premium designs.
- ☐ I can state what participating dividends are, why they are generally not taxable, and name the five classic dividend options.
- ☐ I can explain universal life's unbundled design, its flexible premiums, and the difference between Option A and Option B death benefits.
- ☐ I can say how indexed and variable life credit value, who bears the investment risk in each, and which two licenses variable products require.
- ☐ I can describe group life's master policy, certificates and 31-day

conversion right, and tell credit life, joint, survivorship, final expense and industrial policies apart.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: State Insurance Departments directory**: Free, official. The National Association of Insurance Commissioners' map of all fifty state insurance departments. Use it in every lesson of this unit to find your own department's life insurance consumer guide, which states the free-look, conversion and replacement rules your state actually uses. Ages 14 and up.
- **Insurance Information Institute: Life Insurance Basics**: Free. The industry's consumer-education institute explains term, whole, universal and variable life in plain language — a good one-page review after Lessons 3.2 through 3.4. Ages 14 and up.
- **Insurance Information Institute: How Much Life Insurance Do I Need?**: Free. A short consumer walk-through of the needs questions behind Lesson 3.1. Read it before the Family Coverage Worksheet project and compare its checklist with your DIME columns. Ages 14 and up.
- ***Life Insurance: A Textbook*, by Solomon S. Huebner (1917)**: Free on the Internet Archive. The Wharton professor who gave the profession the human life value concept, in his own words. Dip into the opening chapters with Lessons 3.1 and 3.3 to hear the ideas of this unit stated a century ago. Ages 15 and up.
- **Texas Department of Insurance: Life Insurance Guide**: Free, official. One state's plain-English consumer guide to the policy types in this unit — a model of what your own state's department publishes. Skim it after Lesson 3.4 and note where Texas figures differ from this course's examples. Ages 14 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

3.1 Why Life Insurance: Needs, Human Life Value and the Ministers' Fund

3 sessions of 50 minutes

3.2 Term Life: Renting the Promise

3 sessions of 50 minutes

3.3	**Whole Life: The Promise That Endures**	3 sessions of 50 minutes
3.4	**Flexible Designs: Universal, Indexed and Variable Life**	3 sessions of 50 minutes
3.5	**Group Life and the Special Policies**	3 sessions of 50 minutes

Unit 3 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Time yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says "in this example," use the figures given, and remember that real premiums, rates and rules vary by state and company — the live figures are at your state insurance department's website. Most states pass a licensing candidate at 70%, which is 14 of 20 here — but aim higher. Choose the one BEST answer.

1. **5 pts**

   In the DIME method of needs analysis, the four letters stand for:

   A. Dividends, interest, mortality, expenses

   B. Debt, income, mortgage, education

   C. Death benefit, insurability, maturity, endowment

   D. Deductible, indemnity, maximum, exclusion

2. **5 pts**

   Which fact is used by the human life value approach but NOT by the needs approach?

   A. The family's outstanding debts

   B. The mortgage payoff balance

   C. The children's education costs

   D. The number of working years remaining to the insured's retirement

3. 5 pts

The first life insurance corporation in America, chartered in 1759, was organized to provide for:

A. The widows and orphans of Presbyterian ministers

B. The merchants of the Buttonwood Agreement

C. The victims of the Great Fire of London

D. Union soldiers in the Civil War

4. 5 pts

A life insurance death benefit paid to a named beneficiary as a lump sum is generally:

A. Taxed as ordinary income to the beneficiary

B. Taxed as a capital gain

C. Received free of income tax

D. Taxable only above the premiums paid

5. 5 pts

A family wants coverage that tracks their shrinking 20-year mortgage balance at the lowest cost. The classic fit is:

A. Decreasing term

B. Level term

C. Ordinary whole life

D. Increasing term

6. 5 pts

The renewable feature of a term policy guarantees the insured may continue coverage:

A. At the original premium, with new evidence of insurability

B. Without new evidence of insurability, at a premium for his attained age

C. At the original premium, without evidence

D. Only by converting to permanent insurance

7. 5 pts

Which statement about term life insurance is TRUE?

A. It builds cash value slowly

B. Its premiums may be borrowed back through policy loans

C. It always pays a benefit eventually

D. For the same premium it buys the largest immediate death benefit of any form

8. 5 pts

The conversion feature of a term policy permits exchange:

A. Of a permanent policy for term insurance, with evidence

B. Of term for permanent insurance, with evidence of insurability

C. Of term for permanent insurance, without evidence of insurability

D. Of one insurer's policy for another insurer's, without evidence

9. 5 pts

When a whole life policy matures at age 100 (or 121 under the 2001 table):

A. Coverage simply ends with no payment

B. The cash value equals the face amount and is paid to the policyowner

C. The face amount is paid to the beneficiary

D. Premiums stop but the cash value is forfeited

10. 5 pts

Dividends on a participating whole life policy are:

A. Not guaranteed, and generally not taxable as a return of premium

B. Guaranteed by the contract and taxable as income

C. Guaranteed, but only if left to accumulate at interest

D. Not guaranteed, and fully taxable as income

11. 5 pts

A 20-pay whole life policy issued at age 30 provides coverage:

A. Until age 50, when the policy expires

B. Until age 65 only

C. For 20 years, renewable thereafter

D. For the insured's entire life, with premiums payable only to age 50

12. 5 pts

In this example, a $400,000 whole life policy has a $35,000 outstanding policy loan and $1,500 of accrued loan interest at the insured's death. The beneficiary receives:

A. $400,000

B. $365,000

C. $363,500

D. $436,500

13. 5 pts

A universal life policy has a $250,000 face amount and $42,000 of cash value. Under death benefit Option B, the beneficiary receives:

A. $292,000

B. $250,000

C. $208,000

D. $42,000

14. 5 pts

An indexed universal life policy has a 0% floor and a 10% cap with 100% participation. In a year the index falls 18%, the interest credited is:

A. −18%

B. 0%, though policy charges still reduce the cash value

C. 10%

D. 0%, and the policy is guaranteed not to lapse

15. 5 pts

To sell variable universal life, an agent must hold:

A. A state life insurance license only

B. FINRA registration only

C. A state life insurance license plus FINRA registration (Series 6 or 7)

D. A state life license plus an adjuster license

16. 5 pts

Which policy can lapse in later years even though the owner paid premiums faithfully for two decades?

A. Ordinary whole life kept at its level premium

B. A paid-up 20-pay whole life policy

C. Level term during its stated term

D. A universal life policy funded at minimum premiums

17. 5 pts

In group life insurance, the employer and the covered employee respectively hold:

A. The master policy; a certificate of insurance

B. A certificate of insurance; the master policy

C. Two copies of the same individual policy

D. The policy; no document at all

18. 5 pts

An employee leaving her job may convert her group life coverage by:

A. Applying within 60 days for term insurance at select rates

B. Applying within 31 days for an individual permanent policy at attained-age rates, without evidence of insurability

C. Applying within 31 days, subject to a new medical exam

D. Doing nothing; group coverage continues free for one year

19. 5 pts

A borrower with credit life insurance dies owing $8,200 on a loan that began at $25,000. The policy pays:

A. $25,000 to his widow

B. $8,200 to his widow

C. $8,200 to the lender

D. $25,000 to the lender

20. 5 pts

A married couple needs a single payment for estate settlement costs that fall due only after both spouses have died. The fitting design is:

A. Joint (first-to-die) life

B. Annually renewable term on each spouse

C. A family rider on the husband’s policy

D. Survivorship (second-to-die) life

ANSWER KEY

1. B. DIME totals the survivors' Debt, Income need times years, Mortgage payoff and Education costs — then subtracts resources already in place. The other choices borrow vocabulary from other lessons to distract you.
2. D. Human life value multiplies earnings kept for the family by working years remaining (discounted to present value); debts, mortgage and education are survivor requirements belonging to the needs approach.
3. A. The Presbyterian Ministers' Fund of Philadelphia, chartered 1759, paid annuities to ministers' widows funded by the ministers' own premiums. B belongs to securities history, C to fire insurance a century earlier, D to a war a century later.
4. C. Lump-sum death benefits are generally income-tax-free to the beneficiary, so the full face amount is available for the family's needs. Interest earned on the money afterward is taxable — but that is not what was asked.
5. A. Decreasing term's face amount declines on a schedule matching the amortizing debt, with a level premium — insuring the loan and nothing more. Level term (B) fits income replacement; D runs the wrong direction.
6. B. Renewability waives evidence of insurability — never the price, which is recomputed at attained age. C is the exam's favorite too-good-to-be-true wrong answer, and D confuses renewal with conversion.
7. D. Term is pure protection, so every dollar buys current death benefit — the most coverage per premium dollar. It builds no cash value (A), has nothing to borrow against (B), and most term policies rightly expire unclaimed (C).
8. C. Conversion runs one way — term into permanent — and its whole value is the waiver of evidence; the new premium is attained-age (or original-age with back premiums). B defeats the feature's purpose, and A reverses its direction.
9. B. At maturity the guaranteed cash value has grown to equal the face amount, and the insurer pays it to the living policyowner (the insured endows). C pays the wrong party — the beneficiary collects only at death — and D is the forfeiture Elizur Wright outlawed.
10. A. Dividends return overpaid premium when the insurer's experience beats its assumptions — never guaranteed, and not income to the owner. The taxable piece is the interest earned on dividends left to accumulate, a distinction the other choices blur.

11. D. Limited-pay designs compress the paying period, not the coverage: the policy is paid up at 50 and protection continues for the whole of life. A is the classic trap — only the premiums end.
12. C. Benefit paid = face − loan − accrued interest: $\$400{,}000 - \$35{,}000 - \$1{,}500 = \$363{,}500$. B forgets the interest; A forgives the loan, which insurers never do.
13. A. Option B pays the face amount plus the cash value: $\$250{,}000 + \$42{,}000 = \$292{,}000$. B is Option A's level benefit — the two options are the exam's favorite swap.
14. B. The floor means no index loss is ever deducted — the credit is simply zero — but mortality and expense charges still come out, so cash value can decline and an underfunded policy can still lapse, which is why D overpromises.
15. C. Variable products are both insurance and securities — sold by prospectus from a separate account whose investment risk the policyowner bears — so both credentials are required. A life license alone is the planted wrong answer.
16. D. In a minimally funded UL, rising attained-age mortality charges can eventually outrun the thin cash value and the premium, exhausting the account. The whole life designs (A, B) carry contractual guarantees at their stated premiums, and C cannot lapse mid-term while premiums are paid.
17. A. The sponsor is the policyholder of the single master policy; each employee is a certificate holder who names his own beneficiary but owns no contract rights. B reverses the structure exactly.
18. B. The conversion right is 31 days, to permanent (not term) coverage, priced at attained age, with no evidence — and death within the window is paid by the group policy regardless. A has the wrong window and product; C defeats the right's purpose.
19. C. Credit life is decreasing term with the creditor as beneficiary, capped at the outstanding debt — the lender is made whole, never enriched, and the family's benefit is the extinguished loan. A and B pay the wrong party; D pays a debt that no longer exists.
20. D. Survivorship life pays once, at the second death — matching the estate-cost trigger — and its delayed benefit makes it cheaper than insuring either life alone. Joint life (A) pays at the first death, years before the need.

PORTFOLIO PIECE: THE LIFE POLICY SHELF

Assemble the five artifacts this unit built into one section of your Pathway File — a complete working shelf of the life insurance products: the Family Coverage Worksheet with its DIME and human life value columns and written recommendation (Lesson 3.1); the Term Shopper's Table with its premium curve and renewable/convertible guarantee box (Lesson 3.2); the Whole Life Ledger with its two-curve diagram, loan arithmetic and dividend wheel (Lesson 3.3); the Four Designs Chart comparing whole, universal, indexed and variable life with the worked UL month and indexed-credit calculator (Lesson 3.4); and the Group and Special Policies Sorter with your conversion-rights letter to Mr. Okafor (Lesson 3.5).

Add a one-page cover sheet titled "Which policy for which need?" in your own words: five pretend families, one line each, matched to a product from the shelf with a one-sentence reason — and a closing sentence on the agent's duty to fit the product to the need, citing 1 Timothy 5:8. Every figure on the shelf should be labeled as an example, and every page dated.

LOOK FOR	WHAT IT MEANS
Coverage worksheet	DIME and human life value are both computed correctly from the family's stated facts, resources in place are subtracted, and the recommendation cites the numbers.
Term and whole life pages	The premium curve, the renewable/convertible guarantees, the level-premium mechanism, loan arithmetic and all five dividend options are stated accurately with figures labeled as examples.
Four Designs Chart	Every cell is correct, the variable column shows owner-borne risk and the dual license (life plus FINRA Series 6 or 7), and the UL month and indexed credits compute correctly.
Group sorter and conversion letter	Master policy/certificate structure, participation percentages, the credit life cap and the 31-day conversion trio are all right, and the letter delivers all five facts in plain English a non-insurance reader follows.
Cover sheet	The five need-to-product matches are defensible, the reasoning is the student's own prose, and the Scripture is used honestly rather than decoratively.

3.1 Why Life Insurance: Needs, Human Life Value and the Ministers' Fund

OBJECTIVES

- Tell the story of the Presbyterian Ministers' Fund of 1759 and explain why life insurance began as provision for widows and orphans.
- Name the four jobs of a death benefit: income replacement, debt payoff, final expenses and legacy.
- Calculate a family's coverage need with the DIME method: debts, income, mortgage, education.
- Calculate a simplified human life value and credit the concept to Solomon Huebner in the 1920s.
- Contrast the needs approach with the human life value approach and explain why rule-of-thumb multiples are only starting points.

> **Warm-up.** In five minutes, with pencil and paper: imagine a father who earns the family's whole income dies tonight. List every bill and need his family would still face next month, next year and in ten years. Keep the list — by the end of the lesson you will see that you have just invented the needs approach.

WATCH

Life Insurance Exam [National] 21 – Human Life Value Concept Explained

Open Exam Prep · 4:11

https://www.youtube.com/watch?v=Dx8WAHyZ9qo

> **WHEN TO WATCH**
> Watch after reading the big idea; write the human life value recipe — earnings kept for the family, times working years remaining — in your notebook as the teacher builds it.

BACKUP VIDEO

How Much Life Insurance Do You REALLY Need? How to Calculate It 5 Ways

Insurance Prescription · 19:21

https://www.youtube.com/watch?v=vwj1O5IWdkc

A longer walk through five calculation methods including DIME and human life value; watch it before the project if you want to see the worksheet built on screen, and treat every dollar figure as an example.

KEY TERMS

death benefit (face amount)

The sum the insurer promises to pay the beneficiary at the insured's death, stated on the face page of the policy.

policyowner

The person who owns the contract and its rights — to name beneficiaries, take values and make changes — who may or may not be the insured.

insured

The person whose life the policy covers; the death benefit is paid at this person's death.

beneficiary

The person or entity the policyowner names to receive the death benefit.

income replacement

The chief job of life insurance: replacing the earnings a family loses when a breadwinner dies.

needs approach

A method that totals what the survivors will actually need — debts, income, mortgage, education, final expenses — and subtracts resources already in place.

DIME method

A needs-approach checklist that sums Debt, Income replacement for a chosen number of years, Mortgage balance and Education costs.

human life value approach

A method that measures the economic value of a life as the earnings the person would have provided the family over the remaining working years, discounted to present value.

final expenses

The last costs a death creates — funeral, burial, final medical bills and estate settlement — sometimes called cleanup costs.

legacy

Money intentionally left behind beyond needs — an inheritance, a gift to a church or school — which life insurance can create at the moment it is needed.

lump sum

A death benefit taken as one payment; generally received by the beneficiary free of income tax.

CORE IDEAS

The story. In colonial Pennsylvania, a Presbyterian minister earned little, saved less, and left a widow and children with almost nothing when he died — often turned out of the church-owned house within the year. The ministers knew it, and in 1759 they did something about it. Led by men like **Francis Alison**, a minister and one of the colonies' great educators, the Synod of Philadelphia obtained a charter for the Corporation for Relief of Poor and Distressed Presbyterian Ministers and of the Poor and Distressed Widows and Children of Presbyterian Ministers — mercifully remembered as the **Presbyterian Ministers' Fund**. It was the first life insurance corporation in America. A minister paid modest annual premiums during his

lifetime; at his death the fund paid his widow an annuity, year after year, in proportion to what he had paid in. The Episcopalians chartered a similar corporation ten years later, and these "widows' and orphans' corporations" fixed the character of American life insurance at its birth: not a bet on death, but organized provision for the people a death leaves behind.

How they figured it out. For a century and a half, families guessed at how much provision was enough. The man who replaced guessing with arithmetic was **Solomon S. Huebner**, a professor at the Wharton School in Philadelphia — the same city as the Ministers' Fund. In the 1920s Huebner taught a startling idea: a breadwinner's life has a measurable economic value, just as a building or a ship does, and it can be insured the same way. Add up the earnings a person will devote to his family over his remaining working years, discount them to today's dollars, and you have his **human life value** — the amount his death would actually remove from the household. Huebner pressed the idea so hard that he helped found a college to train agents in it, and the exam still tests his method by name. The industry later balanced it with the **needs approach**, which starts from the other end: not what the life was worth, but what the survivors will require.

The big idea. A death benefit has four jobs, and a good agent can name them in his sleep. First, **income replacement**: the family must eat next month and for years to come, so the benefit must stand in for the paycheck that stopped. Second, **debts**: car loans, credit cards and, above all, the mortgage, so the family keeps the house free and clear. Third, **final expenses**: funeral and burial, final medical bills, the costs of settling the estate — commonly a five-figure sum arriving in the worst possible week. Fourth, **legacy**: money deliberately left beyond the needs — education for children, an inheritance, a gift to a church. Everything else in this unit — term, whole life, universal, group — is merely a different way of funding these same four jobs. The product varies; the purpose does not.

The **needs approach** turns those four jobs into a worksheet, and the exam's favorite version is the **DIME method**. D is **Debt**: every balance other than the mortgage, plus final expenses. I is **Income**: the annual amount the family would need, times the number of years they would need it — commonly until the youngest child is grown, in this example ten to twenty years. M is **Mortgage**: the payoff balance, so the home is secure. E is **Education**: a chosen sum per child for training or college. Sum the four lines, then subtract what the family already has — existing policies, group

coverage at work, savings earmarked for these purposes — and the remainder is the coverage need. The needs approach is personal and concrete: two families with identical incomes can have very different answers, because they owe different debts and are raising different children.

The **human life value approach** comes at the question from the breadwinner's side. Take annual earnings; subtract taxes and the cost of the breadwinner's own upkeep — the share of income he spends on himself — to find what the family actually receives each year. Multiply by the working years remaining to retirement, and, in the full method, discount that stream to present value, since a dollar promised in twenty years is worth less than a dollar today. This course uses the simple multiplication and flags the discounting, which is how the licensing exam usually treats it. Notice what HLV ignores: it says nothing about debts, mortgages or the number of children. It measures the engine, not the load. That is both its elegance and its blindness, and the exam loves to ask which approach considers which facts.

You will also meet **rules of thumb** — "buy seven to ten times your income" is the one agents hear most, and in this example a $60,000 earner would carry $420,000 to $600,000. Treat multiples as a starting point for conversation, never as an answer. A single earner with no dependents may need far less; a young father with four children, a mortgage and a one-income household may need far more. The agent's craft — and, as Unit 9 will show, increasingly the agent's legal duty — is to ground the recommendation in the client's actual facts. A number copied from a slogan is not a needs analysis, and a family discovered underinsured at the worst moment is the profession's oldest failure.

On the exam today. State exams test this lesson as definitions and as contrasts. Know the parties cold: the **policyowner** holds the rights, the **insured** is the life covered, the **beneficiary** collects — one person can hold two of these roles, or all three roles can be split. Know the four jobs of the benefit and that a lump-sum death benefit is generally received income-tax-free. The classic trap pairs the two approaches: the **needs approach** is built on the survivors' requirements — debts, income, mortgage, education — while the **human life value approach** is built on the insured's earnings, years to retirement and a discount to present value. A question that slips "outstanding debts" into a human life value calculation, or "remaining working years" into a needs calculation, is testing whether you can keep the two recipes apart. You can.

PICTURE STUDY



The Widow's Mite (Le denier de la veuve), James Tissot, 1886–1894 · Opaque watercolor over graphite on paper · Brooklyn Museum, New York

Image: Wikimedia Commons, public domain

James Tissot was a fashionable French painter of Paris and London society who, after a religious awakening in 1885, spent the last decades of his life illustrating the Bible with hundreds of meticulous watercolors. Here he paints the widow of Mark 12 giving her two small coins at the Temple treasury — all that she had. The picture opens this lesson because the widow is the person this whole unit exists for: the ministers of 1759 built the first American life insurer precisely so that a pastor's widow would not be left with two coins and nothing more.

Look closely

- Find the widow. How does Tissot set her apart from the richly dressed men around her — in posture, in color, in light?
- Look at the great trumpet-mouthed offering chests. Why might Tissot make the treasury so large and the giver so small?
- Notice the onlookers. Who seems to see her, and who looks past her?
- Follow the light on the pavement. What does it touch, and what does it leave in shadow?

Talk about it

1. The widow gives out of her poverty. What does her situation tell you about what a breadwinner's death could mean for a family in a world without provision?
2. The Ministers' Fund of 1759 was built so widows would receive rather than beg. How is organized provision different from charity, and why might a family prefer it?
3. Jesus said this widow gave more than all the rich men (Mark 12:43–44). What does that teach about how God measures giving — and how should it shape the way an agent treats a small policy for a poor family?

PROJECT

The Family Coverage Worksheet

You will build the first artifact of this unit's Life Policy Shelf: a one-page coverage worksheet for a pretend family, computed both ways — DIME on the left, human life value on the right — with a written recommendation underneath. This is the arithmetic a working agent does before any policy is ever named, and the page anchors every lesson that follows: once you know the need is, in this example, $685,000, the question of *which policy* funds it becomes real.

You will need

- One sheet of paper ruled into two columns, or a single spreadsheet page
- Your exam notebook and calculator
- The III "How Much Life Insurance Do I Need?" page from the kit, for comparison when you finish

Steps

1. Invent the Mercer family and write their facts in a box at the top: breadwinner's age and income, spouse, number and ages of children, debts, mortgage balance, savings, and any group life at work. All pretend, all labeled "in this example."
2. Left column, DIME: write the four lines — Debt (plus final expenses), Income × years, Mortgage, Education — total them, then subtract resources in place. Box the remaining need.
3. Right column, HLV: earnings minus taxes and self-maintenance, times years to retirement. Box the result and write one line noting that discounting to present value would lower it.
4. Compare the two boxes. Write two sentences explaining why they differ — what each method counts that the other ignores.
5. Write a three-sentence recommendation to the Mercers stating a coverage amount and your reasoning, without naming any policy type yet.
6. Add a footer: "Figures are examples. A real family's numbers come from its own documents, and real policies from a licensed agent."

7. Date the page and file it as page one of your Life Policy Shelf.

EXAM NOTEBOOK

1. Make flashcards for every key term in this lesson — policyowner, insured and beneficiary each get their own card — and add them to the course box.
2. Draw the four jobs of a death benefit as four labeled pillars holding up a roof marked THE FAMILY: income, debts, final expenses, legacy.
3. Write a trap list titled “Needs vs. HLV”: needs = the survivors’ bills; HLV = the breadwinner’s earnings × years; the exam swaps their ingredients to catch you.

KEY FORMULAS

$$\text{HLV} \approx \text{annual earnings kept for the family} \times \text{working years remaining}$$
$$\text{DIME need} = \text{Debt} + (\text{Income} \times \text{years}) + \text{Mortgage} + \text{Education} - \text{resources in place}$$

From history. Ten years after the Presbyterians, the Anglican clergy chartered their own “Corporation for the Relief of Widows and Children of Clergymen” in 1769, and the two Philadelphia funds operated side by side for generations — the Presbyterian fund survived, under changing names, for more than two centuries. Early Americans called such ventures “pious corporations,” and their charters spoke of relief and provision, not profit: the vocabulary of American life insurance was religious before it was commercial.

Example 1. A 35-year-old earns $60,000 a year. In this example, taxes and his own upkeep absorb $15,000, and he plans to retire at 65. Estimate his human life value by the simplified method.

Show solution

1. Earnings kept for the family each year: $\$60{,}000 - \$15{,}000 = \$45{,}000$.
2. Working years remaining: $65 - 35 = 30$.
3. Simplified HLV: $\$45{,}000 \times 30 = \$1{,}350{,}000$.
4. The full method would discount those future dollars to present value, which lowers the figure — the exam usually asks only for the recipe and whose facts it uses: the breadwinner's earnings and years, not the family's bills.

Answer: About $1,350,000 before discounting. Human life value measures the earnings the death removes, not the debts the family owes.

Example 2. The Carters: debts and final expenses $25,000; the family needs $50,000 a year for 10 years; mortgage payoff $180,000; education fund $40,000 for each of two children. Mr. Carter has $100,000 of group life at work. In this example, find the DIME need.

Show solution

1. D — Debt and final expenses: $\$25{,}000$.
2. I — Income: $\$50{,}000 \times 10 = \$500{,}000$.
3. M — Mortgage: $\$180{,}000$.
4. E — Education: $2 \times \$40{,}000 = \$80{,}000$.
5. Total need: $\$25{,}000 + \$500{,}000 + \$180{,}000 + \$80{,}000 = \$785{,}000$.
6. Subtract coverage in place: $\$785{,}000 - \$100{,}000 = \$685{,}000$.

Answer: $685,000 of additional coverage. The needs approach always ends by subtracting resources already in place.

Example 3. Exam style. Which fact matters to the human life value approach but NOT to the needs approach?

A. The balance of the family's mortgage

B. The number of years until the insured's retirement

C. The cost of the children's education

D. The family's outstanding car loan

Show solution

1. Sort each choice by whose facts it describes: the survivors' requirements (needs) or the breadwinner's earning power (HLV).
2. A, C and D are all survivor requirements — the M, E and D of the DIME worksheet. They belong to the needs approach.
3. B describes the earning engine: years remaining to retirement multiply annual earnings in the human life value calculation.
4. The trap is reading too fast and picking any money-sounding fact; the question turns entirely on which recipe uses it.

Answer: B. Human life value is earnings kept for the family times working years remaining (discounted); debts, mortgage and education belong to the needs approach.

PRACTICE

1. Easy Name the four jobs of a death benefit.

   Show answer

   Income replacement, payment of debts, final expenses and legacy — every policy in this unit is a different way of funding these same four.

2. Easy What do the four letters of DIME stand for?

   Show answer

   Debt, Income (annual need times years), Mortgage and Education — the exam's favorite needs-approach checklist.

3. **Easy** Who founded the first life insurance corporation in America, and when?

Show answer

Philadelphia's Presbyterian ministers, chartered in 1759 — the Presbyterian Ministers' Fund, built to provide for ministers' widows and orphans.

4. **Medium** A 40-year-old earns $80,000; in this example $20,000 goes to taxes and his own upkeep, and he will retire at 65. Compute his simplified human life value.

Show answer

$(\$80{,}000 - \$20{,}000) \times 25 = \$1{,}500{,}000$. Discounting to present value would lower it.

5. **Medium** Which approach to measuring life insurance need starts from the survivors' requirements?

A. Human life value
B. The needs approach
C. The rule-of-thumb multiple
D. The attained-age method

Show answer

B. The needs approach totals what the family will require — debts, income, mortgage, education — and subtracts resources in place. HLV starts from the breadwinner's earnings, and D is a pricing idea from term insurance, not a needs method.

6. **Medium** In a policy a wife buys on her husband's life, naming their daughter to collect, identify the policyowner, the insured and the beneficiary.

Show answer

The wife is the policyowner (she holds the contract rights), the husband is the insured (the covered life), and the daughter is the beneficiary (she receives the death benefit).

7. Medium Why did Solomon Huebner say a human life could be insured like a building or a ship?

Show answer

Because a breadwinner's life has a measurable economic value — the stream of earnings devoted to the family over the remaining working years, discounted to present value — and a measurable value can be insured against loss.

8. Hard A family needs $45,000 a year for 12 years, owes $18,000 of debts and final expenses and a $150,000 mortgage, and wants $60,000 for education. They hold $250,000 of existing coverage. In this example, find the DIME need.

Show answer

$\$18{,}000 + (\$45{,}000 \times 12) + \$150{,}000 + \$60{,}000 = \$768{,}000$; minus $250,000 in place leaves $518,000 of additional need.

9. Hard Two breadwinners each earn $70,000 and are the same age. One has four children and a mortgage; the other is single with no debts. Which method would give them identical coverage figures, and why is that a weakness?

Show answer

The human life value approach — it looks only at earnings and working years, so identical earners get identical answers. It is blind to the load the earnings carry, which is exactly what the needs approach measures.

10. Hard A death benefit of $500,000 is paid to a widow as a lump sum. How is it generally treated for income tax, and why does that matter to needs planning?

Show answer

A lump-sum death benefit is generally received free of income tax, so the full face amount is available for the four jobs — the planner does not need to gross the figure up for taxes (interest earned on the money afterward is taxable).

11. **Challenge** An agent tells every client, "Just buy ten times your income." Using the Carters from the worked example (need $685,000 on a $50,000 income need — breadwinner earning $60,000), show what the rule would recommend and write two sentences on the danger of the shortcut.

Show answer

Ten times $60,000 is $600,000 — $85,000 short of the family's computed need. A multiple ignores this family's mortgage, children and existing coverage; a different family might be oversold by the same slogan. The recommendation must come from the client's facts.

12. **Challenge** The Ministers' Fund of 1759 paid widows annuities in proportion to premiums their husbands had paid. Write three sentences connecting that design to 1 Timothy 5:8 and to the modern agent's work.

Show answer

Scripture charges a man to provide for his own house, and the Fund let a minister obey that charge beyond his own lifetime — his premiums became his widow's income. The design was provision, not charity: the husband earned the benefit for his family in advance. The modern agent continues the same work, helping a breadwinner turn present earnings into a promise that outlives him.

COMMON MISTAKES

- Mixing the recipes: putting debts and the mortgage into a human life value calculation, or working years to retirement into a needs calculation — each fact belongs to one method only.
- Forgetting the last step of the needs approach: subtract existing coverage, group life and earmarked savings before stating the need.
- Confusing the three parties — the policyowner holds the rights, the insured is the covered life, the beneficiary collects — when one person can hold any two of the roles.
- Treating a rule-of-thumb multiple as a needs analysis; exams and regulators both expect recommendations grounded in the client's actual facts.
- Assuming a lump-sum death benefit is taxed as income to the beneficiary — it is generally income-tax-free, though interest earned on it afterward is taxable.

- Forgetting to count the breadwinner's self-maintenance: human life value uses earnings kept for the family, not gross salary.

Make it a game · DIME Dash. Write the facts of three pretend families on three cards — income, years of need, debts, mortgage, education, existing coverage — keeping the numbers round. Deal one card to each player (parents and siblings welcome). On "go," everyone computes their family's DIME need; first correct total read aloud wins the round, and the checker verifies with a calculator. Then round two: everyone computes simplified human life value for the same family (invent an upkeep figure) and the table must say in one sentence why the two answers differ. Rotate cards and play three rounds. Fastest correct arithmetic takes the game, but a wrong total costs the round even if it was fastest.

Scripture. "But if any provide not for his own, and specially for those of his own house, he hath denied the faith, and is worse than an infidel." (1 Timothy 5:8, KJV)

Paul makes provision for one's household a duty of faith itself, not an optional kindness. The ministers of 1759 read this verse and built an institution so a man's provision could outlive him; a needs analysis done honestly is the same obedience with arithmetic attached.

3.2 Term Life: Renting the Promise

OBJECTIVES

- Define term life insurance as pure death protection for a stated period, with no cash value.
- Distinguish level, decreasing and increasing term, and explain annually renewable term.
- State what the renewable feature guarantees and why renewal premiums are set at attained age.
- State what the convertible feature guarantees and compare original-age with attained-age conversion.
- Explain why decreasing term pairs naturally with a mortgage, and name term's expiry problem honestly.

> **Warm-up.** In five minutes, with pencil and paper: your family rents a house for $1,200 a month. After ten years of rent, how much has been paid, and what does the family own of the house? Write one sentence on why renting can still be exactly the right choice — then keep the page, because term insurance is going to work the same way.

WATCH

Term Life Insurance - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 15:26

https://www.youtube.com/watch?v=8ycFTl6uf3k

> **WHEN TO WATCH**
> Watch after the core ideas; every time the teacher names a term variety or feature — level, decreasing, renewable, convertible — pause and write its one-line promise in your notebook.

BACKUP VIDEO

Term Vs Whole Life on the Insurance Exam

Insurance Exam Queen · 5:32

https://www.youtube.com/watch?v=SqHESfo03Ek

A quick exam-focused contrast of this lesson and the next; watch it after finishing the core ideas to preview how test questions pit the two products against each other.

term life insurance

Pure death protection for a stated period; the benefit is paid only if the insured dies within the term, and the policy builds no cash value.

level term

Term insurance whose face amount stays constant for the whole period, commonly sold with premiums level for 10, 20 or 30 years.

decreasing term

Term insurance whose face amount declines over the period while the premium stays level — the classic match for a shrinking mortgage balance.

increasing term

Term insurance whose face amount grows over the period, usually sold as a rider such as return of premium or cost-of-living coverage.

annually renewable term (ART)

One-year term that renews each year without evidence of insurability, at a premium that increases with the insured's attained age.

renewable

A term feature guaranteeing the right to renew at the end of the period without new evidence of insurability, with the premium based on attained age.

convertible

A term feature guaranteeing the right to exchange the policy for permanent insurance without evidence of insurability, within a stated time.

attained age

The insured's age at the time of renewal or conversion; using it makes the new premium higher but requires no medical proof.

original age (retroactive) conversion

Conversion priced as if the permanent policy had begun at the term policy's issue age, requiring payment of the back premium difference.

evidence of insurability

Proof of health, habits and occupation an insurer normally requires before issuing or increasing coverage — exactly what renewable and convertible features let the insured skip.

reentry (requalification)

A term pricing design letting the insured prove good health at renewal to earn a lower select rate instead of the guaranteed higher one.

CORE IDEAS

The story. In the spring of 1917 the United States entered the First World War, and millions of young men suddenly needed what no prudent insurer would cheaply sell them: life insurance for soldiers sailing toward the trenches. Congress answered on October 6, 1917, with the War Risk Insurance Act amendments, and the Treasury began offering every soldier and sailor up to $10,000 of government life insurance — plain **yearly renewable term**, no war exclusion, premiums a private could afford. The men bought it at a rate that astonished everyone: by the war's end more than four million servicemen carried roughly forty billion dollars of coverage, then the largest block of life insurance on earth. And the law contained a quiet promise that teaches this lesson's biggest idea: after the war, a veteran could **convert** his term policy into permanent government insurance — whole life and endowment forms — without proving his health. Men who came home gassed or wounded, men no company would newly insure, kept their protection because the conversion right had been bought in advance.

How they figured it out. The war policies worked because actuaries had already solved term insurance's two mechanical problems. First, how do you price a one-year promise? Charge roughly the cost of that year's death risk — cheap at 25, dearer every year after, which is why **annually renewable term** premiums climb with **attained age.** Second, how do you protect a man whose health fails from losing coverage just when he finally cannot replace it? Sell the guarantees in advance: a **renewable** policy locks in the right to continue without fresh **evidence of insurability**, and a **convertible** policy locks in the right to exchange term for permanent insurance, again without evidence. The insured pays the new premium for his age — the guarantee is of insurability, never of price — but the underwriter's door can no longer be shut in his face. Those two features turned term from a gamble on staying healthy into a genuine plan.

The big idea. Term life insurance is pure protection: the insurer promises the face amount if the insured dies within the stated term, and nothing if he outlives it. There

is no cash value, no savings element, nothing to borrow against — which is precisely why it is inexpensive. A healthy young adult can, in this example, rent a $500,000 promise for a few hundred dollars a year, pennies per thousand of protection. The analogy the industry itself uses is renting: rent buys full use of the house while you pay, builds no equity, and ends when you stop. Renting is not foolish — it is often exactly right for a season of life when needs are huge and dollars are few, which describes nearly every young family. The agent's job is to know the season, not to sneer at the product. The licensing exam is strictly neutral about term versus permanent, and so is this course.

Term comes in three shapes, named by what the face amount does. **Level term** keeps the face constant — a $300,000 promise in year one and in year twenty — and is the common form for income replacement, sold with premiums leveled over 10-, 20- or 30-year periods. **Decreasing term** starts at the full face and slides toward zero while the premium stays level; it exists because some needs shrink on a schedule, above all a mortgage. A family owing $180,000 this year will owe less every year, so a policy that tracks the balance downward insures the debt and nothing more — this is why decreasing term is the skeleton of mortgage protection and, next unit's cousin, credit life. **Increasing term** grows over time and is rarely sold alone; it lives inside riders — a return-of-premium benefit or cost-of-living coverage — where a rising benefit is wanted. Under them all sits **annually renewable term**, the one-year building block whose rising premium curve explains every other design.

The two great features deserve exact language, because the exam tests their edges. **Renewable** means the insured may continue coverage at the end of the term — year by year in ART, or period by period in longer forms — without new evidence of insurability, paying the premium for his attained age. **Convertible** means the insured may exchange the term policy for a permanent one the insurer offers, without evidence, within the window the contract states. Conversion is normally priced at attained age; a few contracts offer **original-age** conversion, which prices the permanent policy as if issued back at the start — a lower ongoing premium bought by paying the difference in back premiums. Memorize the shared heart of both features: no new underwriting. The insured who developed heart disease in year eight of a ten-year renewable and convertible policy holds rights his health could never buy on the open market.

Honesty requires naming term's weakness as plainly as its strength. The premium that is trivial at 25 is serious at 55 and crushing at 75 — in this example, a rate of $0.90 per thousand at 25 might be $9 per thousand at 60 and many times that at 80 — because the price tracks the real probability of death. Most term policies therefore lapse or expire without ever paying a claim; the family outlives the term, which is, after all, the happy outcome. But a need that proves permanent — final expenses, a dependent who will never be self-supporting, a legacy intention — eventually outlasts any term. That is the **expiry problem**, and it is why the conversion feature matters and why the next lesson's product exists. Term answers temporary needs superbly; it merely cannot be made to stay.

On the exam today. Expect a cluster of questions here, and expect the traps to be definitional. Trap one: renewable and convertible both waive *evidence of insurability*, not the new premium — any answer promising renewal "at the original premium" is wrong. Trap two: which term form fits a mortgage? Decreasing term, because the need itself decreases; level term fits income replacement. Trap three: term's nature — no cash value, no loan value, pure protection; a question crediting term with "tax-deferred cash value growth" has swapped products on you. Trap four: ART premiums increase annually with attained age even though the face stays level. And the comparison question beloved of every state: for the same premium, term buys the largest immediate death benefit of any form — that is its glory — while providing it only for a time — that is its limit.

PICTURE STUDY



A Helping Hand, Émile Renouf, 1881 · Oil on canvas · National Gallery of Art, Washington (Corcoran Collection)

Image: Wikimedia Commons, public domain

Émile Renouf painted the harbors and working people of Normandy, and this picture of an old fisherman letting a little girl believe she is pulling the great oar became one of the most beloved images of its century. It opens the term-life lesson because it shows a season of life: small hands that cannot yet pull their own weight, and a strong hand quietly carrying the load beside them. Term insurance exists for exactly those years — the stretch when children depend wholly on a breadwinner's strength, and the family needs the largest possible promise at the smallest possible price until the small hands grow.

Look closely

- Look at the two pairs of hands on the one oar. Whose strength is actually moving the boat?
- Study the man's face and the girl's. What is each one thinking about the work?
- Notice the size of the oar and the boat against the two figures. How does Renouf make the sea feel like a real place of labor and risk?
- Find the details of the fisherman's trade — nets, planks, worn clothes. What do they say about how this family earns its bread?

Talk about it

1. The girl's help is mostly borrowed strength. For how many years is a child in that position, and what happens to a family if the strong hand is lost during them?
2. Why might a policy that lasts exactly through the child-raising years — and then ends — be an honest fit for a family like this one?
3. The fisherman carries the load without announcing it. How is quiet, planned-for provision a form of love — and what does it imitate in the way God provides for His children?

PROJECT

The Term Shopper's Table

You will build the second artifact of the Life Policy Shelf: a one-page comparison table showing how term premiums behave across ages and designs, using this course's example rates. Working agents keep exactly this picture in their heads — the shape of the curve matters more than any single number on it — and drawing it yourself fixes the shape for good.

You will need

- One sheet of paper or a single spreadsheet page
- Your exam notebook and calculator
- The example rate line from this lesson: $0.90 per $1,000 at 25, $1.40 at 35, $3.20 at 45, $9.00 at 60 — all labeled "in this example"

Steps

1. Rule a table: ages 25, 35, 45 and 60 across the top; face amounts $250,000 and $500,000 down the side.
2. Fill every cell with the annual premium using the lesson's formula — rate per thousand times thousands of face — showing one computation in the margin as your proof of method.
3. Below the table, sketch the premium curve: age across, premium up. Mark where it is gentle and where it turns steep, and label the steep end "the expiry problem."
4. Add a three-row feature box defining level, decreasing and increasing term, each with the one need it fits best (income, mortgage, rider benefits).
5. Add a two-line guarantee box: RENEWABLE = continue without evidence, attained-age premium; CONVERTIBLE = exchange for permanent without evidence.
6. Write a three-sentence recommendation for the Mercer family from Lesson 3.1's worksheet: which term design, what period, and why — citing their need figure.

7. Footer the page “Rates are course examples, not quotes,” date it, and file it in the Life Policy Shelf.

EXAM NOTEBOOK

1. Make flashcards for level, decreasing, increasing and annually renewable term, each with its matching need on the back, and cards for renewable and convertible with the phrase “no new evidence — attained-age price.”
2. Draw the decreasing-term picture: a mortgage balance sliding down a 15-year slope with the policy’s face amount sliding down beside it, premiums level underneath.
3. Write a trap list titled “What term is NOT”: no cash value, no loans, no guaranteed old price at renewal, no coverage after the term — and most policies rightly never pay.

KEY FORMULAS

$$\text{annual premium} = \text{rate per } \$1{,}000 \times \frac{\text{face amount}}{\$1{,}000}$$

From history. The government stayed in the insurance business the war began: veterans’ term policies converted into United States Government Life Insurance, and Washington serviced those contracts for decades — a handful remained in force into the twenty-first century. The wartime lesson stuck in the private market too, and a Massachusetts experiment of 1907 had already pointed the same direction: savings-bank life insurance, championed by the lawyer Louis Brandeis, sold simple low-cost policies over bank counters to working families.

WORKED EXAMPLES

Example 1. In this example, a 10-year level term rate is $0.90 per $1,000 at age 25 and $3.20 per $1,000 at age 45. Find the annual premium for $400,000 of coverage at each age.

Show solution

1. Thousands of face: $\$400{,}000 \div \$1{,}000 = 400$.
2. At 25: $\$0.90 \times 400 = \$360$ per year.
3. At 45: $\$3.20 \times 400 = \$1{,}280$ per year.
4. Same promise, same company, one variable changed: the age-driven probability of death. This curve — gentle young, steep old — is the whole economics of term insurance.

Answer: $360 at 25 and $1,280 at 45, in this example. Term is astonishingly cheap young and relentlessly dearer with age.

Example 2. The Yoders owe $150,000 on a 15-year mortgage. An agent proposes 15-year decreasing term with an initial face of $150,000. In this example, around year 8 the mortgage balance is about $85,000. Walk through how the policy behaves and why this design fits.

Show solution

1. At issue, face and debt match: $150,000. If Mr. Yoder dies in year one, the benefit retires the whole mortgage.
2. The face amount declines on the policy's schedule, roughly tracking the amortizing balance; near year 8 both sit in the neighborhood of $85,000.
3. The premium, meanwhile, stays level for the whole 15 years — a level price for a shrinking benefit is what makes decreasing term inexpensive.
4. At year 15 the mortgage is paid, the need is gone, and the policy expires with it. Nothing was wasted: the family was never exposed, and never paid for coverage it no longer needed.

Answer: Decreasing term mirrors a shrinking debt: face falls with the balance, premium stays level, and coverage ends when the need ends — the textbook mortgage-protection design.

Example 3. Exam style. At the end of his 10-year renewable and convertible term policy, Daniel, now 42 and recently diagnosed with diabetes, wants to keep coverage. Which statement is TRUE?

A. He may renew only if he provides current evidence of insurability

B. He may renew without evidence, at the premium for his attained age

C. He may renew without evidence, at his original age-32 premium

D. He must convert to permanent insurance to keep any coverage

Show solution

1. Name the feature in play: renewability, whose promise is renewal without new underwriting.
2. A contradicts the feature — evidence is exactly what renewability waives.
3. C promises the old price; renewability guarantees insurability, never premium, so renewal is priced at attained age 42.
4. D invents a requirement; conversion is a separate right he may use, not a condition of continuing.
5. B states the rule precisely: no evidence, attained-age premium.

Answer: B. Renewable means no new evidence of insurability; the price, however, is the attained-age premium — the exam's favorite pairing in this lesson.

PRACTICE

1. Easy What does term life insurance promise, and what does it build?

   Show answer

   The face amount if the insured dies within the stated term — pure protection. It builds no cash value, which is why it is the least expensive form per dollar of coverage.

2. Easy Which term design fits a mortgage, and why?

   Show answer

   Decreasing term: its face amount declines on a schedule roughly matching the shrinking loan balance, so the family insures the debt and nothing more.

3. **Easy** In this example, the rate is $1.40 per $1,000 at age 35. Find the annual premium for $250,000 of level term.

Show answer

$1.40 \times 250 = \$350$ per year.

4. **Medium** What exactly does the renewable feature guarantee, and what does it NOT guarantee?

Show answer

It guarantees the right to continue coverage without new evidence of insurability. It does not guarantee the premium, which is recalculated at the insured's attained age.

5. **Medium** A policyowner converts her term policy to whole life using original-age conversion. Compared with attained-age conversion, what does she pay and what does she get?
A. A lump sum of back premium differences; the lower issue-age premium going forward
B. Nothing extra; the lower issue-age premium going forward
C. A higher ongoing premium; no lump sum
D. New medical underwriting; the attained-age premium

Show answer

A. Original-age (retroactive) conversion prices the permanent policy as if issued at the term policy's start — she pays the difference in past premiums and then enjoys the lower issue-age rate. B ignores the cost; C describes attained-age conversion; D contradicts conversion itself, which never requires evidence.

6. **Medium** Why do annually renewable term premiums rise every year even though the face amount is level?

Show answer

Because each year's premium prices that year's probability of death at the insured's attained age, and mortality rises with age — the premium tracks the risk, not the face.

7. Medium Increasing term is rarely bought as a standalone policy. Where does it usually appear?

Show answer

Inside riders — a return-of-premium benefit or cost-of-living coverage — wherever a benefit that grows over time is wanted on top of a base policy.

8. Hard In 1917 Congress sold soldiers yearly renewable term with a postwar conversion right. Explain why the conversion right, not the low price, was the feature that mattered most to a wounded veteran.

Show answer

A veteran who came home with ruined health was uninsurable on the open market at any price. Conversion let him exchange term for permanent insurance without evidence of insurability, so the protection his health could no longer buy was preserved by a right purchased while he was still healthy.

9. Hard A 30-year-old buys 20-year level term for income protection and also carries 15-year decreasing term on his mortgage. At year 16, what coverage remains, and what has each policy cost him in "wasted" premium if he is alive?

Show answer

The decreasing term has expired with the paid-off mortgage; the level term still has four years of full face remaining. Nothing was wasted: each premium bought real protection during the year it covered — insurance pays for certainty, not only for claims.

10. Hard For the same annual premium, why does term always buy a larger immediate death benefit than whole life — and what is the honest other half of that sentence?

Show answer

Every term dollar buys current death protection only, with no cash value or lifelong guarantee to fund, so protection per dollar is maximized. The other half: the protection is temporary, and its price rises steeply if continued into old age.

11. **Challenge** Using this lesson's example rates ($0.90 per thousand at 25; $9.00 at 60), compare the annual cost of $300,000 at each age, and write two sentences a fair-minded agent could say to a 25-year-old about what the comparison does and does not prove.

    Show answer

    At 25: $\$0.90 \times 300 = \$270$; at 60: $\$9.00 \times 300 = \$2{,}700$ — ten times the price in this example. It proves term protection is remarkably cheap in the young years when needs peak; it does not prove term is right for every need, because a need that lasts to old age will meet this same curve at its steep end.

12. **Challenge** James 4:14 calls life "a vapour, that appeareth for a little time, and then vanisheth away." Write three sentences connecting the verse to why a young, healthy breadwinner buys term insurance at all.

    Show answer

    The verse denies anyone knowledge of tomorrow — health and youth are not promises. Term insurance is the honest response priced for a season: a small cost that admits the vapor may vanish early, and provides for the family if it does. Buying it is not morbid but humble — planning that takes God's word about uncertainty seriously.

COMMON MISTAKES

- Writing that renewable or convertible features guarantee the old premium — both waive evidence of insurability only; the new premium is computed at attained age (or bought back in an original-age conversion).
- Matching level term to a mortgage: the mortgage need shrinks, so decreasing term is the fit; level term fits income replacement.
- Crediting term with cash value or loan values — term is pure protection, and any such answer choice has quietly switched to whole life.
- Thinking ART's rising premium means the coverage is shrinking; the face stays level while the price tracks attained-age mortality.
- Calling conversion a move from permanent to term — it runs one way only, term into permanent.
- Saying a term policy that expires unclaimed "wasted" the premiums; each premium purchased that year's real protection.

Make it a game · Renting or Owning?. Write a dozen scenario slips: a 26-year-old with a new baby and a 30-year mortgage; a grandfather wanting money for his funeral whenever it comes; a family insuring a 15-year car-and-student-loan stack; a healthy 40-year-old whose term ends next month after a cancer diagnosis. A reader draws each slip; players race to call the fitting answer — LEVEL TERM, DECREASING TERM, ART, CONVERT IT, or NOT TERM (a permanent need) — and must add one reason in one breath. One point per correct call-plus-reason; the reader's rate card settles disputes. Ten slips a round; writing a tricky new slip for the next round earns a bonus point.

Scripture. "Whereas ye know not what shall be on the morrow. For what is your life? It is even a vapour, that appeareth for a little time, and then vanisheth away." (James 4:14, KJV)

James humbles every plan with the truth that tomorrow is not ours to promise. Term insurance is arithmetic built on this verse: it prices the possibility that the vapor vanishes early, so that humility about the morrow becomes provision for the household rather than mere worry.

3.3 Whole Life: The Promise That Endures

OBJECTIVES

- Tell the story of Elizur Wright, the London policy auction of 1844 and the Massachusetts nonforfeiture law of 1861.
- Explain the level-premium mechanism: overpaying early to build the reserve that funds lifelong coverage.
- Describe guaranteed cash value, its tax-deferred growth, and policy maturity at age 100 or 121.
- Compare ordinary (straight) whole life, limited-pay designs and single-premium whole life.
- Define participating policies, state why dividends are generally not taxable, and name the five classic dividend options plus the policy loan right.

> **Warm-up.** In five minutes, with pencil and paper: an insurer must charge enough over a customer's whole life to cover a death that is certain to happen someday. If the honest yearly cost of coverage at 80 is enormous, how could a company charge a 30-year-old the SAME premium every year for life and still survive? Write your best guess in two sentences — you are about to meet the level-premium idea.

WATCH

Understanding Whole Life Insurance for the Insurance Exam

Insurance Exam Queen · 8:59

https://www.youtube.com/watch?v=Yc07o9t3rT4

> **WHEN TO WATCH**
> Watch after the core ideas; sketch the two curves she describes — level premium and rising cash value meeting the face at maturity — in your notebook while she talks.

BACKUP VIDEO

Whole Life Insurance - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 9:00

https://www.youtube.com/watch?v=9bfCbhoJ-i8

A second teacher's pass through the same ground; watch it before the practice set if the dividend options or the limited-pay designs are still blurring together.

KEY TERMS

whole life insurance

Permanent insurance with a level premium and a guaranteed death benefit for the insured's entire life, building guaranteed cash value that equals the face amount at maturity.

level premium

A premium that stays the same for the life of the policy: higher than the pure cost of protection in early years, lower in later years, with the early excess funding the reserve.

cash value

The policy's guaranteed living value, growing on a schedule in the contract, tax-deferred, available through loans or surrender.

maturity (endowment) age

The age — 100 on older policies, 121 under the 2001 mortality table — at which cash value equals the face amount and the insurer pays the policyowner.

ordinary (straight) whole life

Whole life with premiums payable for the insured's entire life, giving the lowest level premium of the permanent designs.

limited-pay whole life

Whole life whose premiums are compressed into a stated period — 20-pay, or paid-up at 65 — after which the policy is paid up but coverage continues for life.

single-premium whole life

Whole life purchased with one lump-sum payment, immediately paid up and immediately rich in cash value.

participating (par) policy

A policy that shares in the insurer's favorable experience through dividends; nonparticipating policies pay none.

policy dividend

A non-guaranteed return of excess premium paid on participating policies — and, as a return of the policyowner's own money, generally not taxable.

dividend options

The five classic elections: cash, reduction of premium, accumulation at interest, paid-up additions, and one-year term insurance.

policy loan

The owner's right to borrow against cash value; unpaid loans and interest reduce the death benefit, and a loan exceeding the cash value can lapse the policy.

paid-up policy

A policy on which no further premiums are owed while coverage continues — the state every limited-pay design reaches at the end of its paying period.

CORE IDEAS

The story. In 1844 a Yankee mathematician named **Elizur Wright** visited the Royal Exchange in London and watched something that changed American insurance: an auction of life insurance policies. Old men who could no longer afford their premiums stood by while speculators bid on their contracts — the buyer would pay the remaining premiums and collect the face amount when the old man died. Every lapsed policy sold there had been overpaid for years; the companies had quietly pocketed the excess and the policyholder, missing one premium, forfeited everything. Wright went home to Massachusetts outraged. He mastered actuarial mathematics, computed what every policy was actually worth, and in 1858 became one of the state's first insurance commissioners — the exam's "father of life insurance regulation." He forced companies to hold mathematically computed **reserves** for every policy, and in 1861 he won the first **nonforfeiture law**: a lapsing policyholder keeps the value he has built. That value has a name you will use for the rest of this course: cash value.

How they figured it out. Wright's arithmetic exposed the engine inside whole life insurance: the **level premium**. The true yearly cost of insuring a life rises relentlessly with age — trivial at 30, enormous at 85 — and death is eventually certain, so year-by-year pricing must someday become unpayable. The level-premium solution averages a lifetime of rising costs into one flat annual price. In the early years the policyowner pays more than his protection costs; the excess, improved at interest, builds the policy's **reserve**. In the late years he pays far less than his protection costs, and the reserve makes up the difference. The reserve is a liability of the insurer and belongs to the mathematics of the contract; the policyowner's share of that buildup appears in his contract as scheduled, guaranteed **cash value**. Wright's point in 1861 was moral arithmetic: the early overpayments are the policyholder's own money, and lapsing must not forfeit them.

The big idea. Whole life insurance makes three guarantees no term policy makes. The **death benefit is permanent**: cover the premium and the face amount will be paid whether the insured dies at 40 or at 95 — the promise cannot expire. The **premium is level**: fixed at issue age, never raised, which is why buying young locks in a lifetime price. And the **cash value is guaranteed**: a schedule printed in the contract shows its growth year by year, tax-deferred, until at the **maturity age** — 100 on older contracts, 121 under the 2001 mortality table — the cash value equals the face amount and the insurer pays the living policyowner. Between issue and maturity the owner can reach the value by surrendering the policy or borrowing against it. Whole life costs several times what term costs per thousand at young ages, because it is doing a different job: term rents protection for a season; whole life owns a promise that endures.

The design comes in three paying plans. **Ordinary (straight) whole life** spreads premiums over the insured's entire life — the lowest level premium, payable to maturity or death. **Limited-pay whole life** compresses the same lifetime of premiums into a stated stretch: a **20-pay** policy is paid up after twenty years, a **paid-up-at-65** policy when the insured turns 65 — after which no premium is ever owed again while coverage continues for life. Compressing payments raises each premium and builds cash value faster. At the far end of compression stands **single-premium whole life**: one check, immediately paid up, immediately heavy with cash value — and, as Lesson 4.5 will warn, taxed under special rules as a modified endowment contract. The design choice is a cash-flow question: who should pay, for how long, during which earning years? A farmer expecting lean retirement decades might choose paid-up-at-65; a grandparent endowing a grandchild's policy might pay once.

Participating policies, sold classically by mutual insurers, add a yearly grace note: **dividends**. The company prices premiums conservatively; when actual mortality, expenses and investment earnings beat the assumptions, it returns the excess to par policyowners. Two exam facts are non-negotiable. Dividends are **never guaranteed** — an agent who promises them has misrepresented the policy. And they are generally **not taxable**, because the law treats them as a return of the policyowner's own overpaid premium, not as income. The five classic **dividend options**: take **cash**; apply to **reduce the premium**; leave to **accumulate at interest** (the interest, unlike the dividend, is taxable); buy **paid-up additions** — small fully-paid slices of extra whole life that themselves grow value and earn dividends; or buy **one-year term**

insurance, often up to the policy's cash value. Memorize all five with their initials — the exam asks them by name.

The living values have plumbing. A **policy loan** lets the owner borrow up to the cash value from the insurer, with the policy itself as collateral — no credit check, no fixed repayment schedule, interest at the contract rate. The loan need never be repaid in cash: at death the insurer simply deducts the outstanding loan and accrued interest from the face amount, in this example paying $\$500{,}000 - \$42{,}000 = \$458{,}000$. One danger deserves respect: if loan plus interest ever exceeds the cash value, the policy can lapse — and Unit 4 will add that a lapse with a large loan can create taxable income. Surrendering the policy ends coverage and pays the cash value, with gain above premiums paid taxed as income. These living rights are whole life's second nature: the same contract is protection to the beneficiary and a disciplined, guaranteed accumulation to the owner.

On the exam today. State exams adore this lesson's contrasts. Premium order among designs insuring the same face at the same age: single premium highest per payment, then 20-pay, then paid-up-at-65, then ordinary whole life cheapest per year — and the compressed designs build cash value fastest. Know that a limited-pay policy's *coverage* is still for the whole of life; only the *paying period* is limited — the exam plants "coverage ends at 65" as a trap. Know maturity: cash value equals face at age 100 or 121 and is paid to the policyowner. On dividends: not guaranteed, not taxable (return of premium), but interest earned on accumulated dividends is taxable — a three-part distinction the exam tests endlessly. On loans: unpaid loans reduce the death benefit, and only a loan exceeding cash value lapses the policy. And the old reliable: which option buys additional insurance with no evidence of insurability? Paid-up additions.

PICTURE STUDY



The Angelus, Jean-François Millet, 1857–1859 · Oil on canvas · Musée d'Orsay, Paris

Image: Wikimedia Commons, public domain

Jean-François Millet, the painter of French peasant life, shows two field workers pausing at dusk as the distant church bell rings the Angelus prayer. Everything in the picture is level, steady and unhurried: the flat land, the bowed heads, the day's small harvest. It opens the whole life lesson because whole life insurance is the level-premium virtue made into a contract — the same quiet payment made faithfully in every season, decade after decade, building something certain while the bell of time keeps ringing toward evening.

Look closely

- Notice the couple's posture. What does bowing over ordinary work at a set hour, every day, say about habit and faithfulness?
- Find the basket, the fork and the wheelbarrow. How large is this day's harvest — and what would a lifetime of such days amount to?
- Look at the church tower on the horizon. Why might Millet put the source of the bell so small and far away, yet make it govern the whole scene?
- Study the evening light. How does the time of day color the picture's meaning — work nearly done, payment nearly complete?

Talk about it

1. A level premium is the same small payment made faithfully for decades. What does this painting teach about the power — and the difficulty — of steady habits?
2. Elizur Wright fought so that a worker who had paid for years would never forfeit what he had built. Why is that justice especially important for people like the two in this field?
3. The couple stops work to pray because something matters more than the potatoes. How should a Christian hold together diligent provision for the future and daily dependence on God?

PROJECT

The Whole Life Ledger

You will build the third artifact of the Life Policy Shelf: a one-page ledger and diagram of a single pretend whole life policy — its level premium, its growing cash value, its loan plumbing and its dividend options — drawn so clearly that a younger sibling could follow the money. Agents who can draw this page can explain the product honestly; agents who cannot, memorize sales lines instead.

You will need

- One sheet of paper (or a spreadsheet page), ruler, two ink colors
- Your exam notebook and calculator
- This lesson's example figures: $250,000 face, issued at 35, $2,600 annual premium, cash value reaching $9,000 by year 5 and $31,000 by year 10 — all "in this example"

Steps

1. Across the top, draw the two-curve diagram: a flat premium line and a rising cash value curve from issue at 35 to maturity at 121, where cash value meets the face amount. Label the gap between face and cash value "net amount at risk — the insurance part."
2. Below it, rule a mini-ledger for years 1, 5, 10: premium paid to date, guaranteed cash value, and the death benefit (level at $250,000).
3. Add a loan box: compute the death benefit if the owner dies with a $20,000 loan and $1,000 accrued interest outstanding, showing the subtraction.
4. Add the three-design strip: ordinary, 20-pay, single premium — one line each on premium size, paying period and cash value speed.
5. Add the dividend wheel: five spokes, one per option — cash, reduce premium, accumulate at interest (mark "interest taxable"), paid-up additions (mark "no evidence needed"), one-year term.
6. Write two footer sentences: dividends are not guaranteed and are generally not taxable as a return of premium; figures on this page are course examples.
7. Date the page and file it in the Life Policy Shelf.

EXAM NOTEBOOK

1. Make flashcards for the five dividend options — one per card, option on the front, what it does plus its tax note on the back — and a card for nonforfeiture's father, Elizur Wright, Massachusetts, 1861.
2. Draw the level-premium seesaw: early years OVERPAY (building reserve) on one side, late years UNDERPAY (reserve makes up the difference) on the other, balanced on a fulcrum labeled "level premium for life."
3. Write a trap list titled "Whole life myths": coverage on a 20-pay ends at 20 years (false — only premiums end); dividends are guaranteed (false); dividends are taxed (false — but their interest is); a policy loan must be repaid monthly (false — it is settled at death).

KEY FORMULAS

$$\text{benefit paid at death} = \text{face amount} - \text{loan balance} - \text{accrued loan interest}$$

$$\text{total outlay} = \text{annual premium} \times \text{years of paying period}$$

From history. Wright did his valuations by hand for years — reserves on every policy in Massachusetts — and the labor drove him to invent a cylindrical calculating machine he called the arithmeter, which he patented and sold to insurers. The same man had spent the 1830s and 1840s as one of America's most uncompromising abolitionist editors; the exam remembers him for actuarial tables, but his contemporaries knew him as a man who attacked unjust forfeiture wherever he found it.

WORKED EXAMPLES

Example 1. Ruth owns a $500,000 whole life policy with $60,000 of cash value. She borrows $40,000 against it; at her death the loan is still outstanding with $2,000 of accrued interest. In this example, what does her beneficiary receive?

Show solution

1. Write the rule: benefit paid = face − loan balance − accrued interest.
2. Substitute: $\$500{,}000 - \$40{,}000 - \$2{,}000$.
3. Result: $458,000.
4. Notice what did NOT happen: the policy did not lapse (the loan never exceeded cash value), no repayment schedule was ever enforced, and the insurer simply settled the account at death.

Answer: $458,000. Policy loans are never forgiven — they and their interest come off the death benefit.

Example 2. In this example, a $250,000 whole life policy issued at age 35 costs $2,600 a year as ordinary whole life, or $4,700 a year as a 20-pay policy. Compare total outlay if the insured lives to 85, and name what each buyer gets.

Show solution

1. Ordinary whole life pays to death (or maturity): $\$2{,}600 \times 50 = \$130{,}000$ over fifty years.
2. 20-pay: $\$4{,}700 \times 20 = \$94{,}000$, all paid by age 55 — then thirty premium-free years with coverage continuing.
3. Both own the same lifelong $250,000 promise; the 20-pay simply front-loads the funding, so its cash value also grows faster in the early decades.
4. Neither design is “better” — the choice is cash flow: pay less per year for life, or pay more per year during peak earning years and be done.

Answer: Ordinary: $130,000 over 50 years; 20-pay: $94,000 over 20 years, in this example — same permanent coverage, different paying plans.

Example 3. Exam style. A participating policyowner wants her dividends to increase her total death benefit without new evidence of insurability and without further out-of-pocket cost. Which dividend option fits?

A. Cash

B. Accumulation at interest

C. Paid-up additions

D. Reduction of premium

Show solution

1. Translate the want: more insurance, bought by dividends alone, no underwriting.
2. A and D return money or cut her bill — neither adds coverage.
3. B grows a side fund of savings; the fund is paid out at death but it is not insurance, and its interest is taxable.
4. C uses each dividend as a single premium buying a small, fully paid-up slice of additional whole life — no evidence required, and each addition carries its own cash value and earns its own dividends.

Answer: C. Paid-up additions convert dividends into extra permanent coverage with no underwriting — the exam's favorite dividend option.

PRACTICE

1. Easy Name the three guarantees of whole life insurance.

   Show answer

   A permanent death benefit for the whole of life, a level premium fixed at issue, and scheduled, guaranteed cash value growing to equal the face at maturity.

2. Easy At what age does a whole life policy mature, and what happens then?

   Show answer

   Age 100 on older policies and 121 under the 2001 mortality table: cash value equals the face amount, and the insurer pays it to the living policyowner.

3. **Easy** Who was Elizur Wright, and what law is his monument?

Show answer

The Massachusetts commissioner called the father of life insurance regulation; horrified by London's 1844 policy auctions, he won the first nonforfeiture law in 1861, guaranteeing a lapsing policyholder keeps the value he built.

4. **Medium** Rank by annual premium for the same face amount and issue age, highest to lowest: ordinary whole life, 20-pay whole life, paid-up-at-65 (issued at 35).

Show answer

20-pay highest, paid-up-at-65 next (a 30-year paying period), ordinary whole life lowest — the shorter the paying period, the higher each premium and the faster the cash value grows.

5. **Medium** Why are policy dividends generally not taxable?

A. They are gifts from the insurer
B. They are treated as a return of the policyowner's own overpaid premium
C. They are always under the taxable minimum
D. They are taxed, but the insurer pays the tax

Show answer

B. The law treats dividends as giving back premium the policyowner overpaid, so they are not income — though interest earned on dividends left to accumulate IS taxable, the exam's favorite follow-up.

6. **Medium** A 20-pay whole life policy is sold to a 30-year-old. When do premiums stop, and when does coverage stop?

Show answer

Premiums stop at age 50, when the policy is paid up; coverage never stops — it continues for the whole of life to death or maturity. Confusing the two is a classic exam trap.

7. Medium Name the five classic dividend options.

Show answer

Cash, reduction of premium, accumulation at interest, paid-up additions, and one-year term insurance.

8. Hard A policyowner's $300,000 policy has $25,000 of cash value and an outstanding loan of $24,500 accruing interest. What is the near-term danger, and what happens at death if the loan stands at $20,000 with $800 interest instead?

Show answer

If loan plus interest grows past the cash value, the policy can lapse (and Unit 4 adds: with tax consequences). At death with $20,800 outstanding, the beneficiary receives $\$300{,}000 - \$20{,}800 = \$279{,}200$.

9. Hard Explain the level-premium mechanism in three sentences: where does the extra money go early, and who pays for the protection late?

Show answer

In early years the level premium exceeds the true cost of the insured's death risk, and the excess, invested at interest, builds the policy reserve. In later years the true cost far exceeds the premium, and the reserve makes up the difference. The policyowner's contractual share of that buildup is the guaranteed cash value — which is why Wright insisted a lapsing owner must not forfeit it.

10. Hard A client wants his dividends to buy more coverage, but his health has collapsed since issue. Which option serves him, and why does it still work?

Show answer

Paid-up additions: each dividend is a small single premium buying a fully paid slice of additional whole life with no evidence of insurability — the right to buy was purchased with the participating policy, so his health is irrelevant.

11. **Challenge** In this example a 35-year-old can buy $250,000 of 20-year level term for $350 a year or $250,000 of ordinary whole life for $2,600. Write a fair three-sentence comparison an honest agent could give — naming what each buyer has at age 56.

    Show answer

    At 56 the term buyer has paid $7,000, owned full protection through the child-raising years, and now holds an expired policy and steep attained-age prices if the need remains. The whole life buyer has paid $54,600, still owns $250,000 of lifelong coverage at the same premium, and holds guaranteed cash value in five figures. Neither outcome is a trick — one rented protection for a season at minimum cost, the other funded a permanent promise; the right choice belongs to the need.

12. **Challenge** Proverbs 13:22 says a good man leaves an inheritance to his children's children. Write three sentences on how whole life's design — level faithfulness now, certainty later — serves that calling in a way a savings jar might not.

    Show answer

    Whole life turns small, level, scheduled payments into a guaranteed sum that exists in full from the first premium — the inheritance is created the day the contract begins, not after decades of successful saving. The design protects the intention against the two great thieves of legacies: early death, which the face amount answers, and drift, which the fixed premium disciplines. A jar holds what you managed to put in; the policy holds what you promised.

COMMON MISTAKES

- Saying a limited-pay policy's coverage ends when premiums end — the paying period is limited, the coverage is for the whole of life.
- Calling dividends guaranteed, or taxable: they are neither — but interest earned on dividends accumulating at interest IS taxable.
- Forgetting that unpaid policy loans and accrued interest reduce the death benefit, and that a loan exceeding cash value can lapse the policy.
- Writing age 100 for every maturity question: older contracts endow at 100, but policies under the 2001 mortality table mature at 121 — read the question's wording.

- Ranking premiums wrong: shorter paying periods mean higher premiums and faster cash value — single premium and 20-pay outpace ordinary whole life.
- Confusing surrender with a loan: surrender ends coverage and can create taxable gain; a loan keeps coverage in force and is settled against the death benefit.

Make it a game · Dividend Option Auction. Make five cards, one per dividend option, and a stack of situation slips: “wants more coverage, now uninsurable,” “wants lower bills this year,” “wants savings on the side and accepts taxable interest,” “wants cash for Christmas,” “wants one year of extra protection while the baby is small.” The reader draws a slip and the players race to slap the right option card and say why in one sentence. Correct slap-plus-reason keeps the slip; a wrong slap returns one. Add spice with three trap slips — “wants guaranteed dividends” (no such thing) and two loan scenarios that belong to no option card — which must be called out as traps to score. Most slips after two rounds wins.

Scripture. “A good man leaveth an inheritance to his children’s children: and the wealth of the sinner is laid up for the just.” (Proverbs 13:22, KJV)

The proverb assumes provision that outlives the provider by two generations — not hoarding, but faithfulness stretched beyond one lifetime. Whole life insurance is one modern tool for that old obedience: level payments in a man’s working years become a certainty his grandchildren can stand on.

3.4 Flexible Designs: Universal, Indexed and Variable Life

OBJECTIVES

- Tell the story of the late-1970s inflation years and the 1979 debut of universal life.
- Explain universal life's unbundled design: flexible premiums, monthly charges, credited interest and the lapse risk.
- Distinguish Option A (level) and Option B (increasing) death benefits and compute each at a death.
- Describe how indexed universal life credits interest through floors, caps and participation rates — neutrally.
- State who bears the investment risk in variable life and variable universal life, and which two licenses variable products require.

> **Warm-up.** In five minutes, with pencil and paper: a savings account pays 4% while prices rise 12% a year. Compute what $1,000 in that account buys a year from now in today's goods (about $1,040 ÷ 1.12). Write one sentence on how a saver feels watching that — you have just felt the 1970s, the decade that forced insurers to redesign their oldest product.

WATCH

Universal Life Insurance Policies on the Insurance Exam

Insurance Exam Queen · 7:38

https://www.youtube.com/watch?v=BfsQKzjpRpg

> **WHEN TO WATCH**
> Watch after the core ideas; copy her monthly flow — premium in, charges out, interest credited — into your notebook and label Option A and Option B as she contrasts them.

BACKUP VIDEO

Variable Life + Variable Universal Life - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 9:19

https://www.youtube.com/watch?v=hADoF38rhdk

Watch after the core ideas if the variable products feel thin — it drills the separate account, the risk shift and the dual-license rule the exam tests hardest.

universal life (UL)

Flexible-premium, adjustable-benefit permanent insurance that unbundles the contract into a cash value account, monthly mortality and expense charges, and credited interest.

flexible premium

The UL owner's right to raise, lower or skip premiums, so long as the cash value can carry the monthly charges.

mortality charge

The monthly cost of pure death protection inside a UL policy, priced like annually renewable term on the net amount at risk.

net amount at risk

The insurer's true exposure: the death benefit minus the cash value — the slice the mortality charge actually pays for.

Option A (level death benefit)

A UL death benefit equal to the face amount; as cash value grows, the net amount at risk shrinks.

Option B (increasing death benefit)

A UL death benefit equal to the face amount plus the cash value, keeping the net amount at risk level and costing more.

guaranteed minimum interest rate

The contract floor below which a UL policy's credited interest cannot fall, whatever the insurer's current rate declares.

indexed universal life (IUL)

Universal life whose interest credit is tied to a market index's movement, subject to a floor, a cap and a participation rate; the cash value is not invested in the index.

cap and participation rate

The two limiters of an indexed credit: the cap is the most that can be credited, and the participation rate is the share of the index gain counted.

variable life (VL)

Fixed-premium permanent insurance whose values ride separate-account subaccounts chosen by the owner, who bears the investment risk; a minimum death benefit is typically guaranteed.

variable universal life (VUL)

Universal life with separate-account investing: flexible premiums, adjustable benefits, owner-borne investment risk, and generally no guaranteed cash value.

separate account

The insurer's account holding variable-policy investments apart from its general account; its securities nature is why variable products require FINRA registration.

CORE IDEAS

The story. By the late 1970s American savers were living through double-digit inflation, and the arithmetic of the warm-up was national news. Money market funds paid interest in the teens; traditional whole life policies credited their cash values at the low single-digit rates written into decades-old contracts. Policyowners noticed. They borrowed against their policies at the old contract loan rates of 5 or 6 percent and reinvested the money at 12, or surrendered outright — the industry called the stampede **disintermediation**, and it drained the oldest product on the shelf. In 1979 the answer arrived from an unexpected direction: a California life insurer owned by the brokerage house E. F. Hutton introduced **universal life**, a policy that tore the old bundle apart. Premiums became flexible, the death benefit adjustable, and — the headline — the cash value earned a *current* interest rate the company could raise toward market yields, above a guaranteed contractual floor. Within a few years universal life was taking a quarter of new premium dollars in America, and three years earlier, in 1976, the Equitable had issued the first American **variable life** policy, moving cash values into investment markets outright. The flexible era had begun.

How they figured it out. The designers' insight was that every permanent policy is secretly two things: pure yearly protection plus an accumulating fund. Whole life welds them together and hides the joint; universal life **unbundles** them and prints the seam on the annual statement. Each month, the insurer takes the policy's cash value account, adds any premium received, subtracts an **expense charge** and a **mortality charge** — priced like annually renewable term, but only on the **net amount at risk**, the death benefit minus the cash value — and credits interest at the current declared rate, never below the **guaranteed minimum**. Because the student of Lesson 3.2 already understands ART, and the student of Lesson 3.3 already understands cash value, universal life holds no mysteries: it is the two earlier lessons stapled together

with the staple showing. Transparency was the sales pitch, and it is also the exam's angle: the questions test whether you can follow the monthly flow.

The big idea. Universal life's signature is **flexibility with consequences.** The owner may pay more than the suggested premium, less, or nothing at all in a given month — the policy survives so long as the cash value can carry the monthly charges. The death benefit can be raised (with evidence of insurability) or lowered. And the owner chooses its shape: **Option A** pays a level death benefit equal to the face amount, so as cash value grows the net amount at risk shrinks and the mortality charges lighten; **Option B** pays the face amount *plus* the cash value, keeping the net amount at risk level — more total benefit, higher charges. In this example, a $300,000 policy with $40,000 of cash value pays $300,000 under Option A but $340,000 under Option B. The flexibility cuts both ways, and the honest sentence every UL buyer must hear is this: a universal life policy funded with minimum premiums can lapse in later years, when rising mortality charges outrun a thin cash value. Flexibility is not a guarantee; it is a steering wheel.

Indexed universal life changes only the interest-crediting recipe. Instead of a rate the company declares, the credit is tied to the movement of a market index — the contract names it — over a crediting period, shaped by three dials. The **floor**, commonly 0% in this example, means a falling index credits nothing but never takes cash value away (charges still apply). The **cap** sets the most that can be credited — if the cap is 9% and the index rises 15%, the credit is 9%. The **participation rate** sets the share of the index gain that counts — an 80% participation rate turns a 10% index gain into an 8% credit, before any cap. Understand what IUL is not: the cash value is *not invested in* the index; the insurer holds general-account assets and uses options to fund the crediting promise, which is why regulators treat fixed IUL as insurance rather than a security. Teach the dials, run the arithmetic, and promise nothing the contract does not: caps and participation rates can usually be changed by the company within contractual limits.

Variable life crosses the border. Here the cash value leaves the insurer's general account for a **separate account** divided into subaccounts — portfolios of stocks and bonds the policyowner selects — and the **investment risk is the policyowner's.** Values rise and fall with the markets; classic **variable life** keeps a fixed premium and typically guarantees a minimum death benefit, while cash value floats unguaranteed. **Variable universal life** marries the two flexible ideas: UL's adjustable

premiums and benefits with the separate account's market exposure — and generally no guaranteed cash value at all. Because the owner bears market risk, the law calls these policies **securities**: they are sold by prospectus, and the agent must hold *both* a state life insurance license *and* FINRA securities registration — a Series 6 or Series 7. The School Launch Series 65 course maps that securities world if the dual path interests you. For this exam, burn in the one-line versions: fixed products — insurer bears investment risk; variable products — policyowner bears it, two licenses required.

Sales honesty is tested here more than anywhere else in life insurance, because flexible designs are sold with **illustrations** — computer printouts projecting values decades out. Every illustration has two spines: the **guaranteed** column, computed at the contract's minimum interest and maximum charges, and a **non-guaranteed** column at current or hypothetical assumptions. An agent who shows only the sunny column, or lets a client believe a projected value is a promise, has misrepresented the policy — the word Unit 9 will formalize. The settled discipline: present both columns, mark non-guaranteed elements as such, and never sell flexibility as certainty. A universal life policy reviewed honestly every year or two is a serviceable tool; one sold as "set it and forget it" is a lapse notice waiting twenty years to be mailed.

On the exam today. The flexible designs are tested by feature-matching, and precision wins. Universal life: flexible premium, adjustable death benefit, monthly mortality and expense charges, current interest above a guaranteed floor — and the two options, A level, B increasing (face plus cash value). Expect arithmetic: compute the Option B death benefit, or trace a month's cash value. IUL: floor, cap, participation rate — know that a 0% floor means no index-loss deduction, not "cannot lapse," and that cash value is not in the market. Variable products: separate account, owner bears investment risk, prospectus required, and the double credential — state life license plus FINRA registration (Series 6 or 7); a question offering "a life license alone" for VUL is wrong every time. Last trap: which design can lapse despite premiums having been paid for years? Underfunded UL, when charges exhaust the cash value — flexibility's price tag.

PICTURE STUDY



Breezing Up (A Fair Wind), Winslow Homer, 1873–1876 · Oil on canvas · National Gallery of Art, Washington

Image: Wikimedia Commons, public domain

Winslow Homer, America's great painter of the sea, finished this picture for the nation's centennial, and it has meant confidence ever since: a man and three boys driving a small catboat home through a stiffening breeze. It opens the flexible-designs lesson because sailing is the right picture for universal, indexed and variable life — the wind is not guaranteed, the boat heels with the market's weather, and everything depends on a hand at the tiller making adjustments all the way home. A whole life policy is a train on rails; these policies are boats, and boats must be sailed.

Look closely

- Find the man's hand on the tiller and the boy's hand on the sheet. How many live adjustments are being made in this one moment?
- Look at how the boat heels and where the weight sits. What would happen if everyone sat still and ignored the wind?
- Notice the anchor hanging at the bow — unused now, but aboard. What is the guaranteed floor in this picture?
- Compare the little catboat with the big schooner on the horizon. Same wind, different vessels — how does design change the ride?

Talk about it

1. A flexible-premium policy, like a sail, rewards attention and punishes neglect. What kind of owner should buy a boat rather than a train ticket?
2. The boys trust the man at the tiller. When an agent sells a policy whose values depend on markets, whose honesty and skill are the clients trusting, and what does that demand of him?
3. Luke 14:28 asks who builds without first counting the cost. How does counting the cost — guaranteed columns, worst-case funding — honor both wisdom and the people in your boat?

PROJECT

The Four Designs Chart

You will build the fourth artifact of the Life Policy Shelf: a one-page master chart comparing whole life, universal life, indexed UL and variable/variable universal life across the seven features exams test — plus a worked UL month and an indexed-credit calculator. This is the page to tape above your desk for the rest of the course: half the life-insurance questions on any state exam can be answered straight off it.

You will need

- One sheet of paper turned sideways, ruler, two ink colors (or a spreadsheet page)
- Your exam notebook and calculator
- This lesson's example figures for the UL month and the IUL dials

Steps

1. Rule a grid: four columns (WL, UL, IUL, VL/VUL) by seven rows — premium (fixed/flexible), death benefit (fixed/adjustable; Option A/B where they apply), cash value guarantee, how interest or growth is credited, who bears investment risk, lapse risk, licenses required to sell.
2. Fill every cell in five words or fewer; write "owner bears risk" and "life license + FINRA (6 or 7)" in a second color in the variable column so they can never be unseen.
3. Below the grid, work one UL month from the lesson's example — premium in, expenses and mortality out, interest credited — showing all four steps.
4. Beside it, build the IUL dial box: floor 0%, cap 9%, participation 80% in this example; compute the credit for index years of −12%, +8% and +20%.
5. Add a banner across the bottom: ILLUSTRATIONS HAVE TWO COLUMNS — SHOW BOTH. One sentence under it on why the guaranteed column exists.
6. Footer "All figures are course examples," date the page, and file it in the Life Policy Shelf.

EXAM NOTEBOOK

1. Make flashcards: Option A vs. Option B, floor/cap/participation rate, separate account, and one card that says only "VARIABLE = life license + FINRA Series 6 or 7."
2. Draw the UL monthly loop as a circle of four arrows — premium in, expenses out, mortality out, interest in — with the cash value tank in the center and a crack labeled "lapse if the tank runs dry."
3. Write a trap list titled "Flexible-design myths": IUL cash value is invested in the index (false); a 0% floor means the policy cannot lapse (false); VUL guarantees cash value (false); a life license alone can sell variable products (false).

KEY FORMULAS

$$\text{new cash value} = \text{old value} + \text{premium} - \text{expense charge} - \text{mortality charge} + \text{interest credited}$$

$$\text{Option B death benefit} = \text{face amount} + \text{cash value}$$

$$\text{indexed credit} = \min(\text{index gain} \times \text{participation rate},\ \text{cap}),\ \text{never below the floor}$$

From history. Variable life reached America in 1976 by way of the Equitable, but the idea was an import: unit-linked policies had been sold in the Netherlands and Britain since the 1950s. Because the policyowner bears market risk, the Securities and Exchange Commission claimed jurisdiction, and variable policies became the only life insurance sold with a prospectus — the same document Lesson 1.3 of the School Launch Series 65 course meets from the securities side.

WORKED EXAMPLES

Example 1. A universal life policy starts the month with $12,000 of cash value. In this example the owner pays a $200 premium; the expense charge is $25, the mortality charge $60, and interest is credited at 0.4% for the month on the resulting balance. Trace the month.

Show solution

1. Add the premium: $\$12{,}000 + \$200 = \$12{,}200$.
2. Subtract the charges: $\$12{,}200 - \$25 - \$60 = \$12{,}115$.
3. Credit interest: $\$12{,}115 \times 1.004 \approx \$12{,}163$.
4. Note what happens in a month with no premium: the charges still come out, and the cash value alone must carry them — the seed of UL's lapse risk.

Answer: About $12,163. Universal life is this four-step loop, printed on the statement every month.

Example 2. Marta's universal life policy has a $400,000 face amount and $55,000 of cash value at her death. In this example, what does her beneficiary receive under Option A, and under Option B — and which option was charging her more while she lived?

Show solution

1. Option A pays the level face amount: $400,000.
2. Option B pays face plus cash value: $\$400{,}000 + \$55{,}000 = \$455{,}000$.
3. Mortality charges are levied on the net amount at risk. Under A it had shrunk to $\$400{,}000 - \$55{,}000 = \$345{,}000$; under B it stays the full $400,000.
4. So Option B was costing more each month — the increasing benefit is bought with permanently higher charges.

Answer: Option A: $400,000; Option B: $455,000, purchased by higher lifetime mortality charges on a level net amount at risk.

Example 3. Exam style. An indexed universal life contract has a 0% floor, a 9% cap and a 100% participation rate. In this example, what is credited in a year when the index falls 20%, and in a year when it rises 15%?

A. −20%; 15%

B. 0%; 15%

C. 0%; 9%

D. 9%; 9%

Show solution

1. Falling year: the floor answers. The credit is 0% — no index loss is ever deducted, though policy charges still apply.
2. Rising year: participation first — 100% of 15% is 15% — then the cap trims it to 9%.
3. A deducts a market loss, which IUL never does; B ignores the cap; D invents a 9% credit in a down year.
4. C applies both dials correctly.

Answer: C. Floor stops the loss at 0%; the cap limits the gain to 9%. The cash value was never in the index — the dials, not the market, set the credit.

PRACTICE

1. Easy What three freedoms make universal life “flexible”?

   Show answer

   Premiums may be raised, lowered or skipped (while cash value carries the charges); the death benefit may be adjusted (increases need evidence); and the owner chooses Option A level or Option B increasing benefits.

2. Easy Under Option B, a policy with a $200,000 face and $30,000 of cash value pays what at death?

   Show answer

   $\$200{,}000 + \$30{,}000 = \$230{,}000$ — Option B pays face plus cash value.

3. **Easy** In a variable universal life policy, who bears the investment risk?

Show answer

The policyowner — values ride the separate account's subaccounts, and generally no cash value is guaranteed.

4. **Medium** Which licenses must an agent hold to sell variable life or variable universal life?

A. A state life license only

B. FINRA registration only

C. A state life license plus FINRA registration (Series 6 or 7)

D. A state life license plus a property license

Show answer

C. Variable products are both insurance and securities, so both credentials are required — a life license alone (A) is the exam's most-planted wrong answer here.

5. **Medium** An IUL contract has a 0% floor, an 8% cap and a 75% participation rate. In this example, what is credited when the index gains 12%?

Show answer

Participation first: $12\% \times 0.75 = 9\%$; the 8% cap then trims it. Credit: 8%.

6. **Medium** Why do mortality charges fall over time under Option A but not under Option B?

Show answer

Charges are levied on the net amount at risk. Under Option A the level benefit minus growing cash value shrinks that amount; under Option B the benefit grows with the cash value, so the net amount at risk — and the charge — stays level or rises with age.

7. Medium What crisis produced universal life, and what was the new design's headline feature?

Show answer

The high-inflation late 1970s, when savers drained low-crediting whole life policies for double-digit market yields; universal life, introduced in 1979, credited a current, adjustable interest rate above a guaranteed contractual floor.

8. Hard A client funded his UL policy at the minimum suggested premium for twenty years. He is now 68, and the annual statement shows cash value falling every month despite his payments. Explain what is happening and what the design was never able to promise.

Show answer

Mortality charges are priced like annually renewable term at attained age, so at 68 they are large and growing; his thin cash value plus minimum premium can no longer cover them, and the policy is burning toward lapse. UL never promised permanence at minimum funding — flexibility shifted the funding duty, and its consequences, to the owner.

9. Hard "An IUL policy's cash value is invested in the stock market, so a crash can wipe it out." Correct both halves of this sentence.

Show answer

The cash value is not invested in the index — it sits with the insurer, which funds the crediting promise with general-account assets and options. In a crash the floor credits 0% rather than deducting a loss; the value can still decline from policy charges, but not from the index itself.

10. Hard Classic variable life and variable universal life differ on two design points. Name them.

Show answer

Premiums: VL is fixed-premium, VUL flexible. Guarantees: VL typically guarantees a minimum death benefit while cash value floats; VUL generally guarantees neither unless a rider adds one.

11. **Challenge** An illustration shows a UL policy's non-guaranteed column reaching $190,000 of cash value at age 65, and the guaranteed column showing lapse at 61. Write the three-sentence explanation an honest agent owes the client before any signature.

    Show answer

    The right column assumes the company's current interest and charges continue for decades — it is a projection, not a promise. The left column is the contract's actual guarantee: at minimum interest and maximum charges, this funding level fails at 61. If you buy this policy, we will review it regularly and adjust premiums so reality never drifts toward the left column unwatched.

12. **Challenge** Luke 14:28 commends counting the cost before building a tower. Apply the verse in three sentences to choosing between a guaranteed whole life premium and a flexibly funded universal life policy.

    Show answer

    Counting the cost means pricing the whole tower, not the first course of stones — for UL that means asking what funding keeps the policy alive at the guaranteed column's worst case, not the illustration's best. A buyer who can and will steward flexibility may build well with UL; one who wants to set a promise and rest on it is counting rightly when he pays whole life's higher, fixed price. Either choice can be wise; beginning a tower one cannot finish is the only folly the verse forbids.

COMMON MISTAKES

- Letting a question sell variable products on a life license alone — VL and VUL require the state life license AND FINRA registration (Series 6 or 7).
- Computing Option B as face amount only: Option B pays face plus cash value; Option A pays the level face.
- Saying IUL invests cash value in the index — the index only sets the crediting formula, shaped by floor, cap and participation rate.
- Reading the 0% floor as "the policy cannot lose value" — charges still reduce cash value in flat and down years, and underfunded policies still lapse.
- Treating an illustration's non-guaranteed column as a promise; only the guaranteed column is contractual, and both must be shown.

- Forgetting that a UL death-benefit increase requires evidence of insurability, while decreases and premium changes do not.

Make it a game · Who Bears the Risk?. Make four home-base cards — WHOLE LIFE, UL, IUL, VUL — and deal a shuffled stack of feature slips: “flexible premium,” “guaranteed cash value schedule,” “0% floor and a cap,” “separate account,” “needs FINRA registration,” “Option A or B,” “level premium for life,” “can lapse though premiums were paid for years,” “credit set by participation rate.” Players race to place each slip on every base it fits — some fit two or three — and the checker scores a point per correct base and subtracts one per miss. Final lightning round: the reader calls each product and the table must shout INSURER or OWNER for who bears the investment risk before a three-count. Highest score sails home.

Scripture. “For which of you, intending to build a tower, sitteth not down first, and counteth the cost, whether he have sufficient to finish it?” (Luke 14:28, KJV)

Christ assumes a wise builder prices the whole project before laying a stone. Flexible policies make the counting harder and more necessary: the honest agent shows the guaranteed column — the true cost of finishing the tower — before any family starts to build.

3.5 Group Life and the Special Policies

OBJECTIVES

- Tell the story of industrial insurance and the debit agent, from the Newark basement office of 1875 onward.
- Explain group life's structure: master policy, certificate holders, group underwriting and the guards against adverse selection.
- State the 31-day conversion right and what it guarantees a departing employee.
- Describe credit life insurance and the cap tying its benefit to the debt.
- Distinguish juvenile coverage and family riders, joint (first-to-die) and survivorship (second-to-die) policies, and final expense insurance.

> **Warm-up.** In five minutes, with pencil and paper: an insurer offers to cover all 400 employees of a factory under one contract, no medical questions asked. List two reasons the insurer can safely skip individual underwriting for this crowd, and one way a dishonest person might try to abuse such a no-questions offer. Keep the list — it is this lesson's whole theory of group insurance.

WATCH

Group Life Insurance - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 8:15

https://www.youtube.com/watch?v=VSnCOLKykwY

> **WHEN TO WATCH**
> Watch after the core ideas; write the three-word skeleton — master policy, certificates, conversion — and note every number the teacher attaches to the conversion right.

BACKUP VIDEO

Life Insurance Exam [National] 37 – Group Life Insurance Explained

Open Exam Prep · 4:17

https://www.youtube.com/watch?v=rKxFetbpTXY

A four-minute second pass over the master-policy skeleton and conversion right; watch it just before the practice set as a rapid review.

KEY TERMS

group life insurance

Life insurance written on a group of people under one contract, commonly annually renewable term provided through an employer.

certificate of insurance

The document each covered member receives as evidence of coverage under the master policy; members are certificate holders, not policyowners.

adverse selection guards

The rules that keep sick-heavy groups from forming: the group must exist for a purpose other than buying insurance, benefits follow a schedule, and participation minimums apply.

contributory plan

A group plan whose premium employees share, commonly requiring about 75% participation to blunt adverse selection.

credit life insurance

Decreasing term on a borrower's life, payable to the creditor, never for more than the outstanding debt.

master policy

The single contract issued to the group's sponsor — the employer or association — who is the policyholder.

group underwriting

Underwriting the group as a whole — its size, purpose and makeup — rather than each member's health; individual evidence of insurability is normally not required.

noncontributory plan

A group plan whose premium the employer pays entirely, commonly requiring 100% of eligible employees to participate.

conversion right

A departing member's right, within 31 days, to convert group coverage to an individual permanent policy at attained-age rates without evidence of insurability — with coverage continuing during the 31 days.

juvenile insurance and family rider

Coverage on minors applied for by an adult, and the rider package adding term coverage for a spouse and children to a breadwinner's base policy.

joint life vs. survivorship life

Joint (first-to-die) covers two lives and pays at the first death; survivorship (second-to-die) pays at the second, commonly for estate costs.

industrial (home service) insurance

Small-face-amount policies, historically with weekly premiums collected at the insured's home by a debit agent.

CORE IDEAS

The story. In 1875, in the basement of a bank building in Newark, New Jersey, a persistent New Englander named **John Fairfield Dryden** opened what he called the Prudential Friendly Society, copying an idea he had studied for years: the Prudential of London, which since the 1850s had sold penny-a-week policies to British laborers. Dryden's American version insured working families for about three cents a week — enough, at death, to cover a funeral and the doctor's last bill, the twin terrors of a poor household. Because such families had no bank accounts and no spare cash, the premium came to them: an agent walked a weekly route — his **debit** — calling at kitchen doors, collecting coins, marking the little premium book on the table. This was **industrial insurance**, later gentled to "home service," and it grew staggeringly: by 1900, companies selling it counted policies by the million, and one of them raised a tower over Madison Square in New York — for a few years the tallest building on earth — floor by floor out of the workingman's nickels. The profession you are studying was, for two generations, most visibly a man with a collection book walking a neighborhood he knew by name.

How they figured it out. Industrial insurance proved the poor were insurable; the next invention proved they could be insured *wholesale*. In June 1911 the Equitable wrote a single contract covering all the employees of a leather company — no medical examinations, one policy for the lot — and the year after, a contract covering thousands of employees of the Chicago mail-order house Montgomery Ward settled the pattern of **group life insurance**. The actuarial insight is the warm-up's: a workforce assembles itself for work, not for insurance. Nobody joins a factory because he is dying; the group's health mirrors the working population's, so the insurer can underwrite **the group as a whole** — its size, industry, age mix and turnover — and skip the individual medical gate. What the debit agent did door by door, the group certificate did payroll by payroll, and employer-provided life insurance became a fixture of American work.

The big idea. Group life has a three-part skeleton the exam tests relentlessly. The **master policy** is the one contract, issued to the sponsor — employer, union, association — who is the **policyholder** and holds the contract rights. Covered members hold no policy at all; each receives a **certificate of insurance** as evidence of coverage and names his own beneficiary. The coverage itself is commonly **annually renewable term**, with the face amount set by a **benefit schedule** — a multiple of earnings, in this example two times salary, or a flat amount by job class — precisely so no member can select a jumbo benefit against the insurer. And because the group was underwritten as a whole, the individual members normally provide **no evidence of insurability**: the diabetic hired Monday is covered on the same schedule as the marathoner hired Tuesday.

No-questions coverage survives only behind guards against **adverse selection**, and you should be able to recite them. The group must exist for a purpose *other than buying insurance* — a company, a union, a trade association, never a club formed to get cheap coverage for its sick founders. Benefits follow the schedule, not individual choice. And participation minimums keep the pool healthy: a **noncontributory** plan, where the employer pays the whole premium, commonly must cover **100%** of eligible employees; a **contributory** plan, where employees share the cost, commonly requires about **75%** to join — because when joining is optional and costs money, the sickest are the surest to sign up, and a thin pool curdles. New hires typically serve a short eligibility wait, and coverage ends with employment — except for the one right every certificate must carry, which gets its own paragraph.

The **conversion right** is the exam's favorite number in this lesson: an employee who leaves the group may, within **31 days**, convert his group coverage to an **individual permanent policy** — not term — at **attained-age** rates, with **no evidence of insurability**; and if he dies during those 31 days, the group coverage still pays even if he never applied. It is Lesson 3.2's convertibility transplanted: the right protects exactly the worker whose health failed while he was covered — the one no insurer would newly accept. Close behind it comes **credit life**: decreasing term on a borrower's life, sold with a loan, the **creditor** as beneficiary, and the benefit legally capped at the **outstanding debt** — the lender may be made whole, never enriched. The borrower-debtor pays for it directly or in the loan, it is often written as group coverage through the lender, and no one is ever required to buy it from the lender to get the loan.

The special policies finish the shelf. **Juvenile insurance** covers a minor's life on an adult's application — commonly small whole life bought by parents or grandparents; the classic "jumping juvenile" design multiplies the face, in this example fivefold, when the child reaches 21, with no evidence. (Unit 4 adds the payor benefit rider, which waives premiums if the paying adult dies first.) The **family rider** packages coverage: a whole life base on the breadwinner with level term riders on the spouse and children — one children's rider premium covering every current and future child, each convertible at adulthood without evidence. **Joint life** covers two lives, priced on their joint ages, and pays at the **first** death, ending there — fit for partners or a two-income couple. **Survivorship life**, second-to-die, pays at the **second** death — fit for estate settlement costs that fall only when both spouses are gone, and cheaper than two policies. And **final expense** insurance is industrial insurance's modern descendant: small-face whole life, commonly $5,000 to $25,000 in this example, simplified underwriting, sold to seniors for the burial-and-bills job Dryden's three cents a week was doing in 1875.

On the exam today. Group questions are structure questions. Who gets the master policy? The sponsor — the employer is the policyholder. What do employees receive? Certificates; they are certificate holders who name their own beneficiaries but hold no contract rights. Who needs evidence of insurability? Normally no one — the group is underwritten as a whole — which is also the answer to "why benefit schedules and participation rules exist": adverse selection. Burn in the conversion trio: 31 days, permanent coverage at attained age, no evidence — and death within the window is covered regardless. Participation: noncontributory 100%, contributory commonly 75%. Credit life: creditor as beneficiary, benefit never exceeding the debt — any choice paying the family the full original loan amount after years of payments is wrong. And the pairs: joint pays first death, survivorship pays second; a question marrying "estate taxes due at the second death" to "first-to-die" has crossed them on purpose.

PICTURE STUDY



Metropolitan Life Tower, Colin Campbell Cooper, 1910 · Oil on canvas · Private collection

Image: Wikimedia Commons, public domain

Colin Campbell Cooper was America's great painter of the new skyscrapers, and here he paints the Metropolitan Life Insurance Company's marble campanile over Madison Square — at its completion in 1909 the tallest building in the world. He sets it rising out of ordinary rooftops, tenement chimneys and laundry lines, which is the honest way to paint it: that tower was built almost literally from the weekly nickels and dimes of working families, collected at their kitchen doors by debit agents of the industrial insurance era this lesson tells. A monument of marble, funded three cents at a time.

Look closely

- Start at the bottom: rooftops, chimneys, water tanks, wash hung out to dry. Whose homes are these, and what do they have to do with the tower?
- Find the great clock on the tower. Why is a clock a fitting emblem for a company selling promises about time and death?
- Notice how Cooper lights the tower against the hazy city. What feeling is the contrast meant to produce?
- Measure the tower against everything else in the picture. What does its scale say about how many small premiums it took?

Talk about it

1. The industrial insurers built palaces from the pennies of the poor. What duty does an institution owe people whose small, faithful payments made it great?
2. A debit agent knew every family on his route by name. What was gained when insurance became payroll deduction and certificates — and what was lost?
3. Galatians 6:2 commands the bearing of one another's burdens. How is a thousand families paying nickels so that any one family's funeral is covered a picture of that command — and where does a tower like this tempt an institution to forget it?

PROJECT

The Group and Special Policies Sorter

You will build the final artifact of the Life Policy Shelf: a one-page sorter mapping every policy in this lesson to its structure, its beneficiary and its trigger — crowned with a drafted conversion-rights letter to a pretend departing employee. Agents field these questions weekly in real life ("I'm leaving my job — what happens to my life insurance?"), and the letter teaches you to answer in plain, kind, accurate English.

You will need

- One sheet of paper or a spreadsheet page, ruler
- Your exam notebook
- This lesson's key terms and the conversion worked example

Steps

1. Rule a six-row sorter — group life, credit life, juvenile/family rider, joint life, survivorship life, final expense — with four columns: who owns/holds the contract, who is the beneficiary, what triggers payment, and the one exam fact to never miss.
2. Fill the grid in short phrases; in the group row write "employer holds master policy / employee holds certificate," and in the credit row write "creditor paid, capped at the debt" in a second color.
3. Draw the group skeleton beneath: one master policy box over many certificate boxes, with the benefit schedule and the 75%/100% participation rules labeled on the side.
4. Write the conversion letter: five sentences to "Mr. Okafor," who left the company Tuesday with a health condition — what he may convert to, by when, at what kind of rates, what he need not prove, and what happens if he dies within the window.
5. Have a parent read the letter cold and mark anything unclear; revise until a reader with no insurance background gets all five facts right.
6. Add the footer "Days, percentages and amounts are common examples — the certificate and state law control," date the page, and file it with the letter in

the Life Policy Shelf.

EXAM NOTEBOOK

1. Make flashcards: master policy vs. certificate, noncontributory 100% vs. contributory 75%, conversion's three guarantees (31 days, permanent at attained age, no evidence), credit life's cap, joint vs. survivorship triggers.
2. Draw the conversion window as a 31-day calendar strip: group coverage shaded to day 31, an arrow labeled "convert — no evidence" rising to a permanent policy, and a note that death inside the strip still pays.
3. Write a trap list titled "Who gets paid?": group — the employee's named beneficiary; credit life — the creditor, only the balance; joint — at the FIRST death; survivorship — at the SECOND; final expense — small face, built for burial bills.

> **From history.** The tower had a voice as well as a clock: from 1909 its beacon flashed the hours over Manhattan, and the company advertised it as "the light that never fails." Dryden, the three-cent pioneer, ended as a United States senator from New Jersey; and the debit routes his agents walked survived remarkably late — home-service companies were still collecting weekly premiums at kitchen doors in parts of America within living memory.

Example 1. Elena leaves her employer on March 1. Her group certificate provided $100,000 of coverage, and she was diagnosed with a serious heart condition last year. Walk through her conversion rights — and what happens if she dies on March 20 without having applied.

Show solution

1. Her group coverage ends with employment, but the conversion right opens a 31-day window from termination.
2. Within the window she may convert up to her group amount to an individual permanent policy — not term — with no evidence of insurability; her heart condition cannot be considered.
3. The premium is computed at her attained age for the permanent policy she selects — the right guarantees insurability, never price.
4. If she dies March 20, inside the 31 days, the group coverage pays her beneficiary the $100,000 even though she never filed the conversion application.

Answer: Convert within 31 days to permanent coverage at attained-age rates, no evidence required — and death inside the window is covered automatically. The right exists precisely for the newly uninsurable.

Example 2. A borrower takes a $30,000 car loan with credit life insurance. Three years later he dies with $11,400 still owed. In this example, who is paid, how much, and what does his family receive from this policy?

Show solution

1. Credit life is decreasing term tracking the debt; the beneficiary is the creditor — the lender, not the family.
2. The benefit equals the outstanding balance: $11,400, never the original $30,000 — coverage may not exceed the debt.
3. The lender is made whole and the loan is extinguished.
4. The family receives no check — but inherits a paid-off car instead of a debt, which was the policy's whole job.

Answer: The lender receives $11,400, the exact remaining debt; the family's benefit is the canceled loan. Credit life can make a creditor whole, never rich.

Example 3. Exam style. A married couple wants coverage that will pay estate settlement costs, which their attorney says fall due only after BOTH of them have died. Which design fits, and why is it cheaper than the alternative?

A. Joint (first-to-die) life

B. Two separate whole life policies

C. Survivorship (second-to-die) life

D. Annually renewable term on the older spouse

Show solution

1. Match the trigger: the need arises at the second death, so the policy should pay at the second death.
2. A pays at the first death — years or decades before the money is needed — and then ends.
3. B works but buys two full death benefits when only one payout is needed.
4. D expires exactly when the risk is highest and insures only one of the two lives.
5. C pays once, at the second death. Because the insurer pays later — after two life expectancies — survivorship premiums run lower than coverage on either single life.

Answer: C. Survivorship (second-to-die) life matches the estate-cost trigger and is cheaper because the single benefit is paid only after both insureds have died.

PRACTICE

1. Easy In group life insurance, who receives the master policy and what does each covered employee receive?

   Show answer

   The sponsor — commonly the employer — holds the master policy as policyholder; each covered employee receives a certificate of insurance and names his own beneficiary.

2. Easy What participation is commonly required of a noncontributory group plan, and of a contributory plan?

Show answer

Noncontributory (employer pays all): commonly 100% of eligible employees. Contributory (employees share cost): commonly about 75% — both rules exist to blunt adverse selection.

3. Easy Who is the beneficiary of a credit life policy, and what is the most it can ever pay?

Show answer

The creditor, and never more than the outstanding debt — credit life makes the lender whole, not rich.

4. Medium An employee leaving her job wants to keep life insurance despite poor health. State the three guarantees of her group conversion right.

Show answer

She may convert within 31 days of leaving, to an individual permanent policy (not term) at attained-age rates, with no evidence of insurability — and if she dies within the 31 days, the group coverage pays regardless.

5. Medium Why do group plans set benefits by a schedule — a multiple of salary or a flat amount by class — instead of letting each employee choose an amount?

A. To simplify payroll software

B. To prevent adverse selection by those who know their health is poor

C. Because state law forbids choices of any kind

D. To keep commissions level

Show answer

B. Without individual underwriting, free choice would let the sickest select the largest benefits; the schedule removes the lever. A, C and D are inventions.

6. Medium Match the design to the need: (1) business partners each need cash at the first death between them; (2) a couple's estate costs fall due only after both die.

Show answer

(1) Joint life, first-to-die — it pays at the first death and ends. (2) Survivorship life, second-to-die — it pays at the second death, and its delayed single benefit makes it cheaper than insuring either life alone.

7. Medium What was industrial (home service) insurance, and who was the debit agent?

Show answer

Small-face-amount policies — burial-and-final-bill money — with weekly premiums; the debit agent walked a fixed neighborhood route collecting the coins at the insureds' homes and recording them in premium books.

8. Hard A group certificate holder asks to borrow against "his policy's cash value." Give the two-part correction.

Show answer

He holds a certificate, not a policy — the employer owns the master contract — and group coverage is commonly annually renewable term, which builds no cash value to borrow against. His real rights are his beneficiary designation and the 31-day conversion right.

9. Hard A lender tells a borrower the car loan will be approved only if she buys the lender's credit life policy. Name the two separate problems with this sentence.

Show answer

Conditioning the loan on buying insurance from the lender is coercion, which insurance law prohibits (Unit 9 names it), and the borrower is free to decline credit life or cover the debt with her own existing insurance. Credit life is optional protection, not a toll.

10. Hard A family rider covers a breadwinner's whole life base plus term on the spouse and all children for one package premium. What happens to a child's coverage at adulthood, and what does the children's portion cost for a fourth baby born next year?

Show answer

Each child's term coverage is convertible to permanent insurance at adulthood without evidence of insurability; and the children's rider covers all current and future children for the same single rider premium, so the new baby is added at no extra cost.

11. Challenge The group concept rests on one sentence from the warm-up: a workforce assembles itself for work, not for insurance. Explain in three sentences how that single fact replaces individual underwriting — and why a "group" formed to buy insurance breaks the machine.

Show answer

Because people join a factory for wages, the group's health is an unselected sample of the working population, so the insurer can price the group's average risk from its size, industry and age mix. Benefit schedules and participation minimums keep any individual from tilting the sample after the fact. A group formed to buy insurance reverses the logic — the sick have the strongest reason to join — so the sample is poisoned before the first premium, which is why the law requires groups to exist for another purpose.

12. Challenge Dryden's three-cents-a-week policies and a modern employer's group certificate both spread one family's funeral across many hands. Write three sentences connecting them to Galatians 6:2 and to the agent's calling.

Show answer

Both designs are burden-bearing made systematic: a thousand small, faithful payments stand ready so no single widow faces the undertaker alone. Scripture commands the bearing of one another's burdens, and insurance at its best is that command organized with arithmetic and law. The agent's calling is to keep the machinery honest — to remember, between the schedules and certificates, the kitchen-door families the whole structure exists to serve.

COMMON MISTAKES

- Calling the employee the policyowner of group coverage — the sponsor holds the master policy; employees are certificate holders who name beneficiaries but hold no contract rights.
- Letting a conversion answer require evidence of insurability or permit conversion to term — the right is 31 days, permanent coverage, attained-age rates, no evidence.
- Paying credit life proceeds to the family or at the original loan amount — the creditor is the beneficiary, capped at the outstanding balance.
- Swapping the participation rules: noncontributory 100%, contributory commonly 75%.
- Crossing joint and survivorship: joint (first-to-die) pays at the first death; survivorship (second-to-die) pays at the second — estate-cost questions want survivorship.
- Forgetting that death within the 31-day conversion window is covered by the group policy even if no conversion application was ever filed.

Make it a game · Door to Door. One player is the debit agent with a route of six "doors" — six slips, each a household scenario: a factory worker leaving his job Friday (conversion), a borrower's widow asking who gets the credit life money, partners wanting first-death cash, grandparents insuring a newborn, a couple planning for estate costs, a retiree wanting burial money. The agent knocks (taps the table), draws a door, and has twenty seconds to name the right policy or right answer plus one supporting fact; the family checks against the lesson. Each correct door earns a nickel (or a point) for the route book; a miss sends the slip to the next player's route. Rotate agents until every door has been served. Fullest route book wins.

Scripture. "Bear ye one another's burdens, and so fulfil the law of Christ." (Galatians 6:2, KJV)

Paul's command assumes burdens too heavy for one back, and group insurance is that assumption built into a contract: many hands under one family's coffin-day costs. The arrangement fulfils the verse only while the strong actually carry it — which is why the law polices participation, conversion and the treatment of the weakest member.

UNIT 3

Life Insurance: The Policies

In 1759 a group of Philadelphia ministers did something no Americans had done before: they chartered a corporation whose whole business was a promise to widows and orphans. From that **Ministers' Fund** grew everything this unit studies — the products an agent spends most of a life-license exam proving he understands. You will begin with the question underneath every sale: *why* a family buys life insurance at all, and how an agent measures the need, by the **needs approach** and by the **human life value** a Wharton professor taught America to calculate in the 1920s. Then you will meet the policies themselves: **term life**, the pure, inexpensive, expiring promise; **whole life**, the level-premium promise that endures to the end and builds guaranteed **cash value** along the way; and the flexible designs of the last fifty years — **universal**, **indexed** and **variable** life — that unbundled the old contract and, in the variable forms, crossed into securities law.

The unit closes with the policies that cover people in bundles and in special situations: **group life** with its master policy and 31-day conversion right, **credit life**, juvenile and family coverage, joint and survivorship designs, and the old door-to-door **industrial insurance** that built one of the tallest buildings in the world out of nickels and dimes. Licensing exams draw more questions from these policy types than from almost any other topic, and they test by contrast: term against whole life, Option A against Option B, first-to-die against second-to-die. Learn each policy by the need it answers and the comparisons will keep themselves straight.

PREREQUISITES

- Has completed Units 1–2 and can define premium, insurer, insured, policyowner and beneficiary without looking
- Can explain insurable interest and indemnity from Lesson 2.2 — why life insurance is organized provision, not a wager
- Can work comfortably with percents and simple formulas (multiply a salary by a number of years, total a four-line worksheet)
- Has the exam notebook habit running: definitions and comparisons on left pages, corrected practice misses on right pages

MASTERY CHECKLIST

- ☐ I can explain the four jobs of a death benefit — income replacement, debts, final expenses and legacy — and tell the story of the Ministers' Fund of 1759.
- ☐ I can calculate a family's coverage need by the DIME method and by the human life value method, and say how the two approaches differ.
- ☐ I can describe level, decreasing and annually renewable term, and state exactly what the renewable and convertible features each guarantee.
- ☐ I can explain how level-premium whole life builds guaranteed cash value, and compare ordinary, limited-pay and single-premium designs.
- ☐ I can state what participating dividends are, why they are generally not taxable, and name the five classic dividend options.
- ☐ I can explain universal life's unbundled design, its flexible premiums, and the difference between Option A and Option B death benefits.
- ☐ I can say how indexed and variable life credit value, who bears the investment risk in each, and which two licenses variable products require.
- ☐ I can describe group life's master policy, certificates and 31-day

conversion right, and tell credit life, joint, survivorship, final expense and industrial policies apart.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: State Insurance Departments directory**: Free, official. The National Association of Insurance Commissioners' map of all fifty state insurance departments. Use it in every lesson of this unit to find your own department's life insurance consumer guide, which states the free-look, conversion and replacement rules your state actually uses. Ages 14 and up.
- **Insurance Information Institute: Life Insurance Basics**: Free. The industry's consumer-education institute explains term, whole, universal and variable life in plain language — a good one-page review after Lessons 3.2 through 3.4. Ages 14 and up.
- **Insurance Information Institute: How Much Life Insurance Do I Need?**: Free. A short consumer walk-through of the needs questions behind Lesson 3.1. Read it before the Family Coverage Worksheet project and compare its checklist with your DIME columns. Ages 14 and up.
- ***Life Insurance: A Textbook*, by Solomon S. Huebner (1917)**: Free on the Internet Archive. The Wharton professor who gave the profession the human life value concept, in his own words. Dip into the opening chapters with Lessons 3.1 and 3.3 to hear the ideas of this unit stated a century ago. Ages 15 and up.
- **Texas Department of Insurance: Life Insurance Guide**: Free, official. One state's plain-English consumer guide to the policy types in this unit — a model of what your own state's department publishes. Skim it after Lesson 3.4 and note where Texas figures differ from this course's examples. Ages 14 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

3.1 Why Life Insurance: Needs, Human Life Value and the Ministers' Fund

3 sessions of 50 minutes

3.2 Term Life: Renting the Promise

3 sessions of 50 minutes

3.3	**Whole Life: The Promise That Endures**	3 sessions of 50 minutes
3.4	**Flexible Designs: Universal, Indexed and Variable Life**	3 sessions of 50 minutes
3.5	**Group Life and the Special Policies**	3 sessions of 50 minutes

Unit 3 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Time yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says "in this example," use the figures given, and remember that real premiums, rates and rules vary by state and company — the live figures are at your state insurance department's website. Most states pass a licensing candidate at 70%, which is 14 of 20 here — but aim higher. Choose the one BEST answer.

1. **5 pts**

   In the DIME method of needs analysis, the four letters stand for:

   A. Dividends, interest, mortality, expenses

   B. Debt, income, mortgage, education

   C. Death benefit, insurability, maturity, endowment

   D. Deductible, indemnity, maximum, exclusion

2. **5 pts**

   Which fact is used by the human life value approach but NOT by the needs approach?

   A. The family's outstanding debts

   B. The mortgage payoff balance

   C. The children's education costs

   D. The number of working years remaining to the insured's retirement

3. 5 pts

The first life insurance corporation in America, chartered in 1759, was organized to provide for:

A. The widows and orphans of Presbyterian ministers

B. The merchants of the Buttonwood Agreement

C. The victims of the Great Fire of London

D. Union soldiers in the Civil War

4. 5 pts

A life insurance death benefit paid to a named beneficiary as a lump sum is generally:

A. Taxed as ordinary income to the beneficiary

B. Taxed as a capital gain

C. Received free of income tax

D. Taxable only above the premiums paid

5. 5 pts

A family wants coverage that tracks their shrinking 20-year mortgage balance at the lowest cost. The classic fit is:

A. Decreasing term

B. Level term

C. Ordinary whole life

D. Increasing term

6. 5 pts

The renewable feature of a term policy guarantees the insured may continue coverage:

A. At the original premium, with new evidence of insurability

B. Without new evidence of insurability, at a premium for his attained age

C. At the original premium, without evidence

D. Only by converting to permanent insurance

7. 5 pts

Which statement about term life insurance is TRUE?

A. It builds cash value slowly

B. Its premiums may be borrowed back through policy loans

C. It always pays a benefit eventually

D. For the same premium it buys the largest immediate death benefit of any form

8. 5 pts

The conversion feature of a term policy permits exchange:

A. Of a permanent policy for term insurance, with evidence

B. Of term for permanent insurance, with evidence of insurability

C. Of term for permanent insurance, without evidence of insurability

D. Of one insurer's policy for another insurer's, without evidence

9. 5 pts

When a whole life policy matures at age 100 (or 121 under the 2001 table):

A. Coverage simply ends with no payment

B. The cash value equals the face amount and is paid to the policyowner

C. The face amount is paid to the beneficiary

D. Premiums stop but the cash value is forfeited

10. 5 pts

Dividends on a participating whole life policy are:

A. Not guaranteed, and generally not taxable as a return of premium

B. Guaranteed by the contract and taxable as income

C. Guaranteed, but only if left to accumulate at interest

D. Not guaranteed, and fully taxable as income

11. 5 pts

A 20-pay whole life policy issued at age 30 provides coverage:

A. Until age 50, when the policy expires

B. Until age 65 only

C. For 20 years, renewable thereafter

D. For the insured's entire life, with premiums payable only to age 50

12. 5 pts

In this example, a $400,000 whole life policy has a $35,000 outstanding policy loan and $1,500 of accrued loan interest at the insured's death. The beneficiary receives:

A. $400,000

B. $365,000

C. $363,500

D. $436,500

13. 5 pts

A universal life policy has a $250,000 face amount and $42,000 of cash value. Under death benefit Option B, the beneficiary receives:

A. $292,000

B. $250,000

C. $208,000

D. $42,000

14. 5 pts

An indexed universal life policy has a 0% floor and a 10% cap with 100% participation. In a year the index falls 18%, the interest credited is:

A. −18%

B. 0%, though policy charges still reduce the cash value

C. 10%

D. 0%, and the policy is guaranteed not to lapse

15. 5 pts

To sell variable universal life, an agent must hold:

A. A state life insurance license only

B. FINRA registration only

C. A state life insurance license plus FINRA registration (Series 6 or 7)

D. A state life license plus an adjuster license

16. 5 pts

Which policy can lapse in later years even though the owner paid premiums faithfully for two decades?

A. Ordinary whole life kept at its level premium

B. A paid-up 20-pay whole life policy

C. Level term during its stated term

D. A universal life policy funded at minimum premiums

17. 5 pts

In group life insurance, the employer and the covered employee respectively hold:

A. The master policy; a certificate of insurance

B. A certificate of insurance; the master policy

C. Two copies of the same individual policy

D. The policy; no document at all

18. 5 pts

An employee leaving her job may convert her group life coverage by:

A. Applying within 60 days for term insurance at select rates

B. Applying within 31 days for an individual permanent policy at attained-age rates, without evidence of insurability

C. Applying within 31 days, subject to a new medical exam

D. Doing nothing; group coverage continues free for one year

19. 5 pts

A borrower with credit life insurance dies owing $8,200 on a loan that began at $25,000. The policy pays:

A. $25,000 to his widow

B. $8,200 to his widow

C. $8,200 to the lender

D. $25,000 to the lender

20. 5 pts

A married couple needs a single payment for estate settlement costs that fall due only after both spouses have died. The fitting design is:

A. Joint (first-to-die) life

B. Annually renewable term on each spouse

C. A family rider on the husband’s policy

D. Survivorship (second-to-die) life

ANSWER KEY

1. B. DIME totals the survivors' Debt, Income need times years, Mortgage payoff and Education costs — then subtracts resources already in place. The other choices borrow vocabulary from other lessons to distract you.
2. D. Human life value multiplies earnings kept for the family by working years remaining (discounted to present value); debts, mortgage and education are survivor requirements belonging to the needs approach.
3. A. The Presbyterian Ministers' Fund of Philadelphia, chartered 1759, paid annuities to ministers' widows funded by the ministers' own premiums. B belongs to securities history, C to fire insurance a century earlier, D to a war a century later.
4. C. Lump-sum death benefits are generally income-tax-free to the beneficiary, so the full face amount is available for the family's needs. Interest earned on the money afterward is taxable — but that is not what was asked.
5. A. Decreasing term's face amount declines on a schedule matching the amortizing debt, with a level premium — insuring the loan and nothing more. Level term (B) fits income replacement; D runs the wrong direction.
6. B. Renewability waives evidence of insurability — never the price, which is recomputed at attained age. C is the exam's favorite too-good-to-be-true wrong answer, and D confuses renewal with conversion.
7. D. Term is pure protection, so every dollar buys current death benefit — the most coverage per premium dollar. It builds no cash value (A), has nothing to borrow against (B), and most term policies rightly expire unclaimed (C).
8. C. Conversion runs one way — term into permanent — and its whole value is the waiver of evidence; the new premium is attained-age (or original-age with back premiums). B defeats the feature's purpose, and A reverses its direction.
9. B. At maturity the guaranteed cash value has grown to equal the face amount, and the insurer pays it to the living policyowner (the insured endows). C pays the wrong party — the beneficiary collects only at death — and D is the forfeiture Elizur Wright outlawed.
10. A. Dividends return overpaid premium when the insurer's experience beats its assumptions — never guaranteed, and not income to the owner. The taxable piece is the interest earned on dividends left to accumulate, a distinction the other choices blur.

11. D. Limited-pay designs compress the paying period, not the coverage: the policy is paid up at 50 and protection continues for the whole of life. A is the classic trap — only the premiums end.
12. C. Benefit paid = face − loan − accrued interest: $\$400{,}000 - \$35{,}000 - \$1{,}500 = \$363{,}500$. B forgets the interest; A forgives the loan, which insurers never do.
13. A. Option B pays the face amount plus the cash value: $\$250{,}000 + \$42{,}000 = \$292{,}000$. B is Option A's level benefit — the two options are the exam's favorite swap.
14. B. The floor means no index loss is ever deducted — the credit is simply zero — but mortality and expense charges still come out, so cash value can decline and an underfunded policy can still lapse, which is why D overpromises.
15. C. Variable products are both insurance and securities — sold by prospectus from a separate account whose investment risk the policyowner bears — so both credentials are required. A life license alone is the planted wrong answer.
16. D. In a minimally funded UL, rising attained-age mortality charges can eventually outrun the thin cash value and the premium, exhausting the account. The whole life designs (A, B) carry contractual guarantees at their stated premiums, and C cannot lapse mid-term while premiums are paid.
17. A. The sponsor is the policyholder of the single master policy; each employee is a certificate holder who names his own beneficiary but owns no contract rights. B reverses the structure exactly.
18. B. The conversion right is 31 days, to permanent (not term) coverage, priced at attained age, with no evidence — and death within the window is paid by the group policy regardless. A has the wrong window and product; C defeats the right's purpose.
19. C. Credit life is decreasing term with the creditor as beneficiary, capped at the outstanding debt — the lender is made whole, never enriched, and the family's benefit is the extinguished loan. A and B pay the wrong party; D pays a debt that no longer exists.
20. D. Survivorship life pays once, at the second death — matching the estate-cost trigger — and its delayed benefit makes it cheaper than insuring either life alone. Joint life (A) pays at the first death, years before the need.

PORTFOLIO PIECE: THE LIFE POLICY SHELF

Assemble the five artifacts this unit built into one section of your Pathway File — a complete working shelf of the life insurance products: the Family Coverage Worksheet with its DIME and human life value columns and written recommendation (Lesson 3.1); the Term Shopper's Table with its premium curve and renewable/convertible guarantee box (Lesson 3.2); the Whole Life Ledger with its two-curve diagram, loan arithmetic and dividend wheel (Lesson 3.3); the Four Designs Chart comparing whole, universal, indexed and variable life with the worked UL month and indexed-credit calculator (Lesson 3.4); and the Group and Special Policies Sorter with your conversion-rights letter to Mr. Okafor (Lesson 3.5).

Add a one-page cover sheet titled "Which policy for which need?" in your own words: five pretend families, one line each, matched to a product from the shelf with a one-sentence reason — and a closing sentence on the agent's duty to fit the product to the need, citing 1 Timothy 5:8. Every figure on the shelf should be labeled as an example, and every page dated.

LOOK FOR	WHAT IT MEANS
Coverage worksheet	DIME and human life value are both computed correctly from the family's stated facts, resources in place are subtracted, and the recommendation cites the numbers.
Term and whole life pages	The premium curve, the renewable/convertible guarantees, the level-premium mechanism, loan arithmetic and all five dividend options are stated accurately with figures labeled as examples.
Four Designs Chart	Every cell is correct, the variable column shows owner-borne risk and the dual license (life plus FINRA Series 6 or 7), and the UL month and indexed credits compute correctly.
Group sorter and conversion letter	Master policy/certificate structure, participation percentages, the credit life cap and the 31-day conversion trio are all right, and the letter delivers all five facts in plain English a non-insurance reader follows.
Cover sheet	The five need-to-product matches are defensible, the reasoning is the student's own prose, and the Scripture is used honestly rather than decoratively.

UNIT 4

Life Insurance: Provisions, Riders and Annuities

Unit 3 taught you what the policies are; this unit teaches you what the promise actually says. Every life policy carries a set of **standard provisions** — the grace period that forgives a late premium, the **incontestable clause** that makes the promise ironclad after two years, the reinstatement right that revives a lapsed policy, the misstatement-of-age rule that adjusts a benefit instead of voiding it. You will meet the company that put honesty in its own name — the London Indisputable Life Policy Company of 1848 — and the crusading Massachusetts mathematician, **Elizur Wright**, who saw lapsed policies auctioned like furniture in London and came home to invent **nonforfeiture**: the law that says the value you build in a policy can never simply be confiscated. You will learn who gets the money and how — **beneficiaries**, named in order and sometimes in Latin, and the **settlement options** that turn a death benefit into an income.

Then the unit turns the policy upside down. An **annuity** protects against the opposite risk — not dying too soon but living too long — and its story runs from the Roman *annua* through the strange era of the tontine to the suitability rules of today. The unit closes with the agent's last duties — policy delivery and the replacement rules — and with the taxman: why the death benefit passes income-tax-free, how cash value grows untaxed, what a **Section 1035 exchange** may and may not do, and the seven-pay test that separates life insurance from a tax shelter. By the end you can read an entire policy the way an examiner does: promise by promise.

PREREQUISITES

- Has completed Unit 3 and can define term life, whole life, universal life and cash value in one sentence each
- Can work comfortably with percents, ratios and simple division (find 75% of a number, divide proceeds into equal payments)
- Can draw and read a simple family tree and a timeline
- Has the exam notebook, flashcard box and state facts sheet from Units 1–3 up to date

MASTERY CHECKLIST

- ☐ I can state the standard life policy provisions — entire contract, insuring clause, free look, grace period, reinstatement, incontestability, misstatement of age and the suicide clause — with their common time limits.
- ☐ I can tell absolute assignment from collateral assignment and compute a misstatement-of-age adjustment.
- ☐ I can order beneficiaries (primary, contingent, tertiary), contrast revocable with irrevocable designations, and split proceeds per stirpes and per capita from a family tree.
- ☐ I can name the settlement options, say which pays the most per month and why, and work fixed-period and fixed-amount arithmetic.
- ☐ I can describe the major riders — waiver of premium, payor benefit, accidental death, guaranteed insurability, accelerated benefits and return of premium — and say what each costs the promise.
- ☐ I can name the three nonforfeiture options, tell which one is usually automatic, and tell Elizur Wright's story.
- ☐ I can classify any annuity by purchase, start date and investment engine, name its payout options, and compute an exclusion ratio.

- ☐ I can walk a policy through delivery, replacement and the tax rules — FIFO withdrawals, the seven-pay MEC test, Section 1035 exchanges and the group-term $50,000 line.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: Life Insurance consumer pages**: Free, official. The state regulators' own plain-language guide to life policies, provisions and buying decisions. Read it alongside Lessons 4.1 and 4.5, and use its links to find your own state's consumer guides. Ages 15 and up.
- **Insurance Information Institute: What is a beneficiary?**: Free. The industry's consumer-education institute explains beneficiary naming in two minutes of reading. Skim it with Lesson 4.2 before you draw the Harper family tree. Ages 14 and up.
- **Investor.gov: Annuities**: Free, official. The SEC's investor site explains fixed, indexed and variable annuities and why the variable kind is a security. Read it with Lesson 4.4, especially before the annuity map project. Ages 15 and up.
- **IRS: Life insurance and disability insurance proceeds**: Free, official. The tax collector answers, in its own words, whether life insurance proceeds are taxable. Read it with Lesson 4.5 and quote it in your tax one-pager. Ages 15 and up.
- ***Politics and Mysteries of Life Insurance*, by Elizur Wright (1873)**: Free on the Internet Archive. The father of nonforfeiture argues his own case in his own voice. Dip into a chapter with Lesson 4.3 to hear the man you will meet in the story. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

4.1 The Policy's Promises: Standard Provisions and Exclusions
3 sessions of 50 minutes

4.2 Beneficiaries and Settlement Options 3 sessions of 50 minutes

4.3 Riders and Nonforfeiture: Options Built Into the Promise 3 sessions of 50 minutes

4.4 **Annuities: The Income That Cannot Be Outlived** 3 sessions of 50 minutes

4.5 **Delivery, Replacement and the Taxman: Life Insurance Taxation**

3 sessions of 50 minutes

Unit 4 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about a minute a question — set a timer for 25 minutes and finish inside it, just as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example” or “commonly,” use the figures given, and remember that the live numbers — free-look days, grace periods, state replacement rules — belong to your state insurance department. A licensing exam passes at 70% — 14 of 20 here — but aim higher. Choose the one BEST answer.

1. **5 pts**

   An insured dies 18 days after missing a premium payment of $600 on a $100,000 policy with a 31-day grace period. The insurer will pay:

   A. Nothing, because the premium was unpaid

   B. $99,400

   C. $100,000

   D. A refund of all premiums paid

2. **5 pts**

   Three years after issue, an insurer discovers a material misstatement on the application. The insured is alive and premiums are current. The insurer may:

   A. Void the policy for fraud

   B. Adjust the face amount downward

   C. Do nothing — the policy is incontestable after 2 years in force

   D. Cancel at the next anniversary

3. **5 pts**

A man bought a $50,000 policy at stated age 40, paying premiums that, at his true age of 45, would have purchased only $40,000 of coverage (in this example). He dies 12 years later. The beneficiary receives:

A. $40,000

B. $50,000, because the policy is incontestable

C. Nothing — the policy is void

D. A refund of premiums

4. **5 pts**

To reinstate a policy that lapsed 10 months ago, the owner must typically provide:

A. Nothing — reinstatement within 1 year is automatic

B. A new application and the first premium only

C. Back premiums only, since insurability never lapses

D. Evidence of insurability and all back premiums with interest

5. **5 pts**

An insured dies by suicide 20 months after policy issue; the suicide clause runs 2 years. The beneficiary receives:

A. The full face amount

B. A refund of the premiums paid

C. Nothing at all

D. The policy's cash value only

6. **5 pts**

A policyowner assigns her policy to a bank as security for a $30,000 loan. This is:

A. A collateral assignment, giving the bank rights limited to the debt

B. An absolute assignment, transferring all ownership rights

C. Prohibited without the insurer's consent

D. Effective only if the beneficiary consents

7. 5 pts

A policy names the insured's wife as primary beneficiary and his brother as contingent. The wife dies; two years later the insured dies without updating the policy. The proceeds go to:

A. The wife's estate

B. The insured's estate

C. The brother

D. The state's unclaimed property fund

8. 5 pts

The owner of a policy with an irrevocably designated beneficiary wants to take a policy loan. He may do so:

A. Freely — loans are an ownership right

B. Only after converting the designation to revocable on his own signature

C. Only with the insurer's board approval

D. Only with the irrevocable beneficiary's written consent

9. 5 pts

Proceeds of $150,000 are left "to my children equally, per stirpes." Of three children, one died earlier leaving two sons. Each grandson receives:

A. Nothing

B. $25,000

C. $50,000

D. $37,500

10. 5 pts

Insured and primary beneficiary die in the same crash and the order of deaths cannot be determined. Under the Uniform Simultaneous Death Act as written into the common disaster clause, the proceeds are paid:

A. To the contingent beneficiary, as though the primary died first

B. To the primary beneficiary's estate

C. Half to each estate

D. To the insured's creditors first

11. 5 pts

A beneficiary chooses the fixed-PERIOD settlement option. If the insurer credits more interest than guaranteed, the result is:

A. A longer payment period

B. A refund of premium to the owner's estate

C. Larger payments over the same period

D. No change — excess interest belongs to the insurer

12. 5 pts

Which settlement option provides the LARGEST monthly income to a sole beneficiary for life?

A. Life income with 20-year period certain

B. Joint and survivor

C. Installment refund

D. Straight life income

13. 5 pts

Under a waiver of premium rider with a 6-month waiting period, once waiver begins during the insured's total disability:

A. The policy continues but stops building cash value

B. The policy continues in full force, with premiums paid by the insurer

C. The face amount is reduced by each waived premium

D. The policy converts to extended term insurance

14. 5 pts

On a policy insuring a 10-year-old, which rider waives premiums if the child's mother — who pays them — dies or becomes totally disabled?

A. Payor benefit rider

B. Waiver of premium rider

C. Guaranteed insurability rider

D. Accidental death rider

15. 5 pts

Which of the following is NOT a nonforfeiture option?

A. Cash surrender

B. Extended term insurance

C. Automatic premium loan

D. Reduced paid-up insurance

16. 5 pts

A whole life policyowner stops paying premiums and makes no nonforfeiture election. Most policies automatically provide:

A. Cash surrender

B. Reduced paid-up insurance

C. A modified endowment contract

D. Extended term insurance for the full face amount

17. 5 pts

To sell variable annuities, a producer must hold:

A. Only a state life insurance license

B. A state life license with variable authority plus FINRA securities registration

C. Only FINRA registration

D. A property and casualty license

18. 5 pts

An annuitant invested $60,000; her expected return is $80,000, and she receives $400 monthly (in this example). The untaxed portion of each payment is:

A. $300

B. $100

C. $400 — annuity income is tax-free

D. $0 — annuity income is fully taxable

19. 5 pts

Which exchange is NOT tax-free under Section 1035?

A. A whole life policy for another whole life policy

B. A whole life policy for an annuity

C. An annuity for a life insurance policy

D. An annuity for another annuity

20. 5 pts

A 50-year-old owns a modified endowment contract with $15,000 of gain and $35,000 of basis, and takes a $10,000 policy loan. The tax result is:

A. Nothing — policy loans are never taxable

B. $10,000 of untaxed basis returned under FIFO

C. Taxable only if the policy later lapses

D. $10,000 of ordinary income plus a $1,000 penalty

ANSWER KEY

1. B. Death during the grace period is covered, but the insurer deducts the overdue premium: $100,000 − $600 = $99,400. A ignores the grace period; D is the suicide-clause remedy in the wrong question.
2. C. The incontestable clause bars voiding or contesting after 2 years in force during the insured's lifetime. B confuses this with the misstatement-of-age adjustment, which concerns age or sex, not other misstatements.
3. A. Misstatement of age adjusts the benefit to what the premiums would have bought at the true age; it never voids the policy, and incontestability does not block the adjustment — nothing is being contested.
4. D. Reinstatement — commonly available for 3 years after lapse — requires proving insurability and paying the missed premiums with interest (and settling any policy loan). The reward is the original issue-age premium and cash-value schedule.
5. B. Within the suicide period the insurer does not pay the face but must refund premiums paid. After the period expires, suicide is covered like any other death — the clock is everything.
6. A. A lender takes a collateral assignment — temporary and limited to the loan balance, with the remainder of any death benefit going to the beneficiary. Assignment requires written notice to the insurer, not its permission, and a revocable beneficiary's consent is not needed.
7. C. With no primary alive at the insured's death, the contingent class takes. The estate (B) receives proceeds only when every named class has failed — the outcome designations exist to avoid.
8. D. An irrevocable beneficiary holds a vested interest, so loans, surrenders, assignments and beneficiary changes all require that beneficiary's written consent. B is circular — removing the designation itself requires the same consent.
9. B. Per stirpes keeps the deceased child's one-third ($50,000) in his branch, split between his two sons — $25,000 each. A describes per capita; D splits the whole fund per capita among four heads.
10. A. The Act presumes the insured survived the beneficiary, so the proceeds pass to the contingent class — avoiding a pointless trip through the primary's estate, which is exactly what B would cause.

11. C. Under fixed period the calendar is locked, so excess interest enlarges each payment. Under fixed AMOUNT the payment is locked and interest lengthens the calendar — the mirrored pair the exam loves to swap (A).
12. D. Straight life guarantees nothing after the beneficiary's death, so the insurer can pay the most per month. Every added guarantee — a certain period (A), a second life (B), a refund of principal (C) — shrinks the check.
13. B. The insurer pays the premiums itself, so cash value, dividends and the full face continue untouched — and premiums paid during the waiting period are commonly refunded. A, C and D all shrink a promise the rider exists to keep whole.
14. A. The payor benefit watches the premium-payor on a juvenile policy, waiving premiums until the child reaches a stated age. The waiver of premium rider (B) watches the insured's own disability — the trigger is the whole question.
15. C. The automatic premium loan is a loan provision that prevents lapse by borrowing the premium from cash value; the three nonforfeiture options are cash surrender, reduced paid-up and extended term.
16. D. Extended term is usually the automatic option: the cash value buys term insurance at the original face for as long as it can, preserving the protection a silent owner was presumably relying on. B keeps permanence but shrinks the face — the law defaults to the full promise.
17. B. The variable annuity is both an insurance contract and a security — the owner bears investment risk in a separate account — so both credentials are required. Fixed and indexed annuities (A's world) are insurance products only.
18. A. The exclusion ratio is $\$60{,}000 \div \$80{,}000 = 75\%$, so $0.75 \times \$400 = \$300$ returns untaxed and $100 is ordinary income — until her basis is fully recovered.
19. C. Annuity to life insurance is the one forbidden direction — an annuity's untaxed gains cannot buy into the death benefit's income-tax-free treatment. The three permitted arrows are life→life, life→annuity and annuity→annuity, with basis carrying over.
20. D. In a MEC, loans and withdrawals alike are LIFO distributions: gain comes out first ($10,000 of the $15,000 gain is taxable) and the 10% penalty applies before age 59½ — here $1,000. A and B state the non-MEC rules the seven-pay test switched off.

PORTFOLIO PIECE: MY PATHWAY FILE: READING THE WHOLE PROMISE

Assemble the five artifacts this unit built: the policy lifeline chart with every provision pinned to its window and remedy (Lesson 4.1); the Harper family beneficiary tree with its four traced scenarios and the settlement options table ranked by guarantee (Lesson 4.2); the Calder rider menu and Elizur Wright's safety-net table of nonforfeiture options (Lesson 4.3); the annuity map with the Pearl exclusion-ratio worksheet and suitability checklist (Lesson 4.4); and the taxman's one-pager with its five exit lanes, red MEC border and 1035 compass (Lesson 4.5).

Bind them behind a one-page cover sheet titled "The Whole Promise," on which you explain to an imagined first client, in your own words, what it means that a life policy's promises are enforced by law — citing one provision, one nonforfeiture option and one scripture from the unit — and why an agent who knows these pages owes clients the truth about them before any sale. Date the cover sheet and file the set in your Pathway File ahead of the Unit 4 test.

LOOK FOR	WHAT IT MEANS
Policy lifeline	all eight standard provisions appear with their common time limits, correct remedies and an accurate misstatement-of-age example, labeled "commonly — check your state."
Beneficiary and settlement pages	the four Harper scenarios trace correctly (including per stirpes vs. per capita arithmetic and the common disaster outcome), and the options table ranks payments by guarantee with fixed-period/fixed-amount interest effects stated correctly.
Rider and nonforfeiture pages	every rider shows trigger, clock and payment; the safety-net table shows what each option preserves and surrenders, names extended term as the usual automatic option, and classifies the automatic premium loan as a provision.
Annuity map	the three classification questions, the variable-annuity licensing badge, the payout ladder and a correctly computed exclusion ratio all appear, with the suitability checklist in plain words.
Tax one-pager	all five exit lanes carry correct taxed-or-not rules, the MEC border states the seven-pay test with LIFO and the under-59½ penalty, the 1035 compass shows three green arrows and the forbidden annuity-to-life arrow, and the worked miniatures prove the page against both examples.

LOOK FOR	WHAT IT MEANS
Cover sheet	the explanation is accurate, personal and honest — the scripture is used truthfully rather than decoratively, and the pledge connects knowing the provisions to telling clients the truth.

4.1 The Policy's Promises: Standard Provisions and Exclusions

OBJECTIVES

- Name the rights a policyowner holds and state the entire contract and insuring clause provisions.
- State the common time limits of the free look, grace period, reinstatement, incontestable and suicide provisions.
- Compute an adjusted death benefit under the misstatement-of-age provision.
- Distinguish absolute assignment from collateral assignment and say what each transfers.
- Identify the common exclusions — war, aviation in older policies, and hazardous occupations — and what the insurer owes when one applies.

> **Warm-up.** In five minutes, write three promises you have made and kept this year, and beside each, what would have happened if you had attached fine print to it afterward. Keep the paper: this lesson is about a contract whose fine print the law forces into the open — and then, after two years, locks shut.

WATCH

Premiums, Reinstatement, and Incontestability - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 6:23

https://www.youtube.com/watch?v=zw1j2ICNUnc

> **WHEN TO WATCH**
> Watch after the core ideas; each time a provision is named, write its time limit in your notebook — 31, 2, 3 — and say aloud what each number is counting.

BACKUP VIDEO

Insurance Exam- Incontestability vs Time Limit On Certain Defenses Provisions

Insurance Exam Queen · 4:27

https://www.youtube.com/watch?v=_P7d1YScLDc

Watch after the core ideas if the incontestable clause still feels fuzzy — it contrasts the life version with the health-policy cousin you will meet again in Unit 5.

policyowner

The person who owns the contract and holds its rights — naming beneficiaries, assigning the policy, borrowing against it and surrendering it — whether or not he is the insured.

insuring clause

The insurer's basic promise, usually on the first page: to pay the face amount to the beneficiary on proof of the insured's death while the policy is in force.

grace period

The time after a premium's due date — commonly 30 or 31 days — during which the policy stays in force; death during it pays the face minus the overdue premium.

incontestable clause

After the policy has been in force 2 years during the insured's lifetime, the insurer may no longer void it or deny a claim for misstatements in the application.

suicide clause

If the insured dies by suicide within a stated period — commonly 2 years from issue — the insurer pays no face amount but refunds the premiums paid.

entire contract provision

The provision stating that the policy plus the attached copy of the application make up the whole agreement, and nothing outside them can be used against the insured.

free look

A period after delivery — commonly 10 days — during which the owner may return the policy for a full refund of premium, no reason required.

reinstatement provision

The owner's right — commonly within 3 years of lapse — to revive a lapsed policy by proving insurability and paying back premiums with interest.

misstatement of age or sex provision

If the insured's age or sex was stated wrongly, the benefit is adjusted to what the premium would have bought at the true age or sex — the policy is not voided.

exclusion

A risk the policy states it will not cover, such as war or, in older policies, aviation or a named hazardous occupation.

absolute assignment

A transfer of all ownership rights in the policy to another person or entity, permanently.

collateral assignment

A temporary, partial transfer of policy rights to a lender as security for a debt; the lender's claim is limited to the balance owed.

CORE IDEAS

The story. In the London of the 1840s, a life insurance policy could be a trap with a thirty-year fuse. A man paid premiums faithfully for decades; then he died, and the company's lawyers went hunting through his original application for any slip — an uncle's illness forgotten, a doctor's visit unmentioned — and voided the whole contract at the moment it was supposed to pay. The scandal of claims contested at the graveside became so notorious that in 1848 a new company was founded whose very name was its sales pitch: the **London Indisputable Life Policy Company**. Its promise was plain — once issued, its policies would not be disputed. Rivals scoffed that it was surrendering the company's shield against fraud; customers understood that the shield had too often been a sword. The idea spread. In the decades after the American Civil War, United States insurers began writing **incontestable clauses** of their own, advertising policies that, after a short contestable window, became as solid as a deed. What began as one firm's marketing promise became, in time, a required provision in every state — and one of the most heavily tested clauses on the licensing exam.

How they figured it out. The industry learned that a promise nobody trusts cannot be sold, and the states learned not to leave the promising to goodwill. After New York's Armstrong Investigation of 1905 exposed a generation of abuses, New York's 1906 insurance statutes required standard policy provisions by law, and the other states followed with laws of their own. The logic of the system is a trade. The insurer gets a fair chance to catch lies: a contestable period — two years — in which it may investigate and void a policy obtained by material misstatement, and a suicide clause so that no one can buy a policy as a prelude to self-destruction. The insured gets permanence: after two years the insurer must keep its promise even if an innocent error — or, in most states, even a deliberate one — later comes to light, because a widow cannot cross-examine a dead man about an application he signed thirty years before. Each standard provision is one clause of that truce, written by legislatures that had read too many tragic case files.

The big idea. A life policy is owned property, and the **policyowner** — who may or may not be the insured — holds a bundle of rights: to name and change the beneficiary, to assign the policy, to borrow its cash value, to surrender it, to choose how dividends and proceeds are applied. Around those rights the law arranges the standard provisions. The **entire contract provision** says the policy and the attached copy of the application are the whole agreement — the company cannot reach outside them, to its bylaws or a lost memo, to fight a claim; and an agent cannot change the contract by promising things on a porch. The **insuring clause** on page one states the basic promise: pay the face amount to the beneficiary on proof of death while in force. The **consideration clause** recites the exchange — the application's statements and the premium for the insurer's promise. Everything else in this lesson is the fine print that state law forces into daylight, with numbers you must learn as commonly used and verify in your own state: 10-day free look, 31-day grace, 2-year contestability, 2-year suicide clause, 3-year reinstatement.

Begin with the provisions that keep a policy alive. The **free look** — commonly 10 days from delivery — lets the owner return the policy for a full refund, no questions asked; replacements and senior sales often get longer looks (Lesson 4.5 returns to this). The **grace period** — commonly 30 or 31 days after a missed premium — keeps the coverage in force while the owner catches up; if the insured dies within it, the insurer pays the face amount minus the overdue premium. If the grace period passes unpaid, the policy **lapses** — but it is not necessarily gone. Under the **reinstatement provision**, commonly within 3 years of lapse, the owner may revive the original contract by proving insurability again and paying all back premiums with interest, and repaying or reinstating any policy loan. Why bother, instead of just buying a new policy? Because the reinstated policy keeps its original issue-age premium and its old cash-value schedule — for an older insured, that is usually a far better bargain than starting over at a new age and a new price.

Next, the provisions that handle untruth and error. The **incontestable clause**: after the policy has been in force for 2 years during the insured's lifetime, the insurer cannot void it or refuse a death claim because of misstatements in the application — the time for checking is over. (It never excuses not paying premiums, and a policy on a fictitious person or without insurable interest was never a contract at all.) The **misstatement of age or sex provision** handles the most common error without any drama: the policy is not voided, even after many years; instead the death benefit is

adjusted to whatever amount the premiums actually paid would have purchased at the insured's true age or sex. The **suicide clause** — commonly 2 years from issue — protects the pool from a policy bought in despair: within the period the insurer pays no face amount but refunds all premiums paid; after the period, the death is covered like any other. Notice the pattern the exam loves: each clause names a wrong, a window, and exactly what is owed.

Finally, exclusions and assignment. Modern life policies exclude very little, but you must know the classics. A **war or military service exclusion** — more common in wartime eras — limits the benefit, usually to a refund of premiums, if death results from war. Older policies excluded **aviation** except for fare-paying passengers, a relic of the barnstorming age; today only private or experimental flying is sometimes rated or excluded. A **hazardous occupation or hobby** — test pilot, mining, scuba, racing — may be excluded or simply charged a higher premium. When an excluded cause kills the insured, the usual remedy is a refund of premiums paid, not the face amount. Separately, because a policy is property, the owner may **assign** it without the insurer's permission, though written notice is required so the company knows whom to pay. An **absolute assignment** transfers every right permanently — a gift, a sale, a transfer to a trust. A **collateral assignment** hands a lender a temporary claim as security for a loan, limited to the debt; the beneficiary receives whatever remains after the lender is paid.

On the exam today. Provision questions are gift points if you keep the numbers and the remedies straight. Expect a death-during-grace-period question: the claim is paid, minus the overdue premium — not denied, and not paid in full. Expect reinstatement's full price list: proof of insurability plus back premiums with interest, commonly within 3 years — and remember the revived policy keeps its original age and rates, which is the reason to reinstate at all. The misstatement-of-age trap is the word *void*: the correct answer always adjusts the benefit. The suicide-clause trap is the remedy: within the period the insurer refunds premiums, never the face, and after the period it pays in full. Incontestability questions hinge on the clock — two years in force during the insured's lifetime — and on what the clause does not forgive: nonpayment of premium. And when a lender is in the story, the answer is collateral assignment, limited to the debt; when every right changes hands forever, it is absolute.

PICTURE STUDY



The Village Agreement (L'Accordée de village), Jean-Baptiste Greuze, 1761 · Oil on canvas · The Louvre, Paris

Image: Wikimedia Commons, public domain

Jean-Baptiste Greuze made his name in Paris with this 1761 scene of a village betrothal, and all Paris came to look: no kings, no battles — just a father giving a dowry, a young couple, and a notary in the corner writing the promise down. Diderot praised it as painting with a conscience. It opens this lesson because the picture understands something the exam also tests: a serious promise is not left to memory or goodwill. It is spoken before witnesses, priced in money, and written into a contract — which is exactly what the standard provisions do to the insurer's promise.

Look closely

- Find the notary at his little table on the right, pen moving. Everyone else feels the moment; he is making it enforceable.
- Watch the father's two hands — one holding the dowry purse toward the groom, one open in speech. The money and the words travel together, like premium and policy.
- Study the bride's downcast eyes and linked arms — one arm with her mother, one with her groom. A promise moves her from one household's protection to another's.

- Notice the hen and chicks on the floor. Greuze tucks the whole purpose of the contract into the corner: provision for those who cannot provide for themselves.

Talk about it

1. The family could have trusted a handshake. Why does the notary's written record protect the bride better — and how is the entire contract provision the same kind of protection for a policyowner?
2. The dowry is consideration: value given to seal a promise. What are the two halves of consideration in a life insurance contract?
3. Psalm 15 praises the man who swears to his own hurt and changes not. Which moment in this painting — and which clause in this lesson — shows a promise built to hold even when keeping it becomes costly?

PROJECT

The Policy Lifeline: A Provisions Chart

You will build the one-page chart that makes every provision question easy: a policy's life drawn as a single timeline, with each standard provision pinned to its window and its remedy. This page goes into your Pathway File and gets quizzed from for the rest of the course, because provision numbers — 10, 31, 2, 2, 3 — are the cheapest points on any state exam.

You will need

- One sheet of unlined paper turned sideways, ruler and pencil
- Two ink colors — one for windows of time, one for remedies
- Your exam notebook and this lesson's key terms

Steps

1. Draw a long horizontal line labeled THE LIFE OF A POLICY, starting at DELIVERY and running past YEAR 3.
2. At delivery, draw a 10-day bracket labeled FREE LOOK — full refund, no reason needed.
3. At a pretend missed premium, draw a 31-day bracket labeled GRACE PERIOD, and under it write the remedy: death here pays face minus overdue premium.
4. After the grace bracket write LAPSE, then a long 3-year bracket labeled REINSTATEMENT with its price list: proof of insurability + back premiums with interest; reward: original age, original rates.
5. Across the first two years from issue, draw two parallel brackets: CONTESTABLE PERIOD (insurer may void for material misstatement; after it, incontestable) and SUICIDE CLAUSE (within: refund of premiums; after: face paid).
6. In a corner box titled NEVER VOIDS, write the misstatement-of-age rule with its formula and one worked example of your own invention.
7. In a second box titled ASSIGNMENT, contrast absolute (all rights, forever) and collateral (lender, limited to the debt, temporary) in two lines each.

8. Date the page, write “commonly — check your state” under the numbers, and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make a flashcard for each key term in this lesson; on the provision cards, put the common time limit in big numerals in the corner — 10, 31, 2, 2, 3.
2. Draw a two-door diagram titled WHEN THE INSURER DOESN’T PAY FACE: door one, suicide within the period — refund of premiums; door two, excluded cause of death — refund of premiums; and under both, after the window closes, the face is paid.
3. Write a five-line trap list titled “Void vs. adjust vs. deduct,” ending with: misstatement of age ADJUSTS, grace-period death DEDUCTS, and almost nothing after two years VOIDS.

KEY FORMULAS

$$\text{adjusted benefit} = \frac{\text{premium paid}}{\text{premium required at true age}} \times \text{face amount}$$

From history. The oldest surviving life policy in the English-speaking world was itself a disputed promise. In 1583 a London salter named Richard Martin insured the life of William Gybbons for twelve months; Gybbons died just inside the year, and the underwriters argued “twelve months” meant twelve lunar months of 28 days — which had already expired. The court made them pay. Insurers and fine print have been wrestling ever since, which is why the states finally wrote the provisions themselves.

WORKED EXAMPLES

Example 1. Dale bought a $100,000 policy at a stated age of 35, paying $12 per $1,000 of face amount each year — $1,200. At his death the insurer discovers he was actually 38 when he applied, when the rate would have been $15 per $1,000 (in this example). What does the beneficiary receive?

Show solution

1. The misstatement-of-age provision adjusts the benefit; it never voids the policy.
2. Ask what Dale's actual premium would have bought at his true age: $\$1{,}200 \div \$15 = 80$ units of $1,000.
3. Adjusted benefit: $80 \times \$1{,}000 = \$80{,}000$.
4. Check with the formula: $\dfrac{\$12}{\$15} \times \$100{,}000 = \$80{,}000$.

Answer: $80,000 — the amount his real premiums would have purchased at his true age. Incontestability does not block this adjustment; the clause bars voiding the policy, and nothing here is voided.

Example 2. Exam style. Ruth's annual premium of $900 was due March 1 and unpaid. She died March 20. Her policy's face amount is $150,000 and its grace period is 31 days. The insurer should pay:

A. Nothing — the policy lapsed March 1

B. $150,000

C. $149,100

D. A refund of all premiums Ruth ever paid

Show solution

1. March 20 is within the 31-day grace period, so the policy was in force at death.
2. During the grace period a death claim is paid, but the insurer may deduct the overdue premium.
3. $\$150{,}000 - \$900 = \$149{,}100$.
4. A treats the due date as a cliff — the grace period exists precisely to prevent that. D is the suicide-clause remedy, wandering into the wrong question.

Answer: C. Death during the grace period pays the face amount minus the overdue premium: $149,100.

Example 3. Exam style. Marcus let his whole life policy lapse 14 months ago and now wants it back. Under a typical reinstatement provision, which of the following will the insurer require?

A. Nothing — reinstatement is automatic within 3 years

B. Proof of insurability only

C. Back premiums with interest only

D. Proof of insurability plus all back premiums with interest

Show solution

1. Walk the provision's checklist: the right commonly lasts 3 years from lapse — Marcus is within it.
2. The insurer takes on 14 months of risk it never charged for, so it demands the missed premiums, with interest.
3. It also gets to ask whether Marcus is still insurable — a fresh application or health statement.
4. Only D includes both halves of the price. The reward: his original issue-age premium and cash-value schedule come back with the policy.

Answer: D. Reinstatement requires evidence of insurability and payment of back premiums with interest (plus settling any policy loan) — in exchange, the original contract and its original rates revive.

PRACTICE

1. Easy What two documents make up the entire contract?

   Show answer

   The policy itself and the attached copy of the application. Nothing outside them — company bylaws, an agent's verbal promise — can modify the agreement or be used against the insured.

2. Easy How long are the common free look, grace period, contestable period and reinstatement window?

   Show answer

   Commonly 10 days, 31 days (30 in some states), 2 years and 3 years respectively — always checked against your own state's law, which is the live figure.

3. **Easy** The insured dies by suicide 14 months after the policy was issued; the suicide clause runs 2 years. What does the insurer pay?

Show answer

A refund of the premiums paid — not the face amount. After the 2-year period, suicide would be covered like any other death.

4. **Medium** A policyowner uses her $250,000 policy as security for a $40,000 business loan. What kind of assignment is this, and what does the lender get if she dies still owing $25,000?

Show answer

A collateral assignment. The lender collects only the $25,000 still owed; the beneficiary receives the remaining $225,000.

5. **Medium** Which provision keeps an agent's porch-step promise — "don't worry, the company will cover that" — from changing the policy?
A. The insuring clause
B. The entire contract provision
C. The grace period
D. The free look

Show answer

B. The entire contract provision confines the agreement to the policy and attached application; no oral statement can enlarge or shrink it. The insuring clause (A) states the basic promise but does not fence out outside statements.

6. **Medium** The insurer discovers, 5 years after issue, that the insured concealed a serious health condition on the application. The insured is still alive and paying premiums. What can the insurer do?

Show answer

Nothing against the policy — the incontestable clause bars voiding it or denying claims for application misstatements after 2 years in force during the insured's lifetime. It could still cancel for nonpayment if premiums stopped, which incontestability never excuses.

7. Medium Why would an owner reinstate a lapsed policy rather than buy a new one? Give two reasons.

Show answer

The reinstated contract keeps its original issue-age premium, which is lower than any new policy bought at the owner's current age, and its original cash-value schedule continues. (A new policy would also start fresh suicide and contestable periods, while most states treat reinstatement as contestable only as to the reinstatement application.)

8. Hard A policy has a war exclusion. The insured, a reservist, is killed in a combat zone 4 years after issue. What does the beneficiary typically receive under the exclusion?

Show answer

A refund of premiums paid (some versions pay the reserve or cash value), not the face amount. Exclusions operate regardless of the incontestable clause, because the insurer is not contesting the application — it never promised to cover that cause of death.

9. Hard Nora bought a $\$60{,}000$ policy at stated age 30, paying $\$10$ per $\$1{,}000$ yearly. She was actually 33, when the rate would have been $\$12$ per $\$1{,}000$ (in this example). Compute the adjusted death benefit.

Show answer

Premium paid: $60 \times \$10 = \$600$. At the true-age rate it buys $\$600 \div \$12 = 50$ thousands: $\$50{,}000$. Or directly: $\frac{10}{12} \times \$60{,}000 = \$50{,}000$.

10. Hard The insured dies 20 days into the grace period of a $\$75{,}000$ policy with a quarterly premium of $\$210$ overdue. The beneficiary argues the insurer owes the full face "because the clause says the policy stays in force." Settle the matter with figures.

Show answer

The policy was in force, so the claim is valid — but the insurer deducts the overdue premium: $\$75{,}000 - \$210 = \$74{,}790$. The grace period preserves the coverage, not the free ride; the premium for the period was owed.

11. **Challenge** An insurer's lawyer wants to deny three claims: (1) application misstatement discovered in year 3; (2) suicide in year 1; (3) premium never paid after the grace period expired, death in month 14 of the lapse. Which denials survive, and under which provisions?

    Show answer

    (1) Fails — the incontestable clause bars contest after 2 years in force. (2) Succeeds as to the face — the suicide clause applies within its period, but premiums must be refunded. (3) Succeeds — the policy lapsed for nonpayment and was never reinstated; incontestability never excuses nonpayment. The pattern: each provision has its own clock and its own remedy.

12. **Challenge** The 1848 London Indisputable Life Policy Company gave up its right to contest policies at all. Write three sentences on why a company might profit by surrendering a legal weapon, and what modern provision descends from its idea.

    Show answer

    Trust is the product: a policy that might be voided at death is worth less to every honest buyer, so a credible promise not to dispute claims commanded more business and better premiums. The company converted a legal right into a reputation. Its descendant is the incontestable clause — a compromise giving insurers two years to catch fraud and policyowners permanence ever after.

COMMON MISTAKES

- Saying a misstated age voids the policy — it never does; the benefit is adjusted to what the premium would have bought at the true age.
- Paying the full face for a death during the grace period — the overdue premium is deducted first.
- Treating the suicide clause's remedy as the face amount or as nothing at all — within the period the insurer refunds premiums paid.
- Thinking the incontestable clause forgives nonpayment of premium — it bars contests over application misstatements, nothing more.
- Confusing the assignments: collateral is the lender's temporary claim limited to the debt; absolute transfers every right forever — and neither needs the insurer's permission, only written notice.

- Forgetting that reinstatement demands both proof of insurability and back premiums with interest — and that its reward is the original issue-age premium.

Make it a game · Beat the Clock: Provision Court. Write twelve one-line claims on slips — "died day 20 of grace, premium $300 overdue," "age misstated, found in year 6," "suicide, month 30," "lapsed 2 years, wants policy back," "lender assigned $10,000 of a $50,000 policy." A parent plays judge and reads each slip; you have ten seconds to rule: PAY FACE, PAY FACE MINUS, ADJUST, REFUND PREMIUMS, or STATE THE PRICE (for reinstatements), plus the provision's name. One point per correct ruling, a bonus for the correct number (31 days, 2 years, 3 years). Miss one and the judge reads the correction aloud while you write it in your notebook. Best of twelve wins the gavel.

Scripture. "In whose eyes a vile person is contemned; but he honoureth them that fear the LORD. He that sweareth to his own hurt, and changeth not." (Psalm 15:4, KJV)

David's portrait of the man who may dwell on God's holy hill includes one business habit: he keeps his word even when keeping it costs him. The incontestable clause is that virtue written into law — after two years the insurer must stand by its promise though it hurts. An agent who explains a policy truthfully before the sale practices the same verse in advance.

4.2 Beneficiaries and Settlement Options

OBJECTIVES

- Order beneficiary classes — primary, contingent, tertiary — and explain what happens when each class is empty.
- Contrast revocable and irrevocable designations and state the rights an irrevocable beneficiary holds.
- Split proceeds per stirpes and per capita from a drawn family tree.
- Explain the common disaster problem, the Uniform Simultaneous Death Act and the spendthrift clause.
- Name the settlement options, compute fixed-period and fixed-amount payments, and rank the life income options by monthly payout.

> **Warm-up.** In five minutes, draw your own family as a tree — grandparents at top, then parents, then you and any siblings or cousins. Put a small coin symbol beside three people, in order, whom you would trust to use money wisely for the others. You have just drafted a beneficiary designation; keep the tree, because this lesson will teach you the Latin for what you did.

WATCH

Beneficiary Designations - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 4:25

https://www.youtube.com/watch?v=aqIG_EYf2ko

> **WHEN TO WATCH**
> Watch after the big idea; pause at each designation type and point to the person on your warm-up tree who would receive the money under it.

BACKUP VIDEO

Life Insurance Exam [National] 47 – Settlement Options Explained

Open Exam Prep · 4:19

https://www.youtube.com/watch?v=iE9XewANB2M

Watch before the project for a second, fast pass through the settlement options; pause after each option and say aloud what is guaranteed and what that guarantee costs the monthly check.

KEY TERMS

beneficiary

The person or entity named in the policy to receive the death proceeds.

primary beneficiary

The first in line for the proceeds; if no primary survives the insured, the proceeds move to the contingent class.

contingent (secondary) beneficiary

The beneficiary who receives the proceeds only if no primary beneficiary is alive to take them; a tertiary class may stand behind the contingent.

revocable beneficiary

A designation the policyowner may change at any time without the beneficiary's consent.

irrevocable beneficiary

A designation that vests a right in the beneficiary: the owner cannot change it, assign the policy, borrow its value or surrender it without that beneficiary's written consent.

per stirpes

Latin for "by the branch": a deceased beneficiary's share passes down to his or her own living children.

per capita

Latin for "by the head": proceeds are divided equally among the named class members who are alive, with nothing passing down a dead member's branch.

common disaster clause

A policy provision, resting on the Uniform Simultaneous Death Act, that treats the primary beneficiary as having died first when insured and beneficiary die in the same event or within a stated survivorship period.

spendthrift clause

A provision protecting proceeds held by the insurer under a settlement option from the beneficiary's creditors and from being assigned or squandered in advance.

settlement option

A way of paying the death proceeds other than one lump sum: interest only, fixed period, fixed amount, or a life income.

life income (straight life) option

A settlement option paying the beneficiary an income for as long as he or she lives, with payments ending at death — the largest monthly payment of the life options.

joint and survivor option

A life income on two lives: payments continue while either person is alive, often reduced to two-thirds or one-half after the first death.

CORE IDEAS

The story. On the night of April 14–15, 1912, Isidor Straus, the seventy-year-old co-owner of Macy's department store, stood on the deck of the sinking *Titanic* beside his wife Ida. A lifeboat seat was offered; Ida refused it. She had been his wife for forty-one years, she said, and where he went, she would go. They were last seen together, and the sea took them both. Amid the grief, their deaths posed a question the law was poorly built to answer: when a husband and wife die in the same disaster and no one knows who died first, whose heirs inherit? If the wife is the husband's life insurance beneficiary and she outlived him by one unprovable minute, the proceeds pass through *her* estate to *her* heirs — perhaps to people the insured never meant to benefit, after a second round of probate costs. Courts heard such cases for decades, guessing at the order of deaths in shipwrecks and house fires. The answer finally came as the **Uniform Simultaneous Death Act** of 1940: when the order of death cannot be established, each person's property passes as if he or she survived the other — so the insured's proceeds go to the contingent beneficiary, exactly as if the primary had died first.

How they figured it out. Insurers wrote the statute's logic directly into their policies as the **common disaster clause**, and then improved on it. A pure simultaneous-death rule only solves ties, so companies added **survivorship periods**: the primary beneficiary must outlive the insured by a stated time — 30 or 60 days is common in this example — or be treated as having died first. That one sentence keeps proceeds from making a pointless, expensive trip through a dying beneficiary's estate when an accident kills one spouse instantly and the other weeks later. The same era of practical draftsmanship produced the **spendthrift clause** — the courts had upheld protecting a beneficiary's support from his own folly and his creditors in trust law (the Supreme Court blessed the idea in *Nichols v. Eaton*, 1875), and insurers borrowed it so that proceeds left with the company under a settlement option cannot be seized,

assigned or pledged before they are paid out. Each clause is a patch sewn where some real family's tragedy tore a hole.

The big idea. The beneficiary designation is the policyowner's answer to the only question the insuring clause leaves open: *pay whom?* The answer comes in ranked classes. The **primary beneficiary** — one person or several — takes first. If no primary survives (or is deemed to survive) the insured, the **contingent** (secondary) class takes; behind it an optional **tertiary** class waits. If every class fails, the proceeds fall into the insured's **estate** — the default the designation exists to avoid, because money in the estate goes through probate's delay and expense, lies exposed to the estate's creditors, and may enlarge estate-tax exposure. Any person or entity can be named: family, a trust, a charity, a business partner. A **minor** can be named but cannot legally receive the money, so insurers hold it or a court appoints a guardian — the practical answer is a trust or a custodian under a state's Uniform Transfers to Minors Act. The class system is the exam's favorite ladder: know who takes, in what order, and where the money lands when the ladder is empty.

The owner's power over the designation comes in two strengths. A **revocable** designation — the usual choice — can be changed by the owner at will; the beneficiary has a mere expectancy, not a right, and consents to nothing. An **irrevocable** designation vests a legal interest: the owner cannot change the beneficiary, assign the policy, take a policy loan or surrender the contract without the irrevocable beneficiary's written consent, because every one of those acts could shrink what that beneficiary has been promised. Divorce decrees and support agreements are where irrevocable designations usually appear. Then comes the Latin that decides family disputes. Suppose the proceeds are left "to my three children, Ann, Ben and Carl," and Ben dies before the insured, leaving two children of his own. **Per capita** — by the head — divides among the living named beneficiaries only: Ann and Carl split everything, and Ben's children take nothing. **Per stirpes** — by the branch — lets Ben's share flow down his branch of the tree: Ann and Carl each take a third, and Ben's two children split his third. Draw the tree; the arithmetic then does itself.

Once the right person is found, the **settlement options** decide how the money arrives. The default is a **lump sum** — the full proceeds at once, income-tax-free (Lesson 4.5 proves it). Under **interest only**, the company holds the principal and pays the interest it earns — commonly with a guaranteed minimum rate — until a

later date hands the principal over; it is a parking place, often for a young family deciding slowly. Under **fixed period**, the proceeds plus interest are paid in equal installments over a chosen time — say ten years; the *time* is fixed, so extra interest raises the size of each payment. Under **fixed amount**, the beneficiary chooses the payment — say $2,000 a month — and the money lasts as long as it lasts; the *payment* is fixed, so extra interest stretches the *time*. The exam tests exactly that contrast. Neither option promises lifetime income: a fixed period or amount can end while the beneficiary is still very much alive.

The **life income options** fix that, by turning the proceeds into an annuity on the beneficiary's life — this is the bridge to Lesson 4.4. **Straight life** pays the largest monthly check, because it promises nothing after the beneficiary's death: live two months, collect two payments. **Life with period certain** pays for life but guarantees a minimum number of years to someone — ten years certain, commonly — so the check is smaller. A **refund** option guarantees that at least the original proceeds come back, in a lump (cash refund) or in continuing installments (installment refund); smaller still. **Joint and survivor** stretches one income over two lives — a widowed mother and a disabled son, in this example — continuing until the second death, often at two-thirds or one-half of the original payment after the first; because two lives must end before the company stops paying, each check is the smallest of all. The rule that ranks every option: the more the company guarantees, the smaller the monthly payment.

On the exam today. Beneficiary questions are ladder questions: primary takes; if dead, contingent; if all dead, the estate — and the examiner wants you to flinch at "estate" because of probate, creditors and taxes. Expect an irrevocable-beneficiary question built on consent: the owner wants a loan, a surrender or a new beneficiary, and the answer is *not without the irrevocable beneficiary's written consent*. The per stirpes question is a drawn family tree in words — translate it to paper and push the dead child's share down the branch. The common disaster question gives a crash and a beneficiary who lives nine days inside a 30-day survivorship clause: pay the contingent, as though the primary died first. On settlement options, two traps repeat for generations: fixed period versus fixed amount (what does excess interest change — the payment, or the clock?), and which life option pays most per month — straight life, precisely because it guarantees least. And the spendthrift clause protects

proceeds from the *beneficiary's* creditors while the insurer holds them — not from the insured's, and not after the money is paid out.

PICTURE STUDY



The Copley Family, John Singleton Copley, 1776–1777 · Oil on canvas · National Gallery of Art, Washington, D.C.

Image: Wikimedia Commons, public domain

John Singleton Copley, colonial America's greatest portraitist, painted his own household soon after the family was reunited in London in 1775 — himself at the top, his father-in-law, his wife, and the four children tumbled affectionately around her. It is three generations in one frame: exactly the tree an agent draws when a client says "my children, and if anything happens to them, their children." It opens this lesson because every beneficiary designation is a family portrait translated into ranked names — and because the painter has placed himself where the breadwinner stands, just behind everyone he must provide for.

Look closely

- Count the generations — grandfather, parents, children. Map them onto primary, contingent and tertiary classes: who would you rank where, and why?
- Notice whose hands touch whom: the mother gathers two children, the eldest daughter leans on her, the grandfather holds the littlest girl's side. Affection here runs down the branches — per stirpes, by the branch.
- Find the papers in Copley's hand and the doll dropped on the carpet. One speaks of the adult world of documents, the other of the people those

documents exist to protect.

- Study the grandfather's face beside the energetic children. What does his age add to a picture otherwise full of beginnings?

Talk about it

1. If this father insured his life, the painting shows his whole designation problem: a wife, four children, a grandfather. Draft the designation — primary, contingent, per stirpes or per capita — and defend it.
2. The doll on the floor belongs to a minor. Why can a minor be named a beneficiary but not be handed the money, and what arrangements solve it?
3. Proverbs says a good man leaves an inheritance to his children's children. What does it say about a father's heart that the law needed a Latin phrase — per stirpes — to copy it?

PROJECT

The Harper Tree: A Beneficiary and Settlement Workbook

You will design the complete who-gets-what plan for a pretend family — the Harpers — and then pay the same death claim four different ways. The finished page pair (the tree and the options table) goes into your Pathway File, and the arithmetic you do here is the arithmetic of real exam questions.

You will need

- Two sheets of paper, ruler, pencil and two ink colors
- A calculator
- This lesson's key terms and the iii.org beneficiary article from the kit

Steps

1. Create the Harpers: Tom (insured, $240,000 policy), his wife June, their three adult children, and two grandchildren through the middle child. Draw the tree with ages.
2. Write the designation: June primary; the three children equal contingents, per stirpes; Tom's church as tertiary. Add one sentence explaining why the estate was avoided.
3. Scenario 1 — June survives: trace the money with an arrow and label the lump-sum default.
4. Scenario 2 — June and Tom die in a crash, June nine days later, with a 30-day survivorship clause: trace the money to the contingents and cite the common disaster clause and the Uniform Simultaneous Death Act.
5. Scenario 3 — the middle child predeceases Tom and June: split $240,000 per stirpes, then per capita, in a two-column table.
6. Now build the settlement options table for June on $240,000: interest only at 4% in this example ($9,600/year); fixed period 10 years (ignore interest: $2,000/month); fixed amount at $3,000/month (80 months); and the four life income options ranked by payment size with one line each on what is guaranteed.

7. Mark with a star the option you would explain first to a 70-year-old June and, in two sentences, why — needs, not products.
8. Date both pages and clip them into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for every key term; on the per stirpes and per capita cards, draw a tiny three-branch tree on the back with the shares filled in.
2. Draw the settlement options as a staircase: lump sum on the landing, then interest only, fixed period, fixed amount, and the life incomes descending by monthly payment size — label the handrail "more guarantee, smaller check."
3. Write a five-line trap list titled "Who gets paid?", ending with: when every class fails, the ESTATE takes — and that is the answer to avoid, not to pick.

KEY FORMULAS

$$\text{fixed-period payment} \approx \frac{\text{proceeds}}{\text{number of payments}} \quad \text{(plus interest)}$$

$$\text{months paid under fixed amount} \approx \frac{\text{proceeds}}{\text{monthly payment}}$$

From history. Settlement options grew teeth in the Great Depression: with banks failing by the thousands, many widows deliberately left death proceeds with the life insurer at guaranteed interest rather than deposit them anywhere else, and "leave it with the company" became ordinary prudence. Insurance-company guarantees of the 1930s paid out when much else did not — one reason the interest-only and installment options survived into every modern policy.

Example 1. Marta's $300,000 policy names her children Ann, Ben and Carl as equal primary beneficiaries, per stirpes. Ben dies before Marta, leaving two children. At Marta's death, who receives what — and what would change under a per capita designation?

Show solution

1. Draw the tree: Marta; branches to Ann, Ben (deceased, two children) and Carl.
2. Per stirpes — by the branch: each branch keeps its third. Ann $100,000, Carl $100,000, and Ben's third drops to his children: $50,000 each.
3. Per capita — by the head: divide among living named beneficiaries only. Ann and Carl take $150,000 each; Ben's children take nothing.
4. The designation's two Latin words moved $100,000 — which is why agents are taught to ask about grandchildren.

Answer: Per stirpes: Ann $100,000, Carl $100,000, Ben's children $50,000 each. Per capita: Ann and Carl $150,000 each, the grandchildren nothing.

Example 2. A beneficiary elects the fixed-amount option on $120,000 of proceeds, taking $2,500 per month. Ignoring interest in this example, how long do payments run — and what does crediting interest change?

Show solution

1. Months $\approx \$120{,}000 \div \$2{,}500 = 48$ — four years of payments.
2. Under fixed amount, the payment is locked at $2,500; interest credited to the held funds therefore cannot raise the check.
3. Instead, interest adds months: the money lasts longer than 48 payments.
4. Contrast the mirror option: under a 48-month fixed period, the clock is locked, so interest would raise each payment above $2,500 instead.

Answer: About 48 months before interest; interest extends the number of payments under fixed amount, while under fixed period it would enlarge each payment. That mirrored pair is the exam's favorite settlement-option question.

Example 3. Exam style. A 68-year-old widow with no dependents wants the largest possible monthly income from her late husband's $200,000 in proceeds, for as long as she lives. Which settlement option fits?

A. Fixed period, 10 years

B. Life income with 20-year period certain

C. Straight life income

D. Joint and survivor

Show solution

1. Her two requirements: income she cannot outlive, and the largest check.
2. A fails the first test — a fixed period can end while she is alive.
3. B and D are life incomes, but each adds a guarantee (a certain period; a second life), and every added guarantee shrinks the monthly payment.
4. C, straight life, pays for exactly her lifetime and promises nothing after — so the insurer can pay the most per month. With no dependents, the lack of a death-time guarantee costs her nothing she values.

Answer: C. Straight life income pays the most per month of any lifetime option precisely because payments stop at her death; with no one depending on a residue, that trade suits her stated need.

PRACTICE

1. Easy Name the three beneficiary classes in order, and state where proceeds go if all three fail.

   Show answer

   Primary, contingent (secondary), tertiary; if no named beneficiary survives, the proceeds pass to the insured's estate — exposed to probate, creditors and possible estate tax.

2. Easy What rights does an irrevocable beneficiary have that a revocable one lacks?

   Show answer

   A vested interest: the owner cannot change the designation, assign the policy, borrow against it or surrender it without the irrevocable beneficiary's written consent. A revocable beneficiary has only an expectancy.

3. **Easy** Which settlement option pays the beneficiary interest while the company keeps the principal for later?

Show answer

Interest only. The principal is held — commonly with a guaranteed minimum interest rate — and paid out or moved to another option later.

4. **Medium** Proceeds of $180,000 are paid under a 10-year fixed-period option. Ignoring interest in this example, what is the monthly payment, and what does credited interest do to it?

Show answer

$180,000 \div 120 = \$1{,}500$ per month; because the period is fixed, credited interest increases the size of each payment rather than the number of payments.

5. **Medium** Insured and primary beneficiary die in the same accident; the order of deaths cannot be established and the policy has a common disaster clause. Who is paid, and under what law's presumption?

Show answer

The contingent beneficiary — under the Uniform Simultaneous Death Act's presumption that the insured survived the beneficiary, which the common disaster clause writes into the policy (often extended by a 30- or 60-day survivorship period).

6. **Medium** A policyowner names "my wife, if living; otherwise my two sons equally." His wife predeceases him; one son also predeceases him leaving a daughter, and the designation is per capita. Who takes what at his death?

Show answer

The surviving son takes all of it. Per capita divides among the living members of the named class only — the granddaughter takes nothing, which is exactly what per stirpes would have changed.

7. Medium Why do agents urge clients not to let proceeds default to the estate? Give three reasons.

Show answer

Probate delay, probate expense and exposure to the estate's creditors — and for larger estates, possible estate-tax enlargement. A named living beneficiary takes directly, outside the probate process.

8. Hard Which life income option pays the LARGEST monthly amount, and why?

A. Life with 10-year period certain

B. Straight life

C. Installment refund

D. Joint and survivor

Show answer

B. Straight life guarantees nothing after the beneficiary's death, so the insurer can commit the most per month; every other option adds a guarantee (minimum years, refund of principal, a second life) and pays less.

9. Hard A beneficiary elects fixed amount at $1,800 per month on $108,000. Ignoring interest, how many months are paid — and if the company credits interest, does the check or the calendar change? Then state the mirrored answer for a 60-month fixed period.

Show answer

$\$108{,}000 \div \$1{,}800 = 60$ months; interest extends the calendar (more months at the same $1,800). Under a 60-month fixed period the calendar is locked, so interest fattens each check instead.

10. Hard An owner wants to take a $15,000 policy loan, but his ex-wife is the irrevocable beneficiary under their divorce decree. May the insurer process the loan on his signature alone? Explain.

Show answer

No. A policy loan reduces what the irrevocable beneficiary would receive, so her written consent is required — the vested designation restrains the owner's use of loans, surrender, assignment and beneficiary changes alike.

11. **Challenge** The spendthrift clause and the interest-only option are often elected together for a young or imprudent beneficiary. In three sentences, explain how the pair works and name its one clear limit.

Show answer

Interest only keeps the principal in the insurer's hands, paying out only earnings until the beneficiary matures or a trustee takes over. The spendthrift clause shields those held proceeds from the beneficiary's creditors and from being assigned, pledged or anticipated. Its limit: once money is actually paid to the beneficiary, it is ordinary money — the shield covers only what the insurer still holds.

12. **Challenge** Design a designation for this family and defend it in three sentences: a widow, age 64; a responsible married daughter with two children; a son with serious debt problems. Use the lesson's vocabulary.

Show answer

One sound plan: the daughter and son as equal primary beneficiaries per stirpes, with the son's share paid under an interest-only or fixed-amount option protected by the spendthrift clause, and the grandchildren as contingents. Per stirpes keeps a predeceasing child's share in that child's branch. The spendthrift-protected settlement option keeps the son's creditors — and his own haste — away from the principal while still supporting him. (Other defensible designs exist; what is graded is the correct use of the tools.)

COMMON MISTAKES

- Letting "estate" sound safe — on the exam, proceeds falling to the estate is the failure mode (probate, creditors, possible estate tax), not a recommended designation.
- Confusing the Latin: per stirpes sends a dead beneficiary's share DOWN his branch; per capita divides among living named heads only.
- Swapping the fixed options: under fixed PERIOD extra interest raises the payment; under fixed AMOUNT it extends the time.
- Saying any life income option could pay more per month than straight life — adding a period certain, a refund or a second life always shrinks the check.
- Forgetting that an irrevocable beneficiary's written consent is needed for loans, surrenders and assignments — not just for changing the name.

- Assuming the spendthrift clause protects money after it is paid out — it shields only proceeds the insurer still holds under a settlement option.

Make it a game · Who Gets the Check?. Draw the Harper family tree from the project large on one sheet. A parent invents ten quick scenarios aloud — "June died last year, middle child gone too, designation says per stirpes," "everyone named has died," "crash, June lives 9 days, 30-day clause" — and tosses a coin onto the table as the death claim. You have fifteen seconds to slide the coin to the person or split it into shares with scrap-paper markers, naming the rule you used. One point per correct landing, bonus for correct Latin. Then trade: you invent scenarios and the parent slides the coin, while you judge with the answer key you made. First to seven points chooses dessert.

Scripture. "A good man leaveth an inheritance to his children's children: and the wealth of the sinner is laid up for the just." (Proverbs 13:22, KJV)

The proverb looks two generations down the tree — exactly what a per stirpes designation does when it carries a lost child's share to the grandchildren. Naming beneficiaries with care is not paperwork; it is the good man's foresight given legal force, love written in ranked names.

4.3 Riders and Nonforfeiture: Options Built Into the Promise

OBJECTIVES

- Define a rider and describe waiver of premium, payor benefit, accidental death, guaranteed insurability, accelerated benefit, long-term care and return-of-premium riders.
- Tell Elizur Wright's story and explain why nonforfeiture laws exist.
- Name the three nonforfeiture options and state which one is usually automatic.
- Explain the automatic premium loan and why it is a provision rather than a nonforfeiture option.
- Choose a sensible nonforfeiture option for a given family scenario and defend the choice.

> **Warm-up.** In five minutes, answer this with pencil and paper: you have saved $18 of a $30 model kit at the hobby shop on layaway, and now you must stop paying. Write down three fair things the shop could offer you instead of keeping your $18. Keep the list — by the end of this lesson you will discover you have reinvented Elizur Wright's three nonforfeiture options.

WATCH

Riders - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 28:25

https://www.youtube.com/watch?v=tVoyYZhVsng

> **WHEN TO WATCH**
> Watch in two sittings if you like — through the waiver and accidental death riders in session one, the rest before the project — and build a one-line flashcard for each rider as it is named.

BACKUP VIDEO

Non-Forfeiture Options for the Life Insurance Exam

Insurance Exam Queen · 6:56

https://www.youtube.com/watch?v=4VkRVeBXprs

Watch before building the safety-net table; as each option is explained, say aloud what it keeps (face? permanence? cash?) and what it gives up.

KEY TERMS

rider

An amendment attached to a policy that adds, limits or modifies coverage, usually for an extra premium.

payor benefit rider

On a juvenile policy, waives premiums if the adult premium-payor dies or becomes disabled before the child reaches a stated age.

waiver of premium rider

If the insured becomes totally disabled — commonly after a 6-month waiting period — the insurer waives premiums for the duration of the disability while the policy stays fully in force.

accidental death rider (double indemnity)

Pays a multiple — commonly double — of the face amount if death results from an accident, typically within 90 days of the injury and before a stated age.

guaranteed insurability rider

Lets the insured buy stated additional amounts of coverage at specified ages or life events — marriage, a birth — without new evidence of insurability.

accelerated (living) benefit rider

Advances part of the death benefit — commonly up to 50% in this example — to an insured who is terminally ill, reducing what the beneficiary later receives.

long-term care rider

Draws on the policy's death benefit to pay for qualifying long-term care, trading death benefit for care dollars.

return of premium rider

On a term policy, refunds the premiums paid if the insured outlives the term, for a substantially higher premium.

nonforfeiture options

The choices state law guarantees a policyowner who stops paying on a cash-value policy: cash surrender, reduced paid-up insurance, or extended term insurance.

reduced paid-up insurance

Using the cash value as a single premium to buy a smaller, fully paid policy of the same kind, with no further premiums due.

extended term insurance

Using the cash value as a single premium to buy term insurance for the full original face amount for as long as the value will carry it — usually the automatic option.

automatic premium loan

A provision (not a nonforfeiture option) that pays an overdue premium by loan against the cash value, preventing lapse as long as value remains.

CORE IDEAS

The story. In 1844 a Massachusetts mathematician and abolitionist named **Elizur Wright** visited London and wandered into the Royal Exchange on a day when life insurance policies were being auctioned. The sellers were old men who could no longer afford their premiums. Under the rules of the day, a lapsed policy was simply forfeited — decades of payments gone, the insurer enriched by the policyholder's poverty — so the old men sold their policies to speculators, who would pay the remaining premiums and collect when the insured died. Wright watched strangers bidding on the deaths of the men standing before them, and never forgot it. He went

home, mastered actuarial science, and in 1858 became one of the first insurance commissioners of Massachusetts. There he forced insurers to prove their reserves — the savings inside every level-premium policy — and then asked the question that changed the contract itself: if part of every whole life premium builds a reserve, whose money is that? In 1861 Massachusetts answered with the first **nonforfeiture law**: a lapsing policyholder could no longer simply lose the value he had built. Insurance historians call Wright the father of life insurance regulation; every cash surrender check since is his monument.

How they figured it out. The principle Wright established — the reserve belongs in equity to the policyholder — took decades to work out in detail, and the industry's answer became the three-option menu now written into every state's Standard Nonforfeiture Law. The insurer cannot keep the value, but it also cannot be forced to continue a contract nobody is paying for; so the law lets the owner convert the value into one of three things: cash, a smaller permanent policy, or temporary insurance at full size. Alongside the legal guarantee grew the **riders** — a menu of optional promises bolted onto the basic contract for an extra premium, each one invented to answer a real family's question. What if I become disabled and cannot pay? (Waiver of premium.) What if the parent paying for a child's policy dies? (Payor benefit.) What if I die in an accident while the children are young? (Accidental death.) What if my health fails before I can buy more coverage? (Guaranteed insurability.) The pattern to notice: provisions are the promises the law requires; riders are the promises a family chooses to add.

The big idea. A **rider** is an attachment that changes the contract — usually adding coverage for added premium, occasionally restricting it (an aviation exclusion rider is a rider too). Learn the protection riders first. **Waiver of premium**: if the insured becomes totally disabled, commonly before age 60 or 65 and lasting past a waiting period of about 6 months, the insurer pays the premiums itself for as long as the disability lasts — cash value keeps growing, dividends keep arriving, the promise stands whole. Many companies refund the premiums paid during the waiting period once the waiver begins. **Payor benefit** is the same idea wrapped around a juvenile policy: it is the *payor's* death or disability, not the child's, that triggers it, and the premiums are waived until the child reaches a stated age — 21 or 25 commonly. On the exam, the trigger is everything: waiver of premium watches the insured; payor benefit watches the person writing the checks.

Now the riders that add or advance money. The **accidental death benefit** — the famous **double indemnity** — pays a multiple of the face if death is caused by accident, usually requiring death within 90 days of the injury and expiring at an age like 65 or 70; it never adds cash value, and the base face amount is unchanged for ordinary deaths. **Guaranteed insurability** lets a young insured purchase additional stated amounts at option dates — ages like 25, 28, 31 and so on, or at marriage and births — with no new medical questions: health may fail, but the right to buy does not. **Accelerated (living) benefits** turn the policy around to face its owner: a terminally ill insured — commonly with a prognosis of 24 months or less, in this example — may draw an advance, often up to 50%, against the death benefit, with the remainder going to the beneficiary afterward. A **long-term care rider** does something similar for qualifying care costs, spending the death benefit early so that the family does not. And the **return of premium rider** on term insurance refunds the premiums if the insured outlives the term — purchased, always, with a much higher premium along the way. Term riders — a spouse rider, a child rider, additional level or decreasing term on the insured — stack temporary coverage on a permanent base, one premium, one policy.

Then comes Wright's legacy: the **nonforfeiture options** on any policy that builds cash value. Option one, **cash surrender**: take the money and walk away — the coverage ends, and any gain over premiums paid is taxable (Lesson 4.5 does the figures). Option two, **reduced paid-up insurance**: the cash value becomes a single premium buying as much *fully paid* whole life as it will fund at the insured's attained age — a smaller face, the same kind of policy, cash value still growing, and never another premium due. Option three, **extended term insurance**: the cash value becomes a single premium buying *term* insurance for the full original face amount, lasting exactly as long as the value can carry it — 14 years and 120 days, say, computed from the tables in the policy. Extended term is usually the **automatic option** if the owner makes no choice, because it preserves the full death benefit the family was counting on, at least for a time. The choice is a needs question: cash for a family leaving the need behind, reduced paid-up for a permanent but smaller need, extended term to hold the full promise through the remaining dangerous years.

One more rescue device belongs here, though it is a provision rather than a nonforfeiture option — and the exam loves that distinction. The **automatic premium loan** provision, if elected, instructs the insurer to pay any premium still unpaid at

the end of the grace period by borrowing it from the policy's own cash value. The policy does not lapse; it quietly finances itself, loan by loan, until the value is exhausted or the owner resumes paying. It is a lifeline for the forgetful and the temporarily broke — and a slow leak if ignored, since loans bear interest and reduce the death benefit until repaid. Because it merely creates a policy loan, the law classifies it with the loan provisions, not the nonforfeiture options; a four-choice question that lists "automatic premium loan" among the nonforfeiture options is testing exactly that classification.

On the exam today. Rider questions hinge on triggers, clocks and amounts. Waiver of premium: total disability, about a 6-month wait, the insurer pays and the policy rides on whole. Payor benefit: the payor's death or disability on a juvenile policy. Accidental death: accident, commonly within 90 days of injury, a multiple of face — and no effect on cash value. Guaranteed insurability: more coverage at set dates with no evidence of insurability — the phrase the right answer always contains. Accelerated benefits: terminal illness, an advance that *reduces* the death benefit — and the beneficiary's remainder is the number the question wants. Nonforfeiture questions come in two forms: name the three options (cash surrender, reduced paid-up, extended term — and the automatic one is extended term), and classify the impostor (the automatic premium loan is not one of them). The last standard trap is the direction of each option: reduced paid-up shrinks the *face* but keeps the *duration* permanent; extended term keeps the *face* but shrinks the *duration*. Say it twice and it is yours.

PICTURE STUDY



The Life Line, Winslow Homer, 1884 · Oil on canvas · Philadelphia Museum of Art

Image: Wikimedia Commons, public domain

Winslow Homer, America's great painter of the sea, unveiled this canvas in 1884 to immediate sensation: a shipwreck rescue by breeches buoy, the rope-and-pulley line that coastal lifesaving crews fired out to stranded ships. Homer had watched the apparatus demonstrated in England and at Atlantic City, and he paints not the wreck but the rescue — two human beings suspended over rage, held up by a line someone rigged before the storm. It opens this lesson because that is exactly what a rider or a nonforfeiture option is: rescue apparatus built into the promise ahead of time, waiting for the day the ship fails.

Look closely

- Follow the rope line from corner to corner. Everything hangs from it — like a family hanging from a clause someone added years earlier.
- Notice the red scarf hiding the rescuer's face. Homer painted the rescue, not the rescuer's glory. Who is the unseen rescuer when a waiver of premium carries a disabled father's policy?
- Study the woman's hands and posture — past saving herself. Which of this lesson's riders exist precisely for the moment when self-help is over?
- Look at the sea itself, filling most of the canvas. The apparatus is small and the danger is enormous — yet the line holds.

Talk about it

1. The breeches buoy was rigged, drilled and paid for in calm weather. Which costs a family more: rescue apparatus never used, or a storm with no apparatus? Connect your answer to rider premiums.
2. Elizur Wright saw men whose line was cut just when they weakened — lapsing policies forfeited entirely. How do the three nonforfeiture options re-rig the line for a family that can no longer pay?
3. Scripture pictures God commanding rescue for the perishing. When an agent explains an accelerated benefit to a dying client, how is that work an echo of the breeches buoy — and of grace?

PROJECT

The Rider Menu and the Safety-Net Table

You will build two artifacts for your Pathway File. First, a restaurant-style "rider menu" for a pretend family — each rider with its trigger, its clock and its price in plain words. Second, Elizur Wright's safety-net table: the three nonforfeiture options worked for one policy, so you can see with your own eyes what each one preserves and surrenders.

You will need

- Two sheets of paper, ruler, pencil and two ink colors
- A calculator
- This lesson's key terms, and a chapter of Elizur Wright's Politics and Mysteries of Life Insurance from the kit if you want his voice in your ear

Steps

1. Create the Calders: Reed, 32, a carpenter; his wife Tansy, 31; children 4 and 1. Reed owns a $150,000 whole life policy.
2. Design the menu: list waiver of premium, payor benefit (for a child policy), accidental death, guaranteed insurability, accelerated benefit, and a child term rider. For each, write three lines: TRIGGER (what must happen), CLOCK (waiting period, deadline or expiry age, labeled "commonly"), and WHAT IT PAYS OR WAIVES.
3. Mark with a hammer symbol the two riders most important for a carpenter whose hands earn the family's bread, and defend each in one sentence.
4. Now the safety-net table. Suppose at age 45 Reed must stop paying, with cash value $24,000 and these in-this-example values: reduced paid-up $61,000; extended term $150,000 for 15 years, 200 days.
5. Build four columns — CASH, REDUCED PAID-UP, EXTENDED TERM, AUTOMATIC PREMIUM LOAN — and fill five rows: what the family gets now, what coverage remains, how long it lasts, what it costs later, and whether it is a nonforfeiture option at all (the last column's answer is NO — provision).
6. Under the table, write the automatic-option rule: silence chooses extended term, and one sentence on why the law picks the option that preserves the

full face.

7. Circle the option you would recommend to the Calders at 45 if the children were then 17 and 14, and defend it in two sentences by need.
8. Date both pages and clip them into your Pathway File.

EXAM NOTEBOOK

1. Make a flashcard for each rider with the TRIGGER on the front bottom in capitals — DISABLED INSURED, DEAD PAYOR, ACCIDENT, OPTION DATE, TERMINAL ILLNESS — since the trigger is what the exam tests.
2. Draw the three nonforfeiture options as three lifeboats leaving one ship: a small fast boat labeled CASH, a sturdy half-size boat labeled REDUCED PAID-UP (permanent), and a full-size boat with a sand timer labeled EXTENDED TERM (automatic).
3. Write a five-line trap list titled "Not a nonforfeiture option," ending with: the AUTOMATIC PREMIUM LOAN is a loan provision — it rescues the premium, not the forfeiture.

> **From history.** Elizur Wright did his reserve calculations with a machine of his own invention: the Arithmeter, a cylinder of logarithmic scales he patented in 1869, which let a clerk multiply and divide policy values by sliding brass rings. Massachusetts required insurers to prove reserves policy by policy — millions of computations in the age of pen and ink — and the commissioner simply built himself the computer the law required. Regulation and arithmetic have been partners ever since.

Example 1. Ellen, 45, stops paying on her whole life policy: face $100,000, cash value $18,000. In this example her options table reads: cash $18,000; reduced paid-up $42,000; extended term $100,000 for 16 years, 85 days. Her children are 10 and 12. Walk the choice.

Show solution

1. Name what each option preserves: cash preserves nothing but money today; reduced paid-up preserves permanence at $42,000 with no more premiums; extended term preserves the full $100,000 promise, but only into Ellen's early 60s.
2. Name the need: children 10 and 12 depend on her for roughly the next 10–15 years — squarely inside the 16-year extended term window.
3. Match need to option: extended term carries the full face through the dependent years, which is why the law makes it the automatic default.
4. Note the costs: at the term's end, coverage stops with nothing left; if a smaller permanent legacy mattered more than full temporary protection, reduced paid-up would win instead.

Answer: Extended term fits the stated need best: the full $100,000 stands guard through both children's dependency. The graded skill is matching what each option preserves to what the family actually needs.

Example 2. Exam style. An insured with a waiver of premium rider becomes totally disabled on June 1. The rider has a 6-month waiting period. He keeps paying premiums through the year. Which statement is TRUE once the waiver takes effect in December?

A. The policy continues, but cash value stops growing

B. Premiums are waived during disability, and many insurers refund the premiums he paid after June 1

C. The face amount is reduced by the waived premiums

D. The policy becomes extended term insurance

Show solution

1. The rider's promise: during total disability past the waiting period, the insurer pays the premiums itself.
2. Because real premiums are being paid (by the insurer), the policy stays entirely whole — cash value grows and dividends continue, eliminating A and C.
3. D confuses the rider with a nonforfeiture option; nothing has lapsed.
4. B states the practice: waiver begins after the wait, and premiums paid during the waiting period are commonly refunded.

Answer: B. The policy continues exactly as if premiums were being paid — because they are, by the insurer — and premiums paid during the waiting period are commonly refunded when the waiver begins.

Example 3. Exam style. Joel, 24, buys a $50,000 whole life policy with a guaranteed insurability rider allowing $25,000 purchases at ages 25, 28 and 31. At 27 he is diagnosed with a chronic illness that would make him uninsurable. What may he do at 28?

Show solution

1. State the rider's promise: additional stated amounts at option dates with NO evidence of insurability.
2. His diagnosis is irrelevant to the option — that is the entire reason the rider exists and was priced into his premium at 24.
3. At 28 he may buy the stated $25,000, at standard rates for his attained age, no medical questions.
4. What he may not do: buy more than the stated amount, or exercise options early — the schedule is the contract.

Answer: He may purchase the scheduled $25,000 of additional coverage at age 28 without evidence of insurability — his illness cannot be held against him. The rider guarantees the right to buy, on schedule, at attained-age rates.

PRACTICE

1. Easy Name the three nonforfeiture options and the one that usually applies automatically if the owner makes no election.

   Show answer

   Cash surrender, reduced paid-up insurance and extended term insurance; extended term is usually the automatic option.

2. Easy What does the waiver of premium rider do, and what waiting period is common?

   Show answer

   During the insured's total disability the insurer waives (pays) the premiums while the policy continues in full force; a waiting period of about 6 months is common, and premiums paid during the wait are often refunded.

3. Easy Under a double indemnity rider, what must generally be true of the death for the doubled benefit to be paid?

Show answer

It must result from an accident, commonly occurring within 90 days of the injury and before the rider's expiry age (65 or 70 commonly); ordinary deaths pay only the base face amount.

4. Medium A father buys a policy on his 8-year-old daughter. Which rider protects the policy if the father dies when she is 12, and what exactly happens then?

Show answer

The payor benefit rider: premiums are waived from the payor's death (or total disability) until the child reaches a stated age such as 21, when she can take over the premiums on a policy kept fully in force.

5. Medium Which option keeps the ORIGINAL face amount but for a LIMITED time?

A. Cash surrender
B. Reduced paid-up insurance
C. Extended term insurance
D. Automatic premium loan

Show answer

C. Extended term buys the full original face for as long as the cash value can carry it. Reduced paid-up (B) is the mirror image — permanent coverage at a smaller face — and D is not a nonforfeiture option at all.

6. Medium An insured with a terminal diagnosis takes a 50% accelerated benefit on a $200,000 policy. What does the beneficiary receive at death, before considering any fees or interest?

Show answer

About $100,000 — the accelerated advance reduces the death benefit dollar for dollar (insurers may also deduct modest interest or an administrative charge, in this example ignored).

7. Medium Why does the return of premium term rider cost so much more than plain term, and what does the buyer actually receive if he outlives the term?

Show answer

The insurer must charge enough extra to fund refunding every premium to survivors — the refund is the buyer's own extra money returned without growth. Outliving the term returns the premiums paid; dying during it pays the face like ordinary term.

8. Hard How does reduced paid-up insurance differ from the original policy in face amount, duration, premiums and cash value?

Show answer

Smaller face amount (whatever the cash value buys at attained age), same permanent duration, no further premiums ever, and the smaller policy continues to build its own cash value.

9. Hard A policyowner misses a premium and the grace period expires, but the policy does not lapse and no nonforfeiture option takes effect. What provision explains this, and what is slowly happening inside the policy?

Show answer

The automatic premium loan provision paid the premium by borrowing against the cash value. The policy stays whole, but loans accumulate with interest, shrinking the net death benefit and eventually exhausting the value if the owner never resumes paying.

10. Hard Why is extended term insurance usually the automatic nonforfeiture option rather than cash surrender? Answer in terms of what the law assumes a silent policyowner would want.

Show answer

A silent owner has expressed no wish to end protection, so the law preserves what the family was relying on — the full face amount — for as long as the built-up value can fund it. Cash surrender would quietly cancel the very protection the policy existed to provide.

11. **Challenge** Rank the three nonforfeiture options for each family in one line apiece: (a) a widow, 70, children grown and independent, policy need gone; (b) a father, 48, with teenagers and a decade of mortgage left; (c) a grandmother, 62, who wants to leave something permanent for a grandchild with special needs.

Show answer

(a) Cash surrender — the need the policy served has ended, so the value serves her retirement. (b) Extended term — full face through the dependent, mortgaged years matters most. (c) Reduced paid-up — a guaranteed permanent (if smaller) legacy with no further premiums. The options are tools matched to needs, not ranked goods.

12. **Challenge** Elizur Wright said a policy's reserve belongs in equity to the policyholder. Write three sentences connecting the London auction he witnessed in 1844, the Massachusetts law of 1861, and the options table printed in every modern whole life policy.

Show answer

At the Royal Exchange, Wright saw lapsing policyholders forced to auction their contracts to strangers because the insurer would otherwise keep every dollar of built-up value. Convinced that the reserve was the policyholder's own savings, he won the 1861 Massachusetts nonforfeiture law making forfeiture of that value illegal. The options table — cash, reduced paid-up, extended term, printed with guaranteed figures year by year — is that law made visible in every policy.

COMMON MISTAKES

- Listing the automatic premium loan as a nonforfeiture option — it is a loan provision that prevents lapse; the options are cash, reduced paid-up and extended term.
- Reversing the two insurance options: reduced paid-up shrinks the face but is permanent; extended term keeps the full face but is temporary.
- Forgetting that extended term is usually the automatic option when the owner makes no election.
- Confusing the triggers: waiver of premium watches the insured's disability; payor benefit watches the premium-payor's death or disability on a juvenile policy.

- Thinking an accelerated benefit is extra money — it is an advance that reduces the beneficiary's death benefit dollar for dollar.
- Missing the heart of guaranteed insurability: added amounts at scheduled dates with NO evidence of insurability — declining health cannot cancel the option.

Make it a game · Rider Round-Up. Make two stacks of cards. Stack one: the six riders plus the three nonforfeiture options and the automatic premium loan, one name per card. Stack two: ten trigger cards — "insured disabled 7 months," "payor dies, child is 12," "fatal car accident, day 40," "option date, now uninsurable," "terminal diagnosis," "stops paying, wants full face a while longer," "stops paying, wants smaller permanent policy," "forgot one premium, has cash value," "wants the money out," "outlived the 20-year term." Shuffle both, flip one from each: ten seconds to shout MATCH or NO MATCH, with the reason. Score one point per correct call; the automatic-premium-loan card paired with any "nonforfeiture" claim is an automatic NO MATCH — miss it and you lose two. First to ten points wins.

Scripture. "When they were filled, he said unto his disciples, Gather up the fragments that remain, that nothing be lost." (John 6:12, KJV)

After feeding the five thousand, the Lord of abundance still commanded that the fragments be gathered. Nonforfeiture law is that command applied to a family's premiums: the value built up over faithful years must be gathered into cash, paid-up coverage or extended term — not swept away. An agent who shows a struggling client the options table is gathering fragments so that nothing of theirs is lost.

4.4 Annuities: The Income That Cannot Be Outlived

OBJECTIVES

- Explain how an annuity mirrors life insurance and define the accumulation and annuity (payout) phases.
- Classify annuities by purchase method, start date and investment engine — immediate and deferred; single and periodic premium; fixed, indexed and variable.
- Explain why variable annuities require securities registration in addition to a state insurance license.
- Name the annuity payout options and rank them by monthly payment, and compute an exclusion ratio.
- Describe surrender charges and the suitability duty owed to annuity buyers, especially seniors.

> **Warm-up.** With pencil and paper: Grandma Pearl, 70, has $100,000 of savings and spends $1,000 a month of it. In five minutes, compute the age at which her money runs out — then write one sentence on the problem no savings account can solve: she does not know how long she will live. This lesson is about the contract invented for exactly that sentence.

WATCH

Annuity Principles And Concepts - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 15:42

https://www.youtube.com/watch?v=OzD0syM2d70

> **WHEN TO WATCH**
> Watch after the big idea; draw the two-phase timeline — accumulation, then annuitization — as the video walks it, and add each annuity type to your drawing where it belongs.

BACKUP VIDEO

Annuities on the Insurance Exam

Insurance Exam Queen · 19:40

https://www.youtube.com/watch?v=a-eN36957XA

A second full pass in a different teacher's voice; watch before the practice set and tally every classification pair you hear — immediate/deferred, single/flexible, fixed/indexed/variable — against your map.

KEY TERMS

annuity

A contract with an insurer that converts a sum of money into a stream of income, classically guaranteed for as long as the annuitant lives.

annuitant

The person whose life and life expectancy measure the annuity payments — the mirror of the insured in a life policy.

accumulation phase

The period during which a deferred annuity is funded and its value grows tax-deferred; the owner can usually surrender or withdraw during it.

annuity (payout) phase

The period after annuitization when the insurer pays the income stream; the election to annuitize is generally irreversible.

immediate annuity

An annuity bought with a single premium whose payments begin within one payment interval — commonly a month to a year; the classic SPIA (single premium immediate annuity).

deferred annuity

An annuity whose payout begins at a future date, funded by a single premium or flexible periodic premiums, growing tax-deferred until annuitization.

fixed annuity

An annuity paying guaranteed interest from the insurer's general account, with payments of fixed dollar amounts; the insurer bears the investment risk.

indexed annuity

A fixed annuity whose interest crediting is linked to a market index, with a guaranteed floor and caps or participation rates limiting the upside.

variable annuity

An annuity funded through a separate account of investment subaccounts; its value and payments vary with the markets, the owner bears the investment risk, and it is a security requiring FINRA registration to sell.

life income (pure life) payout

The payout option paying only while the annuitant lives — the largest monthly payment, with nothing payable after death.

exclusion ratio

The fraction of each annuity payment that is untaxed return of the owner's own money: investment in the contract divided by expected return.

surrender charge

A declining back-end fee — commonly running 5 to 10 years in this example — on early withdrawals from a deferred annuity.

CORE IDEAS

The story. The oldest retirement contract in the West carries a Latin name: the Roman *annua*, a payment bought for a lump sum and paid yearly for life — our word **annuity** is its grandchild. Around AD 220 the great Roman jurist **Ulpian** drew up the earliest surviving life-expectancy table to value such payments. The idea survived Rome and took a strange turn in 1653, when an Italian banker in Paris, **Lorenzo de Tonti**, proposed to Cardinal Mazarin that subscribers pool money, the crown pay the pool interest, and the income shares of the dead flow to the survivors — last

survivors collecting fortunes. The **tontine** was an annuity crossed with a wager on outliving your neighbors. France floated royal tontines for a century, and in 1868 American insurers revived the design as "tontine insurance" — dividends deferred for years and forfeited by all who lapsed or died. When New York's **Armstrong Investigation of 1905** opened the books, the hoarded funds stood exposed as slush funds for speculation and lobbying. New York outlawed the design in 1906, and the tontine era ended. The honest core of the idea — pooled longevity — survived, purified, as the modern annuity.

How they figured it out. What makes a life annuity work is the same law of large numbers that makes life insurance work, running in reverse. The insurer gathers a thousand 70-year-olds, each with $100,000. Some will live four years, some thirty-four; the mortality table says how the whole pool will behave. Those who die early stop collecting, and their unconsumed principal stays in the pool funding those who live long — actuaries call these **mortality credits**, and they are why a life annuity can pay each person more per month than any private savings plan that must assume the longest possible life. The pricing problem Ulpian first sketched — payments depend on expected lifetime — also explains a modern wrinkle: people who buy annuities tend to be the healthy ones expecting long lives, so insurers price them with their own annuity mortality tables, which assume longer lifespans than life insurance tables do. Same science, opposite risk: life insurance fears early death; the annuity pool funds long life.

The big idea. An annuity is life insurance turned upside down. Life insurance protects a family against the insured dying *too soon*; an annuity protects a person against living *too long* — outliving the money. The contract has two possible phases. In the **accumulation phase** of a deferred annuity, premiums go in — one lump or flexible payments — and the value grows tax-deferred; the owner may withdraw or surrender, facing the insurer's surrender charges and the tax rules of Lesson 4.5. At **annuitization** the value converts, generally irrevocably, into the **payout phase**: an income measured on the **annuitant's** life. The cast mirrors a life policy — **owner** (holds the rights), **annuitant** (the measuring life), **beneficiary** (receives any death benefit — during accumulation, commonly the greater of premiums paid or contract value). An **immediate** annuity (the SPIA) is bought with one premium and begins paying within a payment interval; a **deferred** annuity waits, sometimes decades. On the exam, purchase method, start date and engine are three separate classification

questions about one contract: a “flexible premium deferred fixed annuity” has answered all three.

The engine is the third classification, and the one with a licensing edge. A **fixed annuity** grows at interest the insurer guarantees, backed by its **general account**; payments arrive as fixed dollar amounts, the insurer bears the investment risk, the buyer bearing only the quiet risk that fixed dollars buy less over decades. An **indexed annuity** is a fixed annuity with interest crediting tied to a market index: a guaranteed floor — commonly zero or a small minimum, in this example — under crediting that is capped or scaled by a participation rate, so the buyer trades some upside for a shield on the downside. A **variable annuity** moves the money into a **separate account** divided into investment subaccounts; its accumulation units rise and fall with markets, and its annuity units make the payout itself variable. Because the owner bears investment risk, the variable annuity is legally a **security**: selling one requires FINRA registration — a Series 6 or 7 — and a state variable products line in addition to the life license. (The School Launch Series 65 course at /courses/business/series-65/ walks that road.)

The payout options parallel the settlement options of Lesson 4.2, and the same iron rule ranks them: the more the insurer guarantees, the smaller each check. **Life income (pure life, straight life)** pays the most per month, because payments stop at the annuitant’s death even if that is next spring — the estate gets nothing. **Life with period certain** guarantees a minimum span — ten years commonly — to a beneficiary if the annuitant dies early. **Refund annuities** promise that at least the purchase money comes back: a **cash refund** pays any shortfall in a lump; an **installment refund** keeps paying until premiums are recovered. **Joint and survivor** pays across two lives, usually reducing — to two-thirds or one-half, commonly — after the first death. And **annuities certain** — fixed period or fixed amount — guarantee no lifetime at all, just a schedule, exactly like their settlement-option twins. One more cost of the deferred years: the **surrender charge**, a back-end percentage that declines to zero across, in this example, seven years; many contracts allow a free annual withdrawal — commonly 10% — before the charge bites.

Who should own one — and who should not — is itself tested material, because annuity sales to seniors drew enough abuse that the states acted. Under the NAIC’s annuity suitability rules, strengthened into a **best interest** standard now adopted across most states, a producer recommending an annuity must act in the consumer’s

interest — gathering the suitability facts (age, income, liquidity needs, time horizon, tax status, objectives), disclosing his role and compensation conflicts, and documenting why the recommendation fits. Unit 9 studies the regulation in full; here, learn the sense of it. An annuity rewards money that can stay put: a 40-year-old funding retirement, a 68-year-old converting savings into unoutlivable income. It punishes money that may be needed soon — surrender charges and tax penalties lie across the exit — so the classic unsuitable sale is locking an elderly widow's emergency savings inside a long-surrender-charge deferred annuity. The honest screening question is the lesson's title turned around: does this client actually need income that cannot be outlived, from this money, on this schedule?

On the exam today. Classification questions are assembly lines: name the purchase method (single or flexible premium), the start (immediate or deferred), the engine (fixed, indexed, variable) — and an immediate annuity is necessarily single premium. The licensing question has one answer: selling variable annuities requires both a state insurance license and FINRA securities registration, because the owner bears the investment risk in a separate account; fixed and indexed annuities are insurance products sold on the insurance license alone. Payout questions rank the checks: pure life largest, then down the ladder of guarantees to joint and survivor — and "nothing for the estate under life only" is a fact, not a scandal. The exclusion ratio appears with friendly numbers: investment over expected return gives the untaxed fraction of each payment (gains are ordinary income — never capital gains). Suitability questions put a senior, an emergency fund and a 10-year surrender charge in one stem; the right answer protects liquidity. And the parties: the annuitant is the measuring life; the owner holds the rights — often, not always, the same person.

PICTURE STUDY



Old Woman Saying Grace, Known as 'The Prayer without End', Nicolaes Maes, c. 1656 · Oil on canvas · Rijksmuseum, Amsterdam

Image: Wikimedia Commons, public domain

Nicolaes Maes, one of Rembrandt's most gifted pupils, painted this quiet Dordrecht scene around 1656: an old woman alone at her table, giving thanks over bread and fish while a cat tugs at the cloth to steal the meal. The Dutch nicknamed it 'The Prayer without End.' Beside her sits an hourglass — time running — yet the table is set and the thanks are unhurried. It opens this lesson because an annuity exists to make exactly this picture possible: old age with bread on the table every day, however long the sand runs, provided for by prudence years before and received with gratitude.

Look closely

- Find the hourglass in the warm shadow. Nobody knows how much sand remains — which is the precise risk a life annuity pools away.
- Study the meal: bread, butter, a little fish. Not riches — reliability. What does a modest guaranteed income have in common with this table?
- Watch the cat pulling at the cloth. Even a secured old age has small thieves — rising prices, surrender charges, unsuitable sales. Name the lesson's protections against each.
- Notice her hands and closed eyes: the painting's center is not the food but the thanksgiving over it.

Talk about it

1. Grandma Pearl in the warm-up could outlive her savings; this woman's table is set to the end. Explain, using mortality credits, how a pool of strangers makes the difference.
2. A fixed annuity pays the same dollars for decades. What does the cat at the cloth suggest about the one risk the fixed payment does not cover?
3. Psalm 92 promises fruit in old age to those planted in God's house. How are diligence in youth, honest provision for age, and daily thanksgiving all visible in this one small room?

PROJECT

The Annuity Map and the Pearl Worksheet

You will draw the one-page map that sorts every annuity an exam can describe — three classification questions, one contract — and then put real arithmetic under it by working Grandma Pearl's income problem three ways. Both pages join your Pathway File.

You will need

- Two sheets of paper, ruler, pencil and two ink colors
- A calculator
- This lesson's key terms and the Investor.gov annuities page from the kit

Steps

1. Draw the map as three stacked question boxes: WHEN DOES IT PAY? (immediate / deferred), HOW IS IT BOUGHT? (single premium / flexible premiums), WHAT IS THE ENGINE? (fixed / indexed / variable) — with one-line definitions in each branch.
2. Under the variable branch, draw a badge reading SECURITY: FINRA registration + state variable line required, and a small signpost to the Series 65 course.
3. Across the bottom, draw the two-phase timeline — accumulation, annuitization (one-way door), payout — and mark where surrender charges live and where they end.
4. Add the payout ladder at the right margin: pure life at top (largest check), then period certain, refund options, joint and survivor (smallest), with the iron rule written vertically beside it.
5. Now the Pearl worksheet: using the figures from worked example 1, lay out her exclusion-ratio computation line by line — investment, expected return, ratio, untaxed and taxed slices of the $625 check.
6. Below it, answer in two sentences each: What changes for Pearl under life with 10-year period certain? Under joint and survivor with her sister? (Direction of change is enough — smaller checks, added guarantees.)

7. Finish with a five-line suitability check for Pearl: liquid emergency fund kept outside, time horizon, surrender schedule read aloud, her stated need (lifetime income), and who asked the questions — the agent, in writing.
8. Date both pages and clip them into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the key terms; on the variable annuity card write SECURITY — FINRA + insurance license in red across the bottom.
2. Draw the life-insurance mirror: two arrows on one timeline — life insurance guarding the years BEFORE an early death, the annuity guarding the years AFTER a long life — meeting at retirement.
3. Write a five-line trap list titled "Annuity answers the exam wants," ending with: gains come out as ORDINARY INCOME — never capital gains.

KEY FORMULAS

$$\text{exclusion ratio} = \frac{\text{investment in the contract}}{\text{expected return}}$$

$$\text{expected return} = \text{monthly payment} \times 12 \times \text{life expectancy in years}$$

From history. The mathematics of annuity pricing has a founding book: in 1671 Johan de Witt, Grand Pensionary of Holland, published *The Worth of Life Annuities Compared to Redemption Bonds,* proving to the States-General that the annuities Holland sold to fund its wars were badly underpriced for young lives. It was the first time a government priced a financial promise from mortality data — Ulpian's old idea finally armed with real arithmetic, two centuries before Elizur Wright brought the same rigor to Massachusetts.

WORKED EXAMPLES

Example 1. Pearl, 70, buys an immediate annuity with $90,000 of after-tax savings. It pays $625 a month for life, and the table life expectancy used is 16 years (in this example). How much of each payment is taxable?

Show solution

1. Expected return: $\$625 \times 12 \times 16 = \$120{,}000$.
2. Exclusion ratio: $\dfrac{\$90{,}000}{\$120{,}000} = 75\%$ — the fraction of each check that is her own money coming back untaxed.
3. Untaxed portion: $0.75 \times \$625 = \$468.75$; taxable portion: $\$625 - \$468.75 = \$156.25$, taxed as ordinary income.
4. If Pearl outlives the 16 years, her basis is fully recovered and later payments become fully taxable — the ratio is a schedule, not a permanent discount.

Answer: 75% of each payment ($468.75) is excluded as return of her investment; $156.25 is ordinary taxable income — until her $90,000 basis is used up.

Example 2. Exam style. Rank these payout options from LARGEST to SMALLEST monthly payment for the same premium and annuitant: life with 10-year period certain; pure life; joint and full survivor; installment refund.

Show solution

1. Apply the iron rule: every guarantee beyond the single life shrinks the check.
2. Pure life guarantees nothing after death — largest payment.
3. Life with 10-year period certain adds one modest guarantee — second.
4. Installment refund guarantees the entire premium comes back — third. Joint and full survivor must outlast two lives at full payment — smallest.

Answer: Pure life, then life with 10-year period certain, then installment refund, then joint and full survivor. More guarantee, smaller check — in either direction, that ordering answers the question.

Example 3. Len, 58, put $40,000 into a deferred annuity two years ago; its surrender schedule is 7%, 6%, 5%, 4%, 3%, 2%, 1%, then zero, with 10% of contract value free each year (in this example). The value is now $44,000 and he wants $12,000 for a roof. What surrender charge does he pay?

Show solution

1. Free corridor: $10\% \times \$44{,}000 = \$4{,}400$ may come out with no charge.
2. Charged portion: $\$12{,}000 - \$4{,}400 = \$7{,}600$.
3. Year-3 rate is 5%: $0.05 \times \$7{,}600 = \$380$.
4. Taxes wait for Lesson 4.5 — annuity withdrawals are gains-first (LIFO), and before age 59½ a 10% federal penalty can apply to the taxable part. The roof may be better financed elsewhere; that judgment is what suitability means.

Answer: A $380 surrender charge on this example's schedule — plus income tax on the gain portion and possibly a 10% penalty at his age, which is why deferred annuities fit money that can stay put.

PRACTICE

1. Easy What risk does an annuity insure against, and how does that mirror life insurance?

   Show answer

   An annuity insures against living too long — outliving one's money — paying income for life; life insurance insures against dying too soon. Same mortality science, opposite risks.

2. Easy Name the two phases of a deferred annuity and what happens in each.

   Show answer

   The accumulation phase, when premiums are paid and the value grows tax-deferred, and the annuity (payout) phase after annuitization, when the insurer pays the income — an election that is generally irreversible.

3. Easy Which annuity engine makes the contract a security, and what extra credential does selling it require?

Show answer

The variable annuity, because the owner bears the investment risk in a separate account; selling it requires FINRA securities registration (Series 6 or 7) and the state's variable line in addition to the life insurance license.

4. Medium Why can an immediate annuity only be bought with a single premium?

Show answer

Because payments begin within one payment interval of purchase — there is no accumulation period in which to pay further premiums. Immediate means single premium; deferred annuities may be single or flexible premium.

5. Medium An annuitant dies two months after annuitizing under a pure life option. His son demands the remaining value. What does the insurer owe, and why is this not unfair?

Show answer

Nothing — pure life pays only while the annuitant lives, which is why its checks were the largest available. The unconsumed principal becomes mortality credits funding annuitants who live long; that pooling is the mechanism that makes lifetime income possible at all.

6. Medium Distinguish a fixed annuity from an indexed annuity in two sentences.

Show answer

A fixed annuity credits interest at rates the insurer guarantees from its general account. An indexed annuity is still an insurance product with a guaranteed floor, but its crediting is linked to a market index, limited by caps or participation rates — more upside possibility than plain fixed, never direct market investment.

7. Medium Who are the three parties to an annuity, and which one measures the payments?

Show answer

The owner (holds the contract rights and pays premiums), the annuitant (the measuring life for payments), and the beneficiary (receives any death benefit or remaining guaranteed payments). The annuitant measures; the owner controls — often the same person, not necessarily.

8. Hard During the accumulation phase, the owner of a deferred annuity dies. What does the beneficiary commonly receive?

Show answer

Commonly the greater of the premiums paid or the contract's current value — a death benefit feature of the accumulation phase; the gain portion is taxable to the beneficiary as ordinary income.

9. Hard An annuity pays $500 a month; the investment in the contract was $72,000 and the expected return is $96,000 (in this example). Compute the exclusion ratio and the taxable part of each payment.

Show answer

Exclusion ratio $= \$72{,}000 \div \$96{,}000 = 75\%$, so $375 of each check is untaxed return of capital and $125 is ordinary income — until the $72,000 basis is fully recovered.

10. Hard A 74-year-old widow keeps $30,000 as her entire emergency fund. An agent proposes moving it into a deferred annuity with a 9-year surrender schedule. Judge the recommendation under the best-interest standard and say what facts condemn it.

Show answer

Unsuitable. The money is her only liquidity, the surrender schedule outruns reasonable planning at her age, and a deferred annuity defers income she may need now; the best-interest standard requires gathering exactly these facts — liquidity needs, horizon, age — and they all point away from the sale. The right product serves the need, not the commission.

11. **Challenge** Explain mortality credits in three sentences, using a pool of one thousand 70-year-olds, and state why a joint and survivor annuity must pay less per month than pure life on one of those lives.

Show answer

Each member pays in the same premium, and the mortality table predicts how long the pool as a whole will collect. Members who die early leave unconsumed principal in the pool, which funds the payments of those who live long — those transfers are mortality credits. A joint and survivor contract keeps paying until the second of two deaths, so the pool must stretch the same money across more expected payment years, shrinking each check.

12. **Challenge** Trace the tontine from Lorenzo de Tonti's 1653 proposal to the Armstrong Investigation of 1905 in four sentences, and name the honest principle that survived its abolition.

Show answer

Tonti proposed pooling subscribers' money with the income shares of the dead flowing to survivors, and France ran royal tontines on the design for over a century. American insurers revived it after 1868 as deferred-dividend 'tontine insurance,' where lapsing and dying policyholders forfeited their dividends to the persistent. The hoarded funds bred speculation and lobbying scandals that the Armstrong Investigation exposed in 1905, and New York outlawed the design in 1906. The honest core survived: pooled longevity — the early-dying funding the long-living by open contract rather than concealed forfeiture — which is precisely a life annuity's mortality credit.

COMMON MISTAKES

- Saying a life annuity's unpaid balance goes to the estate under the pure life option — nothing is payable after the annuitant's death; that is why its checks are largest.
- Treating 'immediate' and 'single premium' as independent choices — an immediate annuity is always single premium.
- Calling indexed annuities securities — they are insurance products with guaranteed floors; only the variable annuity is a security requiring FINRA registration.
- Taxing annuity gains as capital gains — the taxable slice of every payment or withdrawal is ordinary income.

- Forgetting the annuitant/owner distinction: the annuitant's life measures payments, but the owner holds the rights.
- Ignoring liquidity in suitability questions — locking a senior's emergency money behind a long surrender schedule is the exam's standard example of an unsuitable annuity sale.

Make it a game · Outlive the Pool. Give each family member 20 pennies as premiums into a bowl — the pool — and a six-sided die as a lifetime: each round, everyone rolls, and a 1 means that player 'retires from the pool' (stops collecting; the pennies stay). Each surviving player draws 2 pennies from the bowl per round as annuity income. Play until the bowl empties, then count: who collected more than the 20 they paid in? Discuss for two minutes where the long-livers' extra pennies came from — the early leavers' unconsumed shares. That transfer is a mortality credit, and you have just run a life annuity on the kitchen table. Replay once with 3-penny draws and watch the pool fail early — pricing matters.

Scripture. "They shall still bring forth fruit in old age; they shall be fat and flourishing;" (Psalm 92:14, KJV)

The psalm promises that those planted in the house of the LORD flourish to the end — old age as harvest, not dread. Honest provision serves that picture: an income that cannot be outlived frees the last years for fruitfulness instead of fear. The agent who matches an annuity to a real need is helping set the old woman's table in the Maes painting.

4.5 Delivery, Replacement and the Taxman: Life Insurance Taxation

OBJECTIVES

- Describe the agent's duties at policy delivery, including the statement of good health when the premium was not paid with the application.
- State the replacement rules — notice, comparison and the extended free look — and connect them to the twisting prohibition studied in Unit 9.
- List the permitted Section 1035 exchanges and the one direction never allowed.
- Apply the basic tax rules: income-tax-free death benefit, tax-deferred growth, FIFO withdrawals, dividends, loans and the taxable gain at surrender.
- Explain the seven-pay test, the consequences of MEC status, and the group term $50,000 rule.

> **Warm-up.** In five minutes, list every way money can leave a life policy — death benefit, dividends, a loan, a withdrawal, a full surrender. Beside each, guess: taxed or not taxed? Keep the sheet and grade yourself at the end of the lesson; most students miss exactly two, and those two are the exam questions.

WATCH

Tax Treatment of Premiums, Benefit/Proceeds, Dividends - Life Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 6:12

https://www.youtube.com/watch?v=Ywe734Me_2Y

> **WHEN TO WATCH**
> Watch after the core ideas with your warm-up sheet beside you, correcting your taxed-or-not guesses in a second color as each rule is confirmed.

BACKUP VIDEO

[Series 6] 20, Life Insurance Taxation

Open Exam Prep · 3:27

https://www.youtube.com/watch?v=5MEAKxjCrGA

A quick second voice on the tax rules from the securities-exam side; watch just before the practice set and check each rule it states against your finished one-pager.

policy delivery

The agent's hand-off of the issued policy to the owner — personally where practice or insurer rules require — with an explanation of its provisions, riders and any changes made in underwriting.

constructive delivery

Delivery in the eyes of the law without the owner's hands on the paper — as when the insurer mails the policy or releases it unconditionally to its agent for the owner.

statement of good health

A signed statement, collected at delivery when the first premium was not paid with the application, affirming the insured's health has not changed since the application; the premium must be collected with it.

replacement

Any transaction in which a new life policy or annuity is purchased and an existing one is or will be lapsed, surrendered, reduced or borrowed against — lawful, but regulated.

conservation

The existing insurer's lawful effort to persuade the policyowner to keep the policy a replacement would end.

Section 1035 exchange

A tax-free exchange under the federal code: life to life, life to annuity, or annuity to annuity — never annuity to life — with the old contract's cost basis carrying over.

cost basis

The owner's own money in the contract — premiums paid minus dividends received — which comes back untaxed.

FIFO (first-in, first-out)

The withdrawal tax rule for non-MEC life insurance: the owner's basis comes out first untaxed, and gains come out, taxably, only after the basis is exhausted.

modified endowment contract (MEC)

A life policy funded faster than the seven-pay test allows; it keeps a tax-free death benefit but loses FIFO — lifetime distributions become LIFO with a 10% penalty before age 59½ — permanently.

seven-pay test

The federal limit from the 1988 law: if cumulative premiums in the first seven years exceed what seven level annual premiums would have paid the policy up, the contract is a MEC.

policy loan

A loan against cash value — not taxable income while the policy stays in force and is not a MEC, but taxable to the extent of gain if the policy lapses or is surrendered with the loan outstanding.

group term $50,000 rule

Employer-paid group term life coverage up to $50,000 is a tax-free benefit; the cost of coverage above $50,000 (from the IRS table) is imputed as taxable income to the employee.

CORE IDEAS

The story. In the early 1980s, with interest rates at historic highs, clever designers noticed that the tax law loved life insurance without ever asking how much of a policy was actually insurance. Cash value grew untaxed; loans came out untaxed; the death benefit passed untaxed. So the industry built policies to be tax shelters first and insurance second: **single-premium whole life**, advertised frankly as the last great tax shelter — park one large deposit, watch it compound tax-free, borrow it back at will, and leave the remainder tax-free at death. Sales boomed; the insurance was a fig leaf on an investment account. Congress had already tightened the definition of life insurance in 1984, and in 1988 it closed the loophole with the **Technical and Miscellaneous Revenue Act** — TAMRA. The act did not ban rich policies; it drew a speed limit called the **seven-pay test** and named the violators **modified endowment contracts**. A MEC keeps its tax-free death benefit, but its living benefits are taxed like an annuity's — gains first, with a penalty for the young. The lesson of the story is the shape of all tax law in this course: Congress protects life insurance generously, exactly to the degree that it is actually insurance.

How they figured it out. The generosity itself is older than the income tax's first decade — the death benefit has been excluded from income since the modern income tax began in 1913, Congress reasoning that a widow's indemnity is the replacement of a loss, not a profit. From that root grow the rules. Premiums on

personal life insurance are paid with after-tax dollars and are **not deductible**; in exchange, the owner's payments form a **cost basis** that always comes back untaxed. Growth inside the policy is **tax-deferred** — no annual tax on the cash value's increase. And the system settles up only when money actually leaves: at death (untaxed face), at surrender (gain over basis taxed), or at withdrawal (basis first, under FIFO). The seven-pay test is the border patrol on that bargain: a policy paid up faster than seven level annual premiums is presumed a shelter wearing insurance's coat, and its lifetime distributions lose the friendly ordering. The same settle-up logic produced **Section 1035**: moving value between like contracts is no occasion for tax, because nothing has really left the system.

The big idea. The agent's last duties come first. A sale is not finished at the signature. **Policy delivery** is a duty: deliver the policy promptly — personally, in careful practice and under many insurers' rules — explain its provisions and riders, and anything underwriting changed, such as a rating or an amended amount. Delivery also starts the **free look** clock. If the first premium was not paid with the application, the agent must collect it at delivery along with a signed **statement of good health** — the coverage is not in effect until premium and statement are in hand, because no conditional receipt ever took hold. (Courts also recognize **constructive delivery**: once the insurer unconditionally releases the policy — mails it, or hands it to its agent for the owner — delivery has legally occurred even before the owner touches it.) The exam's delivery question is nearly always the good-health statement: premium not with the app means statement at delivery, premium with the statement, or no coverage.

Replacement is lawful — sometimes a new policy genuinely serves the client better — but it is the most regulated sale in the business, where **twisting** (misrepresentation used to induce replacement, Unit 9's word) does its damage. Under the NAIC-pattern replacement regulation, when a new policy will cause an existing one to be lapsed, surrendered, reduced or borrowed against, the producer must ask about existing coverage on every application, give the applicant a **Notice Regarding Replacement** listing the policies affected, and the insurers must exchange information — the existing insurer getting its chance at **conservation**. Many states extend the **free look** on a replacement — 30 days commonly. The honest comparison a replacement demands: new contestable and suicide periods begin; the client is older, so rates are higher; surrender charges may bite the old value; a seasoned,

incontestable policy is a real asset being thrown away. The right answer on the exam is never "replacement is prohibited" — it is "replacement is regulated, disclosed and documented."

When moving value really is right, the code provides the tax-free lane: a **Section 1035 exchange** permits life to life, life to annuity, and annuity to annuity — value may step *down* from a death-benefit contract to an income contract, but **never annuity to life insurance**: an annuity's untaxed gains cannot buy their way into the death benefit's income-tax-free exit. The old contract's **cost basis** carries into the new one, and the exchange must be contract for contract — cash passing through the owner's hands is taxable. Now the living-benefit rules. **Dividends** are a return of overcharged premium: untaxed, but they reduce basis — and interest on dividends left to accumulate *is* taxable. **Withdrawals** from a non-MEC policy are **FIFO**: basis out first untaxed, gain taxed after basis is gone. **Policy loans** are not income while the policy lives, but at lapse or surrender an outstanding loan is counted in the settle-up, taxing the gain it helped extract. **Full surrender** taxes the gain: cash surrender value (plus outstanding loans) minus basis, as ordinary income. And the **death benefit** remains income-tax-free — though settlement-option interest is taxable, and a very large estate may face *estate* tax, a different tax.

The **MEC** rules flip exactly one part of that machine. A policy fails the **seven-pay test** when the premiums paid in its first seven years exceed what seven level annual premiums would have needed to pay the policy up — one dollar over and the contract is a MEC **permanently**; a material change, such as a large face increase, restarts the test, and a MEC exchanged under 1035 stays a MEC. The death benefit keeps its income-tax-free character. But every lifetime distribution — withdrawal *and loan alike* — is taxed **LIFO** like an annuity: gain out first, taxable, plus a **10% penalty** on the taxable part before age 59½. Last, the employee-benefit rule for Unit 5: employer-paid **group term life** is tax-free to the employee up to $50,000 of coverage; above that line, the cost of the excess coverage — from the IRS's uniform premium table, not the employer's actual cost — is **imputed income** on the employee's W-2. Premiums the employer pays are its deductible business expense; the death benefit to the family is still income-tax-free.

On the exam today. Delivery questions turn on the statement of good health — required whenever the premium did not accompany the application, collected with the first premium. Replacement questions want the procedure: ask on every

application, notice to the applicant, information to the existing insurer, extended free look — and the word for lying to force a replacement is twisting, a Unit 9 violation. The 1035 question is pure direction: life→life, life→annuity, annuity→annuity are tax-free; annuity→life never is. Tax questions reward the warm-up sheet: premiums not deductible; growth deferred; dividends untaxed (their accumulated interest taxed); non-MEC withdrawals FIFO; loans untaxed while the policy lives; surrender gain = cash value plus loans minus basis, ordinary income; death benefit income-tax-free, its settlement-option interest taxable. The MEC stem hides three fangs: the seven-pay test, LIFO-plus-10%-penalty on lifetime money before 59½, and permanence — once a MEC, always a MEC, even through a 1035 exchange. And the group-term number to circle is $50,000: below it, silence; above it, table-cost imputed income.

PICTURE STUDY



Two Tax Collectors, Marinus van Reymerswaele, 1540s · Oil on panel · National Museum, Warsaw

Image: Wikimedia Commons, public domain

Marinus van Reymerswaele, a Dutch painter of the early 1500s, made a career of one subject: men and their money ledgers. His tax collectors — repeated in many versions, this one now in Warsaw — were popular precisely because everyone recognized them: the grasping faces, the fantastic costumes of greed, the ledger recording every coin owed. The satire has a serious side that fits this lesson: the ledger always gets written. Life insurance enjoys remarkable kindness in the tax ledger — but the kindness has borders, and the agent who knows exactly where they lie (surrender gains, MECs, the $50,000 line) serves clients honestly in the taxman's own language.

Look closely

- Find the ledger and the writing hand. Every rule in this lesson is an entry rule: what gets written into taxable income, and what never does.
- Study the two faces. Reymerswaele paints greed as distortion. Contrast the honest settle-up of a tax code that excludes a widow's death benefit.
- Count the kinds of records — bound ledger, loose papers, sealed documents hanging behind. Compare your own tax one-pager project: fewer papers, clearer lines.

- Notice the coins heaped between the men. Money in motion is what the taxman sees; money resting inside a policy he has agreed, by law, not to count yet.

Talk about it

1. The painting mocks collectors who squeeze; yet this lesson shows a tax code deliberately gentle to life insurance. Why would lawmakers choose gentleness here — what behavior are they rewarding?
2. The seven-pay test exists because some buyers dressed investments in insurance's coat. How is gaming a generous rule a kind of dishonesty even when it is legal cleverness?
3. Jesus answered the tax question with a coin and a line about Caesar and God. What belongs to each when a family plans with life insurance — and what duty does the agent owe both?

PROJECT

The Taxman's One-Pager

You will build the single most reusable page in your Pathway File: a one-page map of every way money moves through a life policy, each lane marked TAXED or NOT TAXED, with the 1035 arrows and the MEC border drawn in red. Half the tax questions on a licensing exam can be answered by glancing at this page in memory.

You will need

- One sheet of unlined paper turned sideways, ruler, pencil, and red and black ink
- A calculator
- This lesson's key terms and the IRS life insurance proceeds FAQ from the kit

Steps

1. Draw the policy as a box in the center labeled CASH VALUE — GROWS TAX-DEFERRED, with PREMIUMS (AFTER-TAX, NOT DEDUCTIBLE) flowing in from the left.
2. Draw five exit lanes to the right, one per line, each labeled with its rule: DEATH BENEFIT (income-tax-free; settlement-option interest taxable), DIVIDENDS (untaxed; reduce basis; accumulated interest taxable), WITHDRAWAL (FIFO: basis first), LOAN (untaxed while in force; counted at lapse/surrender), SURRENDER (gain = CSV + loans − basis, ordinary income).
3. In red, draw the MEC border across the bottom: the seven-pay test in one sentence, then the flipped rules — LIFO, 10% penalty before 59½, once-a-MEC-always-a-MEC — and the one thing unchanged: the death benefit stays income-tax-free.
4. In a corner box, draw the 1035 compass: three green arrows (life→life, life→annuity, annuity→annuity) and one red barred arrow (annuity→life), with BASIS CARRIES OVER written beneath.
5. In a second corner, the group term line: a wall at $50,000 — tax-free below, table-cost imputed income above.

6. Work Ira's surrender and Vera's MEC withdrawal (the worked examples) in miniature at the bottom margin as proofs that your map gives the right answers.
7. Add a delivery-and-replacement sidebar in three lines: statement of good health when premium didn't accompany the application; replacement = notice + comparison + extended free look; twisting is the Unit 9 word for lying to force one.
8. Date the page, write "federal rules as of 2026 — figures in examples" at the foot, and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the key terms; on the MEC card, write the three fangs on the back — SEVEN-PAY, LIFO + 10% UNDER 59½, PERMANENT.
2. Draw the 1035 compass from memory: three green arrows and the single forbidden red one, annuity→life.
3. Write a five-line trap list titled "Taxed or not?", ending with: the death benefit is INCOME-tax-free — interest the insurer pays on it afterward is not.

KEY FORMULAS

$$\text{taxable gain at surrender} = (\text{cash surrender value} + \text{outstanding loans}) - \text{cost basis}$$

$$\text{cost basis} = \text{premiums paid} - \text{dividends received}$$

From history. The income-tax kindness to life insurance is as old as the tax itself: the Revenue Act of 1913, the first law under the new Sixteenth Amendment, expressly excluded life insurance death proceeds from income — Congress treating a family's indemnity as the making-whole of a loss rather than gain. Seventy-five years of policy design later, TAMRA's seven-pay test of 1988 had to define how much insurance a tax shelter must actually contain — the 1913 generosity finally acquiring a fence.

WORKED EXAMPLES

Example 1. Ira surrenders his whole life policy: cash surrender value $48,000, total premiums paid $36,000, dividends received in cash over the years $2,000, no loans. Compute his taxable gain and name its character.

Show solution

1. Cost basis = premiums − dividends: $\$36{,}000 - \$2{,}000 = \$34{,}000$.
2. Taxable gain = cash surrender value − basis: $\$48{,}000 - \$34{,}000 = \$14{,}000$.
3. Character: ordinary income — never capital gain — in the year of surrender.
4. Had he instead exchanged the policy for an annuity under Section 1035, no tax now: the $34,000 basis would carry into the annuity.

Answer: A $14,000 gain taxed as ordinary income. Dividends were never taxed when received, so they reduce the basis that comes back untaxed now — the system settles up exactly once.

Example 2. Vera, 45, owns a MEC worth $60,000 with a cost basis of $40,000. She withdraws $25,000. In this example, what is taxed, and what penalty applies?

Show solution

1. The contract's gain is $\$60{,}000 - \$40{,}000 = \$20{,}000$.
2. MEC distributions are LIFO: gain comes out first. Of her $25,000, the first $20,000 is taxable ordinary income; the remaining $5,000 is untaxed basis.
3. She is under 59½, so a 10% penalty applies to the taxable part: $0.10 \times \$20{,}000 = \$2{,}000$.
4. Had the policy not been a MEC, FIFO would have made the entire $25,000 an untaxed return of basis — the whole difference the seven-pay test makes.

Answer: $20,000 taxable as ordinary income plus a $2,000 penalty; $5,000 comes out untaxed. The same policy without MEC status would have owed nothing — gain ordering is the entire game.

Example 3. Exam style. Which of the following qualifies as a tax-free Section 1035 exchange?

A. A deferred annuity exchanged for a whole life policy

B. A whole life policy exchanged for an annuity

C. An annuity surrendered for cash used to buy another annuity a month later

D. A life policy surrendered, with the proceeds mailed to the owner, who buys a new life policy

Show solution

1. Recite the permitted directions: life→life, life→annuity, annuity→annuity — never annuity→life.
2. A runs the forbidden direction: annuity gains cannot migrate into life insurance's tax-free death benefit.
3. C and D break the form: 1035 is a direct, contract-for-contract exchange — cash passing through the owner's hands is a taxable surrender followed by an ordinary purchase.
4. B is a permitted direction executed as an exchange; the old basis carries into the annuity.

Answer: B. Life to annuity is a permitted 1035 direction when done as a direct exchange; A reverses the one forbidden arrow, and C and D take taxable cash along the way.

PRACTICE

1. Easy Are premiums on a personal life policy deductible, and is the death benefit taxable income to the beneficiary?

   Show answer

   No and no: premiums are paid with after-tax dollars and are not deductible, and the death benefit passes to the beneficiary free of income tax — the bargain in place since the 1913 income tax.

2. Easy When must an agent obtain a statement of good health at policy delivery?

Show answer

When the first premium was not paid with the application; the agent collects the premium together with the signed statement, and coverage is not effective until both are in hand.

3. Easy Name the three permitted Section 1035 exchanges and the one never permitted.

Show answer

Life to life, life to annuity, and annuity to annuity are tax-free; annuity to life insurance is never a tax-free exchange.

4. Medium Why are policy dividends not taxable income when received, and what about them IS taxable?

Show answer

Dividends are treated as a return of overcharged premium — the owner's own money back — so they are untaxed but reduce cost basis. Interest earned on dividends left to accumulate with the insurer is taxable each year.

5. Medium A non-MEC policy has $30,000 of basis and $12,000 of gain. The owner withdraws $20,000. How much is taxable, and under what rule?

Show answer

Nothing — FIFO treats the first $30,000 out as return of basis, and her $20,000 withdrawal fits inside it. Only after basis is exhausted would further withdrawals be taxable gain.

6. Medium What is twisting, and which routine replacement safeguards exist to prevent it?

A. Replacement is simply illegal

B. Misrepresentation used to induce replacement; safeguards are the replacement notice, insurer-to-insurer information, conservation rights and an extended free look

C. Charging different premiums to different classes

D. Sharing commissions with the client

Show answer

B. Replacement itself is lawful but regulated — asked about on every application, documented by the Notice Regarding Replacement, reported to the existing insurer (which may attempt conservation), and protected by an extended free look. A overshoots; C is unfair discrimination and D is rebating, both Unit 9 topics.

7. Medium An employer pays for $80,000 of group term coverage on an employee. What is taxed, and how is the amount determined?

Show answer

The cost of the coverage above $50,000 — here $30,000 of excess — is imputed to the employee as taxable income, measured by the IRS uniform premium table rather than the employer's actual cost. Coverage up to $50,000 is a tax-free benefit.

8. Hard Why is a policy loan not taxable income while the policy is in force, and when does that change?

Show answer

Borrowed money is not income because it carries an obligation to repay, with the cash value as security. If the policy lapses or is surrendered with the loan outstanding, the settle-up counts the loan as part of the amount received, taxing the gain over basis — and in a MEC, loans are taxable LIFO distributions from the start.

9. Hard A policy's seven-pay level premium is $4,000. The owner pays $4,000 in year one and $9,000 in year two. Is the policy a MEC, and what arithmetic decides it?

Show answer

Yes. The test caps cumulative premiums at the seven-pay schedule: by year two the cap is $2 \times \$4{,}000 = \$8{,}000$, and he has paid $13,000. Exceeding the cap at any point in the first seven years makes the contract a MEC — permanently.

10. Hard Rhoda surrenders a policy with cash surrender value $27,000 and an outstanding loan of $8,000; premiums paid were $28,000 and dividends received $3,000. Compute the taxable gain.

Show answer

Basis $= \$28{,}000 - \$3{,}000 = \$25{,}000$. Amount realized $= \$27{,}000 + \$8{,}000 = \$35{,}000$. Taxable gain $= \$35{,}000 - \$25{,}000 = \$10{,}000$, ordinary income — the loan she already spent is counted in the settle-up.

11. Challenge A client holds a MEC and asks whether a 1035 exchange into a fresh policy would cure its status, and whether his beneficiary should worry about the death benefit's taxation. Answer both in three sentences.

Show answer

No cure: once a contract is a MEC, every contract received for it in a 1035 exchange is also a MEC — the status follows the money permanently. His lifetime distributions, including loans, remain LIFO with a 10% penalty on taxable amounts before 59½. The death benefit, however, keeps life insurance's income-tax-free character; MEC status punishes living withdrawals, not the widow.

12. **Challenge** Congress could have taxed cash-value growth annually like a savings account. In three sentences, defend the actual design — deferral, FIFO, tax-free death benefit, seven-pay border — as a coherent policy rather than a loophole.

Show answer

The code rewards families for pre-funding their own protection: deferral and FIFO leave a policy undisturbed while it does insurance work, and the untaxed death benefit treats a widow's indemnity as replacement of loss, not profit. The generosity is fenced — surrender gains are taxed, and the seven-pay test strips the friendly ordering from contracts that are investments wearing insurance's coat. The design taxes the system exactly once, at the point where money stops being protection and becomes spendable wealth.

COMMON MISTAKES

- Forgetting the statement of good health: whenever the first premium did not accompany the application, it must be collected at delivery together with the premium — before coverage takes effect.
- Running a 1035 exchange backward — annuity to life insurance is never tax-free; the three green arrows are life→life, life→annuity, annuity→annuity.
- Taxing dividends — they are an untaxed return of premium that reduces basis; only the interest on accumulated dividends is taxable.
- Applying FIFO to a MEC — MEC withdrawals AND loans are LIFO (gain first) with a 10% penalty on taxable amounts before age 59½, and the status is permanent even through a 1035 exchange.
- Omitting the outstanding loan from the surrender settle-up — taxable gain is cash surrender value PLUS loans MINUS basis.
- Misplacing the group term line — employer-paid coverage is tax-free only up to $50,000; above it, the IRS table cost of the excess is imputed income.

Make it a game · Taxed or Not?. Write fifteen money-movement cards: “death benefit to widow,” “dividend received in cash,” “interest on accumulated dividends,” “withdrawal from non-MEC under basis,” “loan from healthy policy,” “loan from MEC, owner is 45,” “surrender with $10,000 gain,” “1035 life→annuity,” “1035 annuity→life,” “employer-paid group term, $40,000,” “employer-paid group term, $90,000,” and four of your own. A parent flips cards one at a time; players race to slap the card and call TAXED or NOT TAXED, then must give the rule in one sentence to keep the point — no rule, no point. The annuity→life card is a trick: the correct call is TAXED (it is no exchange at all). Highest score after fifteen cards collects a pretend refund.

Scripture. “They say unto him, Caesar’s. Then saith he unto them, Render therefore unto Caesar the things which are Caesar’s; and unto God the things that are God’s.” (Matthew 22:21, KJV)

The Lord’s answer honors both ledgers: the coin bearing Caesar’s image is rendered to Caesar, and the life bearing God’s image is rendered to God. Tax rules deserve the same two-sided honesty — pay exactly what the law asks, claim exactly the kindness it grants, and shade nothing. An agent who explains a MEC or a surrender gain truthfully is rendering to both at once.

UNIT 4

Life Insurance: Provisions, Riders and Annuities

Unit 3 taught you what the policies are; this unit teaches you what the promise actually says. Every life policy carries a set of **standard provisions** — the grace period that forgives a late premium, the **incontestable clause** that makes the promise ironclad after two years, the reinstatement right that revives a lapsed policy, the misstatement-of-age rule that adjusts a benefit instead of voiding it. You will meet the company that put honesty in its own name — the London Indisputable Life Policy Company of 1848 — and the crusading Massachusetts mathematician, **Elizur Wright**, who saw lapsed policies auctioned like furniture in London and came home to invent **nonforfeiture**: the law that says the value you build in a policy can never simply be confiscated. You will learn who gets the money and how — **beneficiaries**, named in order and sometimes in Latin, and the **settlement options** that turn a death benefit into an income.

Then the unit turns the policy upside down. An **annuity** protects against the opposite risk — not dying too soon but living too long — and its story runs from the Roman *annua* through the strange era of the tontine to the suitability rules of today. The unit closes with the agent's last duties — policy delivery and the replacement rules — and with the taxman: why the death benefit passes income-tax-free, how cash value grows untaxed, what a **Section 1035 exchange** may and may not do, and the seven-pay test that separates life insurance from a tax shelter. By the end you can read an entire policy the way an examiner does: promise by promise.

PREREQUISITES

- Has completed Unit 3 and can define term life, whole life, universal life and cash value in one sentence each
- Can work comfortably with percents, ratios and simple division (find 75% of a number, divide proceeds into equal payments)
- Can draw and read a simple family tree and a timeline
- Has the exam notebook, flashcard box and state facts sheet from Units 1–3 up to date

MASTERY CHECKLIST

- ☐ I can state the standard life policy provisions — entire contract, insuring clause, free look, grace period, reinstatement, incontestability, misstatement of age and the suicide clause — with their common time limits.
- ☐ I can tell absolute assignment from collateral assignment and compute a misstatement-of-age adjustment.
- ☐ I can order beneficiaries (primary, contingent, tertiary), contrast revocable with irrevocable designations, and split proceeds per stirpes and per capita from a family tree.
- ☐ I can name the settlement options, say which pays the most per month and why, and work fixed-period and fixed-amount arithmetic.
- ☐ I can describe the major riders — waiver of premium, payor benefit, accidental death, guaranteed insurability, accelerated benefits and return of premium — and say what each costs the promise.
- ☐ I can name the three nonforfeiture options, tell which one is usually automatic, and tell Elizur Wright's story.
- ☐ I can classify any annuity by purchase, start date and investment engine, name its payout options, and compute an exclusion ratio.

- ☐ I can walk a policy through delivery, replacement and the tax rules — FIFO withdrawals, the seven-pay MEC test, Section 1035 exchanges and the group-term $50,000 line.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: Life Insurance consumer pages**: Free, official. The state regulators' own plain-language guide to life policies, provisions and buying decisions. Read it alongside Lessons 4.1 and 4.5, and use its links to find your own state's consumer guides. Ages 15 and up.
- **Insurance Information Institute: What is a beneficiary?**: Free. The industry's consumer-education institute explains beneficiary naming in two minutes of reading. Skim it with Lesson 4.2 before you draw the Harper family tree. Ages 14 and up.
- **Investor.gov: Annuities**: Free, official. The SEC's investor site explains fixed, indexed and variable annuities and why the variable kind is a security. Read it with Lesson 4.4, especially before the annuity map project. Ages 15 and up.
- **IRS: Life insurance and disability insurance proceeds**: Free, official. The tax collector answers, in its own words, whether life insurance proceeds are taxable. Read it with Lesson 4.5 and quote it in your tax one-pager. Ages 15 and up.
- ***Politics and Mysteries of Life Insurance*, by Elizur Wright (1873)**: Free on the Internet Archive. The father of nonforfeiture argues his own case in his own voice. Dip into a chapter with Lesson 4.3 to hear the man you will meet in the story. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

4.1 The Policy's Promises: Standard Provisions and Exclusions

3 sessions of 50 minutes

4.2 Beneficiaries and Settlement Options 3 sessions of 50 minutes

4.3 Riders and Nonforfeiture: Options Built Into the Promise 3 sessions of 50 minutes

4.4 **Annuities: The Income That Cannot Be Outlived** 3 sessions of 50 minutes

4.5 **Delivery, Replacement and the Taxman: Life Insurance Taxation**

3 sessions of 50 minutes

Unit 4 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about a minute a question — set a timer for 25 minutes and finish inside it, just as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example” or “commonly,” use the figures given, and remember that the live numbers — free-look days, grace periods, state replacement rules — belong to your state insurance department. A licensing exam passes at 70% — 14 of 20 here — but aim higher. Choose the one BEST answer.

1. **5 pts**

   An insured dies 18 days after missing a premium payment of $600 on a $100,000 policy with a 31-day grace period. The insurer will pay:

   A. Nothing, because the premium was unpaid

   B. $99,400

   C. $100,000

   D. A refund of all premiums paid

2. **5 pts**

   Three years after issue, an insurer discovers a material misstatement on the application. The insured is alive and premiums are current. The insurer may:

   A. Void the policy for fraud

   B. Adjust the face amount downward

   C. Do nothing — the policy is incontestable after 2 years in force

   D. Cancel at the next anniversary

3. **5 pts**

A man bought a $50,000 policy at stated age 40, paying premiums that, at his true age of 45, would have purchased only $40,000 of coverage (in this example). He dies 12 years later. The beneficiary receives:

A. $40,000

B. $50,000, because the policy is incontestable

C. Nothing — the policy is void

D. A refund of premiums

4. **5 pts**

To reinstate a policy that lapsed 10 months ago, the owner must typically provide:

A. Nothing — reinstatement within 1 year is automatic

B. A new application and the first premium only

C. Back premiums only, since insurability never lapses

D. Evidence of insurability and all back premiums with interest

5. **5 pts**

An insured dies by suicide 20 months after policy issue; the suicide clause runs 2 years. The beneficiary receives:

A. The full face amount

B. A refund of the premiums paid

C. Nothing at all

D. The policy's cash value only

6. **5 pts**

A policyowner assigns her policy to a bank as security for a $30,000 loan. This is:

A. A collateral assignment, giving the bank rights limited to the debt

B. An absolute assignment, transferring all ownership rights

C. Prohibited without the insurer's consent

D. Effective only if the beneficiary consents

7. 5 pts

A policy names the insured's wife as primary beneficiary and his brother as contingent. The wife dies; two years later the insured dies without updating the policy. The proceeds go to:

A. The wife's estate

B. The insured's estate

C. The brother

D. The state's unclaimed property fund

8. 5 pts

The owner of a policy with an irrevocably designated beneficiary wants to take a policy loan. He may do so:

A. Freely — loans are an ownership right

B. Only after converting the designation to revocable on his own signature

C. Only with the insurer's board approval

D. Only with the irrevocable beneficiary's written consent

9. 5 pts

Proceeds of $150,000 are left "to my children equally, per stirpes." Of three children, one died earlier leaving two sons. Each grandson receives:

A. Nothing

B. $25,000

C. $50,000

D. $37,500

10. 5 pts

Insured and primary beneficiary die in the same crash and the order of deaths cannot be determined. Under the Uniform Simultaneous Death Act as written into the common disaster clause, the proceeds are paid:

A. To the contingent beneficiary, as though the primary died first

B. To the primary beneficiary's estate

C. Half to each estate

D. To the insured's creditors first

11. 5 pts

A beneficiary chooses the fixed-PERIOD settlement option. If the insurer credits more interest than guaranteed, the result is:

A. A longer payment period

B. A refund of premium to the owner's estate

C. Larger payments over the same period

D. No change — excess interest belongs to the insurer

12. 5 pts

Which settlement option provides the LARGEST monthly income to a sole beneficiary for life?

A. Life income with 20-year period certain

B. Joint and survivor

C. Installment refund

D. Straight life income

13. 5 pts

Under a waiver of premium rider with a 6-month waiting period, once waiver begins during the insured's total disability:

A. The policy continues but stops building cash value

B. The policy continues in full force, with premiums paid by the insurer

C. The face amount is reduced by each waived premium

D. The policy converts to extended term insurance

14. 5 pts

On a policy insuring a 10-year-old, which rider waives premiums if the child's mother — who pays them — dies or becomes totally disabled?

A. Payor benefit rider

B. Waiver of premium rider

C. Guaranteed insurability rider

D. Accidental death rider

15. 5 pts

Which of the following is NOT a nonforfeiture option?

A. Cash surrender

B. Extended term insurance

C. Automatic premium loan

D. Reduced paid-up insurance

16. 5 pts

A whole life policyowner stops paying premiums and makes no nonforfeiture election. Most policies automatically provide:

A. Cash surrender

B. Reduced paid-up insurance

C. A modified endowment contract

D. Extended term insurance for the full face amount

17. 5 pts

To sell variable annuities, a producer must hold:

A. Only a state life insurance license

B. A state life license with variable authority plus FINRA securities registration

C. Only FINRA registration

D. A property and casualty license

18. 5 pts

An annuitant invested $60,000; her expected return is $80,000, and she receives $400 monthly (in this example). The untaxed portion of each payment is:

A. $300

B. $100

C. $400 — annuity income is tax-free

D. $0 — annuity income is fully taxable

19. 5 pts

Which exchange is NOT tax-free under Section 1035?

A. A whole life policy for another whole life policy

B. A whole life policy for an annuity

C. An annuity for a life insurance policy

D. An annuity for another annuity

20. 5 pts

A 50-year-old owns a modified endowment contract with $15,000 of gain and $35,000 of basis, and takes a $10,000 policy loan. The tax result is:

A. Nothing — policy loans are never taxable

B. $10,000 of untaxed basis returned under FIFO

C. Taxable only if the policy later lapses

D. $10,000 of ordinary income plus a $1,000 penalty

ANSWER KEY

1. B. Death during the grace period is covered, but the insurer deducts the overdue premium: $100,000 − $600 = $99,400. A ignores the grace period; D is the suicide-clause remedy in the wrong question.
2. C. The incontestable clause bars voiding or contesting after 2 years in force during the insured's lifetime. B confuses this with the misstatement-of-age adjustment, which concerns age or sex, not other misstatements.
3. A. Misstatement of age adjusts the benefit to what the premiums would have bought at the true age; it never voids the policy, and incontestability does not block the adjustment — nothing is being contested.
4. D. Reinstatement — commonly available for 3 years after lapse — requires proving insurability and paying the missed premiums with interest (and settling any policy loan). The reward is the original issue-age premium and cash-value schedule.
5. B. Within the suicide period the insurer does not pay the face but must refund premiums paid. After the period expires, suicide is covered like any other death — the clock is everything.
6. A. A lender takes a collateral assignment — temporary and limited to the loan balance, with the remainder of any death benefit going to the beneficiary. Assignment requires written notice to the insurer, not its permission, and a revocable beneficiary's consent is not needed.
7. C. With no primary alive at the insured's death, the contingent class takes. The estate (B) receives proceeds only when every named class has failed — the outcome designations exist to avoid.
8. D. An irrevocable beneficiary holds a vested interest, so loans, surrenders, assignments and beneficiary changes all require that beneficiary's written consent. B is circular — removing the designation itself requires the same consent.
9. B. Per stirpes keeps the deceased child's one-third ($50,000) in his branch, split between his two sons — $25,000 each. A describes per capita; D splits the whole fund per capita among four heads.
10. A. The Act presumes the insured survived the beneficiary, so the proceeds pass to the contingent class — avoiding a pointless trip through the primary's estate, which is exactly what B would cause.

11. C. Under fixed period the calendar is locked, so excess interest enlarges each payment. Under fixed AMOUNT the payment is locked and interest lengthens the calendar — the mirrored pair the exam loves to swap (A).
12. D. Straight life guarantees nothing after the beneficiary's death, so the insurer can pay the most per month. Every added guarantee — a certain period (A), a second life (B), a refund of principal (C) — shrinks the check.
13. B. The insurer pays the premiums itself, so cash value, dividends and the full face continue untouched — and premiums paid during the waiting period are commonly refunded. A, C and D all shrink a promise the rider exists to keep whole.
14. A. The payor benefit watches the premium-payor on a juvenile policy, waiving premiums until the child reaches a stated age. The waiver of premium rider (B) watches the insured's own disability — the trigger is the whole question.
15. C. The automatic premium loan is a loan provision that prevents lapse by borrowing the premium from cash value; the three nonforfeiture options are cash surrender, reduced paid-up and extended term.
16. D. Extended term is usually the automatic option: the cash value buys term insurance at the original face for as long as it can, preserving the protection a silent owner was presumably relying on. B keeps permanence but shrinks the face — the law defaults to the full promise.
17. B. The variable annuity is both an insurance contract and a security — the owner bears investment risk in a separate account — so both credentials are required. Fixed and indexed annuities (A's world) are insurance products only.
18. A. The exclusion ratio is $\$60{,}000 \div \$80{,}000 = 75\%$, so $0.75 \times \$400 = \$300$ returns untaxed and $100 is ordinary income — until her basis is fully recovered.
19. C. Annuity to life insurance is the one forbidden direction — an annuity's untaxed gains cannot buy into the death benefit's income-tax-free treatment. The three permitted arrows are life→life, life→annuity and annuity→annuity, with basis carrying over.
20. D. In a MEC, loans and withdrawals alike are LIFO distributions: gain comes out first ($10,000 of the $15,000 gain is taxable) and the 10% penalty applies before age 59½ — here $1,000. A and B state the non-MEC rules the seven-pay test switched off.

PORTFOLIO PIECE: MY PATHWAY FILE: READING THE WHOLE PROMISE

Assemble the five artifacts this unit built: the policy lifeline chart with every provision pinned to its window and remedy (Lesson 4.1); the Harper family beneficiary tree with its four traced scenarios and the settlement options table ranked by guarantee (Lesson 4.2); the Calder rider menu and Elizur Wright's safety-net table of nonforfeiture options (Lesson 4.3); the annuity map with the Pearl exclusion-ratio worksheet and suitability checklist (Lesson 4.4); and the taxman's one-pager with its five exit lanes, red MEC border and 1035 compass (Lesson 4.5).

Bind them behind a one-page cover sheet titled "The Whole Promise," on which you explain to an imagined first client, in your own words, what it means that a life policy's promises are enforced by law — citing one provision, one nonforfeiture option and one scripture from the unit — and why an agent who knows these pages owes clients the truth about them before any sale. Date the cover sheet and file the set in your Pathway File ahead of the Unit 4 test.

LOOK FOR	WHAT IT MEANS
Policy lifeline	all eight standard provisions appear with their common time limits, correct remedies and an accurate misstatement-of-age example, labeled "commonly — check your state."
Beneficiary and settlement pages	the four Harper scenarios trace correctly (including per stirpes vs. per capita arithmetic and the common disaster outcome), and the options table ranks payments by guarantee with fixed-period/fixed-amount interest effects stated correctly.
Rider and nonforfeiture pages	every rider shows trigger, clock and payment; the safety-net table shows what each option preserves and surrenders, names extended term as the usual automatic option, and classifies the automatic premium loan as a provision.
Annuity map	the three classification questions, the variable-annuity licensing badge, the payout ladder and a correctly computed exclusion ratio all appear, with the suitability checklist in plain words.
Tax one-pager	all five exit lanes carry correct taxed-or-not rules, the MEC border states the seven-pay test with LIFO and the under-59½ penalty, the 1035 compass shows three green arrows and the forbidden annuity-to-life arrow, and the worked miniatures prove the page against both examples.

LOOK FOR	WHAT IT MEANS
Cover sheet	the explanation is accurate, personal and honest — the scripture is used truthfully rather than decoratively, and the pledge connects knowing the provisions to telling clients the truth.

UNIT 5

Health Insurance

In 1929 the schoolteachers of Dallas had a problem as old as sickness itself: a hospital stay could swallow a month's pay, and nobody could say whose turn was next. A Baylor University administrator named Justin Ford Kimball offered them a strange new bargain — fifty cents a month, and the hospital would be there when the bill came — and from that little plan grew the whole world this unit explores. You will learn how **medical expense insurance** shares a big bill through **deductibles**, **coinsurance** and the **out-of-pocket maximum**, and how the HMO, PPO, EPO and POS networks differ. You will meet **disability income insurance** — the policy that pays when the paycheck stops — and the definitions that decide everything.

Then the unit turns to the promises society itself makes: **Medicare** with its four parts, **Medicaid** for those in need, and the **long-term care** policies built around six activities of daily living. You will memorize the twelve **uniform mandatory provisions** every individual health policy carries and the five-rung **renewability ladder**, and you will finish with group health, COBRA continuation, health savings accounts and the specialized policies — dental, vision, AD&D and the limited plans that must say so on their face. Health insurance is the most calculation-heavy and list-heavy part of the licensing exam; this unit gives you the stories that make the lists stick.

PREREQUISITES

- Can compute percentages of dollar amounts quickly and accurately (20% of $8,400 without hesitation)
- Can define premium, insurer, insured, peril and indemnity from Units 1 and 2
- Can explain utmost good faith and the agent's duty of honest applications from Unit 2
- Has completed Units 3 and 4, or can state what a beneficiary, a grace period and a reinstatement are

MASTERY CHECKLIST

- ☐ I can walk a medical bill through deductible, coinsurance and out-of-pocket maximum and compute exactly what the insured and the insurer each pay.
- ☐ I can contrast HMO, PPO, EPO and POS plans by network, gatekeeper and referral rules.
- ☐ I can explain own-occupation versus any-occupation disability, and why benefits are capped at about 60–70% of earnings.
- ☐ I can compute when a disability check actually arrives from the elimination period and the payment-in-arrears rule.
- ☐ I can name what Medicare Parts A, B, C and D each cover, what Medigap does, and how Medicaid differs from them all.
- ☐ I can state the six activities of daily living and the common 2-of-6 (or cognitive impairment) long-term care benefit trigger — and that Medicare does not pay for custodial care.
- ☐ I can list the twelve mandatory uniform provisions with their time limits and climb the renewability ladder from cancellable to noncancellable.
- ☐ I can state the COBRA continuation rules (18 and 36 months, employers of 20 or more, up to

102% of premium) and the HSA eligibility rules.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **HealthCare.gov Glossary of Health Coverage Terms**: Free, official. Plain one-paragraph federal definitions of deductible, coinsurance, out-of-pocket maximum and every network type. Keep it open beside Lessons 5.1 and 5.5 and check your flashcard definitions against it. Ages 14 and up.
- **Medicare & You (the official Medicare handbook)**: Free, official. The handbook the government mails to every Medicare household each fall, with the current year's real figures for Parts A, B, C and D. Use it with Lesson 5.3 to replace this course's example numbers with this year's actual ones. Ages 15 and up.
- **LongTermCare.gov (Administration for Community Living)**: Free, official. The federal government's plain-language site on what long-term care is, what it costs and who pays — including the fact, tested on every exam, that Medicare does not cover most custodial care. Read the basics pages with Lesson 5.3. Ages 15 and up.
- **An Employee's Guide to Health Benefits Under COBRA (U.S. Department of Labor)**: Free, official. The Labor Department's own guide to continuation coverage — qualifying events, election windows and premiums. Skim it with Lesson 5.5; its tables are the exam's COBRA questions in plainer clothes. Ages 15 and up.
- **NAIC Consumer Insurance Resources**: Free, official. The National Association of Insurance Commissioners' consumer guides on health coverage, Medicare supplements and long-term care, plus the directory of all fifty state insurance departments. Use it all unit long whenever a lesson says 'check your state.' Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

5.1 Medical Expense Insurance: Deductibles, Networks and the Big Bill

3 sessions of 50 minutes

5.2 Disability Income: Insuring the Paycheck — 3 sessions of 50 minutes

5.3 Medicare, Medicaid and Long-Term Care — 3 sessions of 50 minutes

5.4	**The Uniform Provisions: How a Health Policy Behaves**	3 sessions of 50 minutes
5.5	**Group Health, HSAs and the Specialized Policies**	3 sessions of 50 minutes

Unit 5 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example,” use the figures given, and remember that real deductibles, premiums, HSA limits and Medicare figures change yearly and live at your state insurance department, the official federal sites and the current Medicare handbook. A state licensing exam passes at 70% — 14 of 20 here — but aim higher. Choose the one BEST answer.

1. **5 pts**

   A major medical policy has a $500 calendar-year deductible and 80/20 coinsurance, and the insured has met nothing this year. Covered charges are $15,500 (no cap reached). The insured pays:

   A. $3,500

   B. $3,100

   C. $500

   D. $3,000

2. **5 pts**

   Which of the following accumulates toward a plan's in-network out-of-pocket maximum?

   A. Monthly premiums

   B. The deductible, in-network coinsurance and copays

   C. Charges for services the policy does not cover

   D. All money the insured spends on health care of any kind

3. 5 pts

A health plan requires members to select a primary care physician who coordinates care and issues referrals, but members may also go outside the network at a higher cost. This is:

A. An HMO

B. An EPO

C. A PPO

D. A POS plan

4. 5 pts

Under settled federal health-insurance law, a major medical insurer may NOT:

A. Charge different premiums by age within legal limits

B. Sell plans in bronze, silver, gold and platinum tiers

C. Impose a lifetime dollar limit on essential health benefits

D. Cover dependents on a parent's plan to age 26

5. 5 pts

A surgeon develops a hand tremor, can no longer operate, and takes a teaching post. Her disability policy defines total disability by the own-occupation standard. The insurer should:

A. Deny the claim because she is gainfully employed

B. Pay the claim, because she cannot perform the duties of her own occupation

C. Pay only a partial benefit

D. Pay only if she quits teaching

6. 5 pts

Compared with a 30-day elimination period, a 180-day elimination period on the same disability policy will:

A. Lower the premium, because the insured absorbs more of the early loss

B. Raise the premium, because the policy lasts longer

C. Not affect the premium

D. Raise the benefit amount automatically

7. 5 pts

Nora, whose policy pays $2,500 a month with a 90-day elimination period and benefits paid in arrears, is totally disabled on January 1. Her first benefit check arrives about:

A. January 1

B. April 1

C. May 1

D. July 1

8. 5 pts

An employer pays the entire premium for its group long-term disability plan and deducts the cost. When a worker collects benefits, they are:

A. Income-tax-free

B. Taxable income to the worker

C. Taxable to the employer

D. Tax-free up to 60% of salary

9. 5 pts

Doctors' office visits, outpatient services and durable medical equipment are covered under which part of Medicare?

A. Part A

B. Part B

C. Part C only

D. Part D

10. 5 pts

A family asks which program will pay for their grandmother's expected years of custodial nursing home care. She is 80, on Original Medicare, with modest savings. The accurate answer is:

A. Medicare Part A, for as long as care continues

B. Her Medigap policy

C. Medicare Part C, if she switches

D. Not Medicare — long-term care insurance, her own funds, or Medicaid if she qualifies financially

11. 5 pts

A Medigap (Medicare supplement) policy is guaranteed issue, regardless of health, during:

A. The six months beginning when the buyer is 65 or older and enrolled in Part B

B. Any January

C. The 24 months after any hospital stay

D. The buyer's entire lifetime

12. 5 pts

Which statement correctly contrasts Medicare and Medicaid?

A. Both are needs-based

B. Medicare is state-run; Medicaid is purely federal

C. Medicare is based on age or disability regardless of wealth; Medicaid is needs-based, state-run with federal funds

D. Medicaid covers only people over 65

13. 5 pts

Under the uniform mandatory provisions, written proof of loss is generally due within how many days of the loss?

A. 20

B. 15

C. 60

D. 90

14. 5 pts

Under the uniform provisions, the grace period on a monthly-premium individual health policy is commonly:

A. 7 days

B. 10 days

C. 31 days

D. 45 days

15. 5 pts

Ten days after his health policy is automatically reinstated, an insured breaks his leg; twenty days after reinstatement he contracts bronchitis. The reinstated policy covers:

A. Both losses — accidents immediately, and the sickness because it began after the 10-day wait

B. The leg only

C. The bronchitis only

D. Neither loss for 45 days

16. 5 pts

A disability policy that the insurer must renew to age 65 AND whose premium can never be raised above the rate stated in the policy is:

A. Guaranteed renewable

B. Conditionally renewable

C. Optionally renewable

D. Noncancellable

17. 5 pts

Carla is laid off (not for misconduct) from a company with 75 employees. Her COBRA rights are:

A. 36 months at the employer's expense

B. 18 months at up to 102% of the full group premium, elected within 60 days

C. 18 months at her old payroll-deduction price

D. None, because she was laid off

18. 5 pts

Which person may contribute to a health savings account?

A. A worker enrolled in Medicare

B. A college student claimed as a dependent on her parents' tax return

C. A worker covered only by a qualifying high-deductible health plan

D. A worker with an HDHP plus full low-deductible coverage under a spouse's plan

19. 5 pts

An AD&D policy carries a $60,000 principal sum with a standard schedule. The insured loses one hand in a covered accident. The policy pays:

A. $60,000

B. $15,000

C. Nothing — dismemberment requires two losses

D. $30,000, the capital sum

20. 5 pts

A policy pays $150 for each day the insured is hospitalized, regardless of actual charges, and covers nothing else. Which statement is TRUE?

A. It is a basic hospital expense policy

B. It may lawfully be sold as a substitute for major medical coverage

C. It is a hospital indemnity policy and must be conspicuously labeled a limited policy

D. It violates the principle of indemnity and cannot be sold

ANSWER KEY

1. A. Deductible first ($500), then 20% of the remaining $15,000 ($3,000), for $3,500 total. D forgets the deductible; B applies 20% to the whole bill.
2. B. Cost sharing on covered in-network care counts. Premiums never count (A), non-covered services never count (C), and D sweeps in out-of-network and non-covered spending that commonly does not accumulate.
3. D. Gatekeeper plus an out-of-network door is the point-of-service hybrid. The HMO has the gatekeeper but no out-of-network benefit (A); the PPO has out-of-network coverage but no gatekeeper (C); the EPO has neither gatekeeper nor out-of-network coverage (B).
4. C. Lifetime and annual dollar limits on essential health benefits are prohibited. A and B are how the market lawfully works, and D is a requirement, not a prohibition.
5. B. Under own-occupation, inability to perform one's own occupation is total disability even while earning in another field. A and D state the any-occupation logic; C confuses total with partial disability.
6. A. The elimination period is a deductible measured in time; the more loss the insured retains, the cheaper the coverage. B confuses the elimination period with the benefit period.
7. C. The elimination period runs January through March; benefits accrue beginning about April 1, and the first month's benefit is paid at its end — about May 1. B forgets payment in arrears.
8. B. Employer-paid premiums make the benefits taxable to the recipient. Benefits are tax-free when the insured paid the premiums with after-tax dollars — the pairing the exam loves to reverse.
9. B. Part B is medical insurance — physicians and outpatient care, with a premium, an annual deductible and roughly 80/20 cost sharing. Part A is hospital insurance; Part D is drugs; Part C is the private package that must include at least A and B.
10. D. Medicare does not pay for long-term custodial care; its skilled nursing benefit is brief, skilled-only and follows a qualifying hospital stay. Medigap only fills Medicare's own gaps (B), and Advantage plans must match A and B, which exclude custodial care (C).
11. A. The Medigap open enrollment window is six months from age-65-plus-Part-B enrollment; afterward insurers may underwrite. The other windows are

inventions.

12. C. Medicare is an age- and work-based federal entitlement; Medicaid serves people of any age with low income and assets, administered by the states within federal rules — and it, not Medicare, pays custodial long-term care for those who qualify.
13. D. The claims clock runs 20 days for notice of claim, 15 for the insurer to send forms, 90 for proof of loss, and 60 days to (commonly) 3 years for legal actions. A and B belong to the earlier links of the chain.
14. B. The trio is 7 days (weekly premiums), 10 days (monthly), 31 days (all other modes). 45 days belongs to automatic reinstatement, a different clock entirely.
15. A. Reinstated coverage applies to accidents at once and to new sickness after 10 days; both losses here fall on the covered side of their rules. The 45 days (D) is how long insurer silence may run before reinstatement becomes automatic, not a coverage wait.
16. D. Only noncancellable adds the frozen premium to guaranteed renewal. Guaranteed renewable (A) — the exam's favorite tempter here — guarantees renewal but allows premium increases by class.
17. B. Termination other than gross misconduct gives 18 months; the beneficiary pays the entire group premium plus up to 2%, electing within the 60-day window. The 36-month periods belong to dependents' events such as death, divorce or a child aging out.
18. C. HSA eligibility requires a qualifying HDHP and falls to three disqualifiers the exam rotates: Medicare enrollment (A), dependent status (B), and other non-HDHP coverage (D).
19. D. A single dismemberment commonly pays the capital sum — 50% of the principal. The full principal sum (A) is for accidental death or double losses such as two limbs or the sight of both eyes.
20. C. A per-day fixed benefit is hospital indemnity — lawful, useful as a supplement, and required to announce its limits on its face. Selling it as a major medical substitute (B) is misrepresentation, and A describes expense reimbursement, which this is not.

PORTFOLIO PIECE: MY PATHWAY FILE: THE HEALTH INSURANCE SECTION

Assemble the health section of your Pathway File from this unit's five projects: the Big Bill Walkthrough spreadsheet with its three plans and the two-by-two network grid (Lesson 5.1); the Paycheck Protection Chart with its three elimination-period timelines and definitions box (Lesson 5.2); the Medicare Map and the pocket ADL trigger card (Lesson 5.3); the Provisions Wall Chart with the claims clock and renewability ladder (Lesson 5.4); and the four-page Harper Hardware benefits booklet (Lesson 5.5). Open the section with a one-page cover sheet written for an imaginary first client: three short paragraphs explaining, in your own words, what health insurance shares and caps, what it deliberately leaves to the family (elimination periods, custodial care, limited policies), and why an agent who quotes the gaps out loud — citing the Samaritan's two pence and Galatians 6:2 — is worth trusting with the rest.

LOOK FOR	WHAT IT MEANS
Big Bill Walkthrough	All three plan columns compute correctly (deductible, coinsurance, cap), patient plus insurer totals reconcile to the bill, and the network grid sorts HMO, PPO, EPO and POS by gatekeeper and out-of-network rules without error.
Paycheck Protection Chart	Benefit range computed at 60–70%, all three timelines show the correct accrual start and first-check date in arrears, and the taxation footnote states the employer-paid versus self-paid rule correctly.
Medicare Map and trigger card	The four parts, Medigap and Medicaid are placed and described accurately, two current-year figures are penciled in with their source and year, and the card lists all six ADLs with the 2-of-6-or-cognitive trigger and the custodial-care warning.
Provisions Wall Chart	All twelve mandatory provisions appear with correct time limits, the claims clock reads 20–15–90–60–3, the mandatory/optional columns are sorted by whom each protects, and the renewability ladder states the premium rule at the top two rungs.
Benefits booklet	COBRA numbers (20, 18, 36, 102, 60), HSA eligibility and the triple tax advantage, the AD&D schedule, and the limited-policy labeling are all stated accurately in plain English a new employee could follow.

LOOK FOR	WHAT IT MEANS
Cover sheet and reflection	Explains cost sharing, the deliberate gaps and the agent's honest role in the student's own words, uses the unit's Scripture honestly rather than decoratively, and is dated and signed.

5.1 Medical Expense Insurance: Deductibles, Networks and the Big Bill

OBJECTIVES

- Tell the story of Justin Ford Kimball's 1929 Baylor plan for Dallas schoolteachers and how it grew into hospital prepayment plans.
- Walk a covered medical bill through deductible, coinsurance and out-of-pocket maximum and compute each party's share.
- Contrast HMO, PPO, EPO and POS plans by network, gatekeeper and referral rules.
- Distinguish basic medical expense coverage from major medical, and describe the high-deductible health plan design.
- State the settled federal rules every major medical policy now obeys: guaranteed issue, coverage of pre-existing conditions, no lifetime or annual dollar limits on essential benefits, and dependent coverage to age 26.

> **Warm-up.** With pencil and paper: a surgery's covered charges are $20,000. The patient must pay the first $1,000 himself, then 20% of the rest. Compute the patient's total and the insurer's total, and check that the two add back to $20,000. Keep the page — by the end of the lesson you will know the names of every number you just used.

WATCH

Medical Expense Insurance

Insurance Practice Exams · 7:45

https://www.youtube.com/watch?v=H6aUfPYlF3A

> **WHEN TO WATCH**
> Watch after reading the big idea; every time a cost-sharing term is named — deductible, coinsurance, copay, out-of-pocket maximum — write it in the order the dollars actually flow.

BACKUP VIDEO

Medical Plans: HMO vs PPO on the Health Insurance Exam

Insurance Exam Queen · 7:33

https://www.youtube.com/watch?v=gaY4cE4aR1k

Watch before the project if the four network designs blur together; build the two-by-two grid (gatekeeper? out-of-network?) in your notebook as she talks.

KEY TERMS

medical expense insurance

Health insurance that pays the costs of medical care — hospital, surgical and physicians' expenses — rather than replacing lost income.

deductible

The amount of covered expenses the insured must pay out of his own pocket, usually per calendar year, before the policy begins to pay.

coinsurance

The percentage sharing of covered expenses above the deductible between insurer and insured — classically 80% insurer, 20% insured.

copayment

A flat dollar amount the insured pays for a specific service, such as an office visit or a prescription, regardless of the bill's size.

out-of-pocket maximum

The most an insured pays in deductibles, coinsurance and copays for covered in-network services in a year; beyond it the insurer pays 100% — also called the stop-loss limit.

network

The set of doctors, hospitals and other providers that have contracted with a plan to treat its members at negotiated prices.

HMO (health maintenance organization)

A plan that provides care through its own network, requires members to choose a primary care physician who acts as gatekeeper, and generally pays nothing for out-of-network care except emergencies.

PPO (preferred provider organization)

A plan whose members may see any provider without referrals, paying less in network and more out of network.

EPO (exclusive provider organization)

A plan with no referral requirement but no out-of-network coverage except emergencies — a PPO's freedom inside an HMO's fence.

POS (point-of-service) plan

A hybrid requiring a gatekeeper primary care physician like an HMO but allowing out-of-network care at higher cost like a PPO.

high-deductible health plan (HDHP)

A major medical plan with a high deductible and lower premium, designed by federal law to pair with a health savings account.

major medical insurance

Comprehensive coverage with high maximum benefits, a deductible and coinsurance — the standard modern design, in contrast to basic plans that pay first-dollar but small amounts.

CORE IDEAS

The story. In the Dallas of the late 1920s, hospitals had a quiet ledger problem: schoolteachers. They were respectable, employed and utterly unable to pay a hospital bill — one administrator found that Dallas teachers owed Baylor University Hospital more in unpaid bills than the hospital could carry. In 1929 **Justin Ford Kimball**, a former school superintendent newly in charge of Baylor's medical units, proposed a bargain nobody had tried at scale: any Dallas teacher could prepay **fifty cents a month**, and in return the hospital would furnish up to **twenty-one days of**

semi-private hospital care a year. More than a thousand teachers signed up in the first months. The sick teacher no longer faced a ruinous bill, the hospital no longer faced an empty collection drawer, and the healthy teachers' half-dollars quietly carried the sick ones — risk pooling, applied to hospital beds. The idea spread from city to city through the 1930s as hospital service plans, and when the plans adopted a common emblem, the movement took its name from the symbol: the Blue Cross.

How they figured it out. Kimball could set his price because he had data: as a school administrator he had run the teachers' sick-benefit fund, so he knew roughly how often teachers were hospitalized and for how long. That is the same law of large numbers you met in Unit 1, now applied to hospital days instead of houses. But medical insurance had a problem fire insurance never faced: the insured helps decide how much care to use. A man cannot burn his house a little more because he is insured, but a patient with full coverage can visit the doctor more, stay longer and agree to more tests. Insurers learned to answer this **moral hazard** not by refusing to pay but by making the patient a partner in every bill — a share small enough not to bar needed care, large enough to make him ask what things cost. Out of that insight came the whole cost-sharing toolkit of this lesson: deductibles, coinsurance, copayments, and a ceiling on the patient's share so that sharing never becomes ruin.

The big idea. Every medical expense claim flows through the same channel, in the same order, and the exam will make you walk it. First the insured pays the **premium** just to own the policy — premiums are not cost sharing and never count toward anything else. When care comes, the insured pays the **deductible** — in this example the first $1,000 of covered charges each calendar year. Above the deductible, insurer and insured split covered charges by the **coinsurance** percentage, classically **80/20**: the insurer pays 80 cents of each dollar, the insured 20. Along the way, some services carry flat **copayments** instead. And the insured's total of deductible, coinsurance and copays for covered in-network care is capped by the **out-of-pocket maximum** — once he reaches it, the insurer pays 100% of covered charges for the rest of the year. That cap is the stop-loss idea: cost sharing is meant to make patients careful, not to bankrupt the unlucky.

Where you may go for care is governed by the plan's **network**, and the exam tests four designs by two questions: is there a gatekeeper, and is there out-of-network coverage? The **HMO** answers yes and no: you choose a **primary care physician (PCP)** who treats you first and issues **referrals** to specialists, and except for true

emergencies the plan pays nothing outside its network. The **PPO** answers no and yes: no gatekeeper, no referrals, and you may go out of network — you simply pay a larger share there. The **EPO** takes the HMO's fence without its gatekeeper: no referrals needed, but in-network only. The **POS** plan takes the HMO's gatekeeper and adds a PPO-style door: your PCP coordinates care, but you may step out of network at a higher cost. Emergencies are covered everywhere under all four designs — a heart attack does not check a directory.

Two older distinctions still appear on exams. **Basic medical expense** plans — basic hospital, basic surgical, basic physicians' — pay from the first dollar, with no deductible, but only up to small stated limits; when the limit is gone, the patient is alone. **Major medical** reverses the bargain: broad coverage and very high maximums, with the patient sharing early costs through a deductible and coinsurance. A supplemental major medical policy can sit on top of a basic plan, with a **corridor deductible** between them — the insured pays that corridor after the basic benefits are exhausted and before the major medical begins. The modern descendant of major medical is the **high-deductible health plan**: in this example a $3,400 family deductible in exchange for a much lower premium, with federal law pairing it to a tax-favored health savings account you will study in Lesson 5.5.

Finally, the settled rules of **federal health-insurance law**, which reshaped the individual and small-group markets in 2010 and which every exam now treats as plain mechanics. Major medical policies are **guaranteed issue** during open enrollment — an applicant cannot be declined for health history — and **pre-existing conditions** are covered, not excluded. **Lifetime and annual dollar limits** on essential health benefits are prohibited; the old "million-dollar lifetime cap" is history. Children may remain on a parent's policy to **age 26**. Individual and small-group plans are sold in four **metal tiers** named for the share of costs the plan is expected to pay on average: bronze about 60%, silver about 70%, gold about 80%, platinum about 90%. Preventive care in network is covered without cost sharing. Learn these as you learned the grace period — as how the machine works.

On the exam today. The claim calculation is the most predictable arithmetic question on the health exam: deductible first, then the coinsurance split, then check the out-of-pocket maximum — and remember that **premiums never count** toward deductible or out-of-pocket maximum, and that out-of-network and non-covered charges commonly do not either. Expect a network matching question: gatekeeper

plus no out-of-network coverage is an HMO; no gatekeeper plus out-of-network coverage is a PPO; no gatekeeper but in-network only is an EPO; gatekeeper with an out-of-network option is a POS. Watch the basic-versus-major-medical trap — basic pays first dollar but little, major medical pays big but shares — and the corridor deductible between a basic plan and its supplemental major medical. And when a question names a dollar figure for a deductible or a tier, treat it as that question's example; the live figures change yearly and live at your state insurance department and the official federal sites.

PICTURE STUDY



The Sick Child, Gabriël Metsu, circa 1664–1666 · Oil on canvas · Rijksmuseum, Amsterdam

Image: Wikimedia Commons, public domain

Gabriël Metsu painted the quiet middle-class rooms of Holland's golden age, and this canvas — a mother holding her feverish child, the untouched porridge beside them — is his most tender. Amsterdam in the 1660s knew sickness intimately; plague had swept the city only a few years before, and every parent knew the weight in this woman's lap. Metsu hangs a small Crucifixion on the wall behind them, placing the household's suffering under a greater one. The picture opens this lesson because medical expense insurance exists for exactly this room: so that when sickness arrives uninvited, the family's whole attention can belong to the child, not to the bill that is coming.

Look closely

- Study the child's body — slumped, heavy, one arm hanging. Metsu painted the posture of fever without a single frightening detail. How does he make you feel the sickness?
- Find the bowl of porridge on the table, full and abandoned. What does the untouched meal tell you about the day this household is having?
- Look at the mother's hands and face. She is not panicking; she is keeping watch. What costs of sickness does this picture show that no policy reimburses?

- Find the Crucifixion on the wall behind them. Why might the painter place that picture over this particular scene?

Talk about it

1. If this mother must also fear a ruinous bill, something in this room changes. What does prepayment — Kimball's fifty cents a month from a thousand teachers — buy a household beyond money?
2. Cost sharing asks every family to carry part of every bill. Where in this picture do you see the argument for an out-of-pocket maximum — a point past which the sick should not pay more?
3. The mother can hold and watch, but she cannot command the outcome, and neither can any insurer. What does this picture teach about the limits of what money and medicine can promise — and who holds what they cannot?

PROJECT

The Big Bill Walkthrough: One Surgery, Three Plans

You will build the claim calculator that anchors the health half of your Pathway File: a one-page spreadsheet that takes one pretend hospital bill and walks it through three pretend plans — an HMO, a PPO used out of network, and a high-deductible plan — showing exactly who pays what at every step. Agents who can do this arithmetic on paper earn trust in one conversation; exam candidates who can do it earn the easiest points on the test.

You will need

- Free spreadsheet software (Google Sheets or LibreOffice Calc), or ruled paper and a calculator
- Your exam notebook and pen
- The HealthCare.gov glossary from the kit, open for checking definitions

Steps

1. Create a column for the pretend patient: the Harper family's covered surgery bill of $28,000 (pretend money, in-network charges).
2. Create three plan columns with these example terms — Plan H (HMO): $500 deductible, 90/10 coinsurance, $4,000 out-of-pocket max; Plan P (PPO, used OUT of network): $2,000 out-of-network deductible, 60/40 coinsurance, $10,000 out-of-network out-of-pocket max; Plan D (HDHP): $3,400 deductible, 80/20 coinsurance, $7,000 out-of-pocket max.
3. For each plan, compute in labeled rows: deductible paid, remaining charges, patient coinsurance, patient total before cap, patient total after cap, insurer total. Check every column: patient total plus insurer total must equal $28,000.
4. Below the table, write the two sorting questions for networks (gatekeeper? out-of-network coverage?) and classify all four designs — HMO, PPO, EPO, POS — in a two-by-two grid.
5. Add a box titled WHAT NEVER COUNTS, listing: premiums, non-covered services, and (commonly) out-of-network charges against the in-network out-of-pocket maximum.

6. Write a three-sentence paragraph: which plan would you recommend to a healthy 26-year-old with savings, and which to a family expecting heavy medical use this year — and why neither answer is 'always.'
7. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for all twelve key terms, and on the deductible, coinsurance and out-of-pocket maximum cards add a tiny worked number example on the back.
2. Draw the claim channel as a pipeline: PREMIUM (outside the pipe) → DEDUCTIBLE → 80/20 SPLIT → OUT-OF-POCKET MAX → INSURER PAYS 100%, with a note that premiums never enter the pipe.
3. Write a five-line trap list titled 'Networks,' ending with: EPO = no referrals, no out-of-network; POS = gatekeeper + an out-of-network door.

KEY FORMULAS

$\text{insured pays} = \text{deductible} + c \times (\text{covered charges} - \text{deductible})$, capped at the out-of-pocket maximum

$\text{insurer pays} = \text{covered charges} - \text{insured's share}$

$\text{coinsurance share} = c \times (\text{covered charges} - \text{deductible})$ where c is the insured's percentage, commonly 20%

From history. Kimball's half-dollar plan nearly wasn't first: industrial 'hospital ticket' schemes and lumber-camp doctors had sold prepaid care for decades. What made Baylor's version the famous one was enrollment through an employer group — the Dallas school district — which gathered healthy and sick teachers alike and kept the pool sound. The blue cross emblem itself came later, from plan publicist E. A. van Steenwyk in St. Paul, Minnesota, in the early 1930s; the symbol proved so trusted that the plans took its name.

Example 1. A policy has a $1,000 calendar-year deductible, 80/20 coinsurance and a $6,000 out-of-pocket maximum (in this example). The insured, with nothing yet paid this year, has covered in-network charges of $21,000. What does the insured pay, and what does the insurer pay?

Show solution

1. Deductible first: the insured pays the first $1,000. Remaining covered charges: $\$21{,}000 - \$1{,}000 = \$20{,}000$.
2. Coinsurance next: the insured's 20% share is $0.20 \times \$20{,}000 = \$4{,}000$.
3. Check the cap: deductible plus coinsurance is $\$1{,}000 + \$4{,}000 = \$5{,}000$, which is under the $6,000 out-of-pocket maximum, so no adjustment.
4. Insurer pays the rest: $\$21{,}000 - \$5{,}000 = \$16{,}000$.

Answer: Insured $5,000; insurer $16,000. Deductible, then coinsurance, then the cap — always in that order.

Example 2. Same policy — $1,000 deductible, 80/20, $6,000 out-of-pocket maximum — but the covered charges are $60,000. Now what does the insured pay?

Show solution

1. Deductible: $1,000. Remaining: $59,000.
2. Uncapped coinsurance would be $0.20 \times \$59{,}000 = \$11{,}800$, for a total of $12,800.
3. But the out-of-pocket maximum stops the insured at $6,000 of deductible plus coinsurance combined.
4. Insurer pays everything else: $\$60{,}000 - \$6{,}000 = \$54{,}000$, and 100% of covered in-network charges for the rest of the year.

Answer: The insured pays $6,000 — the stop-loss cap — and the insurer pays $54,000. The bigger the bill, the more the cap matters.

Example 3. Exam style. Marta wants a plan with no referral requirements, but she is willing to give up all out-of-network coverage to lower her premium. Which plan design fits?

A. HMO

B. PPO

C. EPO

D. POS

Show solution

1. Ask the two sorting questions: gatekeeper? out-of-network coverage?
2. Marta wants no gatekeeper and no referrals — that eliminates the HMO (A) and the POS (D), which both use a primary care physician as gatekeeper.
3. She accepts in-network-only coverage — that eliminates the PPO (B), which pays (less) out of network.
4. No referrals plus network-only is the exclusive provider organization.

Answer: C. An EPO combines a PPO's freedom from referrals with an HMO's network-only coverage (emergencies excepted).

PRACTICE

1. Easy In what order does a medical expense claim flow through the insured's cost sharing?

   Show answer

   Deductible first, then coinsurance (with copays along the way), with the out-of-pocket maximum capping the insured's total — after which the insurer pays 100% of covered in-network charges for the year.

2. Easy What is the difference between a copayment and coinsurance?

   Show answer

   A copayment is a flat dollar amount per service (such as $30 per office visit in this example); coinsurance is a percentage split of covered charges above the deductible, such as 80/20.

3. **Easy** Which plan design requires a primary care physician gatekeeper and pays nothing out of network except emergencies?

Show answer

The HMO. The PPO has neither restriction, the EPO has the network restriction without the gatekeeper, and the POS has the gatekeeper with an out-of-network option.

4. **Medium** A policy has a $500 deductible and 80/20 coinsurance. Covered charges are $10,500. What does the insured pay (no cap reached)?

Show answer

$\$500 + 0.20 \times (\$10{,}500 - \$500) = \$500 + \$2{,}000 = \$2{,}500$. The insurer pays $8,000.

5. **Medium** Which of the following counts toward an insured's out-of-pocket maximum?

A. Monthly premiums

B. The deductible and in-network coinsurance

C. Charges for services the policy does not cover

D. Balance bills from out-of-network providers, under every plan

Show answer

B. Deductibles, in-network coinsurance and copays accumulate toward the cap. Premiums never count (A), non-covered services never count (C), and out-of-network charges commonly do not count toward the in-network maximum (D).

6. **Medium** A basic surgical expense policy pays benefits from the first dollar. Why might its insured still face a large unpaid bill?

Show answer

Basic plans pay first-dollar but only up to low stated limits; once the scheduled benefit is exhausted, the patient pays everything beyond it. Major medical reverses this: the insured shares early costs but is protected against the big bill.

7. Medium Under settled federal health-insurance law, which of the following may a major medical insurer still do?

   A. Impose a lifetime dollar limit on essential health benefits

   B. Decline an open-enrollment applicant for her health history

   C. Exclude a pre-existing condition for twelve months

   D. Charge different premiums by age within the limits the law allows

   Show answer

   D. Age-based rating within legal limits remains. Lifetime and annual dollar limits on essential benefits are prohibited (A), coverage is guaranteed issue in open enrollment (B), and pre-existing condition exclusions are gone (C).

8. Hard A plan has a $2,000 deductible, 70/30 coinsurance and a $7,500 out-of-pocket maximum. Covered charges are $40,000. Compute the insured's and insurer's shares.

   Show answer

   Uncapped: $\$2{,}000 + 0.30 \times \$38{,}000 = \$13{,}400$, which exceeds the cap, so the insured pays $7,500 and the insurer pays $32,500.

9. Hard An insured has a basic hospital plan that exhausts at $5,000 and a supplemental major medical policy with a $300 corridor deductible and 80/20 coinsurance. The covered bill is $15,300. Who pays what?

   Show answer

   Basic plan pays the first $5,000; the insured pays the $300 corridor; the remaining $10,000 splits 80/20, so the major medical pays $8,000 and the insured $2,000 more — $2,300 in all. The corridor deductible bridges the two policies.

10. Hard From the story: why could Kimball price the Baylor plan at fifty cents a month with reasonable confidence, and what Unit 1 principle was he using?

    Show answer

    He had years of records from the teachers' sick-benefit fund showing how often teachers were hospitalized and for how long, so he could estimate expected hospital days per thousand teachers — the law of large numbers, which turns individual uncertainty into group predictability.

11. **Challenge** A healthy young client compares a low-deductible plan (premium $450/month, $1,000 deductible) with an HDHP (premium $280/month, $3,400 deductible), both 80/20 — example figures. In a year with no claims, and in a year with a $3,400 covered bill, which costs less in total (premiums plus cost sharing)?

    Show answer

    No claims: low-deductible costs $5,400 in premiums, HDHP $3,360 — HDHP wins by $2,040. With the $3,400 bill: low-deductible totals $\$5{,}400 + \$1{,}000 + 0.20 \times \$2{,}400 = \$6{,}880$; HDHP totals $\$3{,}360 + \$3{,}400 = \$6{,}760$ — still slightly less in this example. The lesson: compare total yearly cost, not deductibles alone, and remember the answer flips as expected care rises.

12. **Challenge** A friend says: 'Insurance companies invented deductibles just to cheat people out of coverage they paid for.' Using moral hazard and the out-of-pocket maximum, write a three-sentence fairer account.

    Show answer

    Cost sharing exists because fully free care invites overuse, which would push every member's premium up — the deductible and coinsurance make each patient a partner in the bill. The out-of-pocket maximum shows the design's honest intent: sharing stops exactly where it would become ruin, and the insurer then pays 100%. A plan with no cost sharing at all would simply be a much more expensive plan.

COMMON MISTAKES

- Counting premiums toward the deductible or the out-of-pocket maximum — premiums buy the policy and never count as cost sharing.
- Applying the coinsurance percentage to the whole bill instead of to covered charges remaining after the deductible.
- Forgetting the out-of-pocket maximum on big-bill problems — always compute the uncapped share, then check it against the cap.
- Confusing the EPO and the POS: the EPO has no gatekeeper and no out-of-network coverage; the POS has a gatekeeper and an out-of-network option.
- Saying 'the HMO never covers out-of-network care' without the exception the exam expects: emergencies are covered.
- Treating basic medical expense plans as better because they pay 'from the first dollar' — they exhaust at low limits, which is exactly the catastrophe major

medical exists to cover.

Make it a game · Walk the Bill. Write six pretend covered bills on slips ($800, $4,000, $12,000, $28,000, $60,000, $150,000) and agree on one plan aloud: $1,000 deductible, 80/20, $6,000 out-of-pocket max. A parent draws a slip and starts a 60-second timer; you must announce the insured's share and the insurer's share before it rings — deductible, coinsurance, cap, in that order. One point per correct split; lose a point if you forget to check the cap. Then swap: you draw, and the parent computes while you check their work with a calculator. First to five points picks dessert. For a harder round, change the plan terms between slips.

Scripture. “And on the morrow when he departed, he took out two pence, and gave them to the host, and said unto him, Take care of him; and whatsoever thou spendest more, when I come again, I will repay thee.” (Luke 10:35, KJV)

The Samaritan did not only bind wounds — he arranged payment for care he could not stay to give, and promised to cover what the bill ran over. Medical expense insurance, at its honest best, organizes that same mercy in advance: provision made today so that a stranger's care is paid for on the day of trouble.

5.2 Disability Income: Insuring the Paycheck

OBJECTIVES

- Explain what disability income insurance replaces and why benefits are capped at roughly 60–70% of earnings.
- Contrast the own-occupation and any-occupation definitions of total disability and explain why the definition decides the claim.
- Compute when benefits begin and when the first check arrives from the elimination period and payment in arrears.
- Distinguish partial, residual and presumptive disability benefits, and short-term from long-term coverage.
- State how group and individual disability differ, how occupational and non-occupational coverage interact with workers' compensation, and how the premium payer determines the taxation of benefits.

> **Warm-up.** In five minutes, list everything your household would still have to pay in a month in which the main earner could not work at all — and then write what the biggest asset in most working families actually is. (Hint: it is not the house. It drives to work every morning.) Keep the list; this lesson insures it.

WATCH

Disability Income Insurance Explained | NJ Accident & Health Exam Prep

Good Agents TV · 6:03

https://www.youtube.com/watch?v=5xFB6DZ8gLU

> **WHEN TO WATCH**
> Watch after the big idea; each time a policy feature is named — elimination period, benefit period, own occupation — pause and write its one-line definition before he gives it.

BACKUP VIDEO

Elimination and Benefit Periods in Disability Insurance - Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 2:47

https://www.youtube.com/watch?v=d3m4NM__DXA

A quick second pass on the two clocks of every claim; watch it right before the project and then draw the timeline from memory.

KEY TERMS

disability income insurance

Insurance that replaces a portion of earned income, usually as a monthly benefit, when the insured cannot work because of sickness or injury.

own-occupation definition

Total disability defined as the inability to perform the duties of the insured's own occupation — the more generous definition, common in the first period of a claim.

any-occupation definition

Total disability defined as the inability to perform any occupation for which the insured is reasonably suited by education, training or experience — the stricter definition.

elimination period

The waiting period after disability begins during which no benefits are payable — a deductible measured in time instead of dollars.

benefit period

The maximum length of time benefits will be paid during one continuous disability — such as two years, five years or to age 65.

partial disability

A benefit, commonly a flat percentage such as 50% of the total benefit, paid when the insured can perform some but not all duties or can work only part-time.

residual disability

A benefit based on the percentage of income actually lost when the insured works with reduced earnings — proportionate, not flat.

presumptive disability

A provision paying the full benefit, often without the usual proof, when the insured suffers specified losses such as sight, hearing, speech or the use of two limbs.

probationary period

A period after the policy is issued, commonly 15 to 30 days, during which sickness-caused disability is not covered — a one-time guard against buying coverage while already getting sick.

recurrent disability

A provision treating a disability that returns within a stated time, commonly six months, as a continuation of the first claim — with no new elimination period.

Social Insurance Supplement (SIS) rider

A rider paying an extra benefit while the insured is not receiving expected social insurance benefits, and reducing when those benefits begin.

waiver of premium

A provision waiving the policy's own premiums while the insured is totally disabled, commonly after 90 days of disability.

CORE IDEAS

The story. In 1859 a Hartford stonemason-turned-businessman named **James G. Batterson** traveled to England and saw something new: companies selling tickets that insured railway passengers against accidental injury — a few pence for coverage between stations. Batterson came home determined to sell accident insurance to Americans, and in 1864 he founded the Travelers Insurance Company in Hartford to do it. The company's own founding legend fixes the scale of the thing: a local banker, **James Bolter**, met Batterson and asked, half joking, what it would cost to insure him

for the four-block walk from the post office to his home on Asylum Street. Two cents, said Batterson. Bolter paid the two pennies, walked home unhurt, and the coins were kept as the first accident premium in America. Behind the joke stood a serious discovery of the industrial age: machines, railways and factories could take away a man's ability to earn long before they took his life — and a family could be ruined not by a death but by a paycheck that stopped.

How they figured it out. Insuring a paycheck raised a problem that insuring a life never did: a dead man cannot malinger, but a living one might. If a policy paid a disabled worker *more* than he earned working, some would discover that recovery did not pay — the moral hazard you met in Lesson 5.1, now applied to time itself. The industry's answers became the architecture of every disability policy. Benefits are capped at roughly **60% to 70% of gross earnings**, so working always beats claiming. The insured waits out an **elimination period** before benefits begin — a deductible in days rather than dollars, which screens out the short illnesses almost anyone can weather and reserves the policy for the long ones nobody can. And benefits are defined by careful tests of what the insured can and cannot do, verified by physicians, because the thing insured — capacity to work — cannot be photographed like a burned house.

The big idea. On a disability claim, **the definition decides everything**. Under an **own-occupation** definition, the insured is totally disabled if he cannot perform the substantial duties of *his own* occupation — a surgeon whose hand tremor ends her surgical career collects even if she could teach anatomy. Under an **any-occupation** definition, benefits are owed only if the insured cannot work at *any* occupation for which he is reasonably suited by education, training or experience — the same surgeon, able to teach, collects nothing. Own-occupation coverage is more generous and costs more; many policies split the difference, applying own-occupation for an initial period (commonly the first two years, in this example) and any-occupation afterward. When an exam question gives you an occupation, an injury and a definition, read the definition like a lawyer — it is the whole question.

Two clocks run on every claim. The **elimination period** — commonly 30, 60, 90 or 180 days — is the time deductible: no benefits accrue during it, and the longer the insured is willing to wait, the lower the premium. The **benefit period** — two years, five years, to age 65 — is how long benefits can last; longer periods cost more. And the exam's favorite arithmetic hides in a third fact: disability benefits are paid **in**

arrears, at the end of each benefit month, not in advance. An insured with a 90-day elimination period who becomes disabled on March 1 satisfies the waiting period at the end of May — and receives the first check about a month later, near the end of June. Four months without a dollar: that is why the course keeps saying an emergency fund and an elimination period must be chosen together.

Between fully working and fully disabled lies most of real life, and the policy maps it. A **partial disability** benefit pays a flat fraction — commonly 50% of the total benefit — while the insured works reduced duties or hours. A **residual disability** benefit is finer-grained: it pays the share of the benefit equal to the share of income actually lost, so a salesman earning 40% less collects 40% of his benefit. **Presumptive disability** handles the losses so severe the insurer stops asking: loss of sight, hearing, speech, or the use of two limbs triggers the full benefit, commonly for life, even if the insured manages to work. Add the **probationary period** (a one-time window after issue, commonly 15 to 30 days, during which new *sickness* is not covered — accidents are covered from day one), the **recurrent disability** rule (a relapse within commonly six months continues the old claim with no new elimination period), and **waiver of premium**, and you can read nearly any disability policy.

Finally, the market's shape. **Short-term disability** (STD) policies, common as group coverage, carry brief elimination periods (0 to 14 days, in this example) and benefit periods measured in weeks or months — commonly 13 to 52 weeks (up to about two years in some plans); **long-term disability** (LTD) picks up after STD ends and can run to age 65. **Group** coverage through an employer is cheaper and simpler but usually ends with the job and uses stricter definitions; **individual** policies cost more but belong to the insured, follow him between jobs, and can be noncancellable. **Non-occupational** policies — the standard for group coverage — exclude disabilities arising from work, because **workers' compensation** (Unit 7) covers those; **occupational** coverage includes them, for people workers' comp misses. A **Social Insurance Supplement rider** pays extra while expected social insurance benefits — which are hard to qualify for and slow to begin — are not being received, then reduces when they are. And taxation follows the premium: where the *employer* pays the premium and deducts it, benefits are taxable income to the worker; where the insured pays with after-tax dollars, benefits arrive income-tax-free.

On the exam today. Expect the definitions question — own-occupation pays the surgeon-turned-teacher, any-occupation does not — and read which period of the policy the question is in. Expect elimination-period arithmetic: no benefits during the wait, benefits accrue afterward, first check a month later still, because payment is in arrears. Know that a longer elimination period means a **lower** premium (it is a deductible, not a benefit), and that benefits are capped near 60–70% of earnings to keep work worth more than claiming — both tested nearly verbatim. Distinguish partial (flat percentage) from residual (proportional to lost income). Memorize the presumptive list: sight, hearing, speech, two limbs. And on taxation, follow the premium dollars: employer-paid premiums make taxable benefits; personally paid after-tax premiums make tax-free benefits — the exam swaps these constantly.

PICTURE STUDY



Work, Ford Madox Brown, 1852–1865 · Oil on canvas · Manchester Art Gallery, Manchester

Image: Wikimedia Commons, public domain

Ford Madox Brown spent thirteen years on this one canvas, determined to paint something no gallery then thought paintable: ordinary labor as a heroic subject. At the center, navvies dig a waterworks trench in a London street while every class of society — the rich who need not work, the poor who cannot find it, the thinkers who work with their minds — arranges itself around the men with shovels. It opens this lesson because the picture's whole argument is this unit's premise: the working man's strength is the engine everything else depends on. Disability income insurance exists for the day that engine stops.

Look closely

- Find the navvies at the center — study their stance, their tools, their sunburn. The painter gives them the light a Renaissance artist gave saints. Why?
- Find the ragged children in the foreground, one minding the baby. Whose paycheck do they depend on, and what in the picture would feed them if it stopped?
- Find the idle figures — the wealthy riders behind, the lounging onlookers. The painting contrasts those who need not work with those who must. Which group needs this lesson's policy more?

- Look at the two gentlemen on the right, watching and thinking (the painter meant them as 'brainworkers'). Is their work insurable too? What would 'own occupation' mean for each figure in the painting?

Talk about it

1. The navvy's capital is his body. Translate that into this lesson's terms: what is the largest asset most working families own, and which policy insures it?
2. If one of the central diggers shattered his arm, walk his family through the next 120 days under a policy with a 90-day elimination period. What fills the gap the policy deliberately leaves?
3. Scripture says that a man who will not provide for his own house 'hath denied the faith.' How is buying disability coverage — or building the savings that make its waiting period survivable — an act of provision rather than of fear?

PROJECT

The Paycheck Protection Chart

You will build a one-page chart for the Pathway File that designs a disability policy for a pretend worker — and proves, with a timeline, exactly when his money would arrive. Agents who draw this timeline for clients prevent the most common and bitterest disability surprise: the four silent months between an injury and the first check.

You will need

- One sheet of paper turned sideways, ruler and two ink colors (or a spreadsheet page)
- Your exam notebook
- A calculator

Steps

1. Invent your pretend client: name, age, occupation and gross monthly income (pretend money — say, a $4,500-a-month electrician).
2. Compute his benefit range at 60% and at 70% of earnings, and write one sentence on why the insurer will not sell him 100%.
3. Draw a 12-month timeline starting at a disabling injury on day 1. Mark three versions beneath it: a 30-day, a 90-day and a 180-day elimination period, each with its benefit-accrual start and its first-check date (one month later, in arrears).
4. Beside each version, note the premium direction (shortest wait = highest premium) and the emergency-fund months the family would need to cross the gap.
5. Add a definitions box: write own-occupation and any-occupation in one line each, and state which one your electrician should want if his hands are his trade.
6. Add a benefits ladder: total, partial (flat 50%), residual (proportional), presumptive (sight, hearing, speech, two limbs — full benefit), each with a one-line example for an electrician.

7. Finish with a taxation footnote: employer-paid premiums → taxable benefits; self-paid after-tax premiums → tax-free benefits. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the twelve key terms; on the elimination-period card, write 'TIME deductible — longer wait = LOWER premium' in capitals.
2. Draw the claim timeline as a horizontal bar: INJURY → [elimination period: $0] → [benefits accrue] → first check one month later, and label the whole silent stretch 'emergency fund lives here.'
3. Write a five-line trap list titled 'Definitions decide,' ending with: presumptive = sight, hearing, speech, two limbs — full benefit, work or no work.

KEY FORMULAS

$$\text{monthly benefit} \approx 0.60 \text{ to } 0.70 \times \text{gross monthly earnings}$$ (capped by the insurer; commonly 60–70%)

$$\text{residual benefit} = \frac{\text{income lost}}{\text{prior income}} \times \text{total monthly benefit}$$

$$\text{benefits begin} = \text{date of disability} + \text{elimination period}$$, with the first check about one month later (paid in arrears)

From history. Batterson's railway-ticket inspiration had a name: the Railway Passengers Assurance Company of London, founded in 1849, which sold accident coverage with the train ticket itself. Travelers outgrew the gimmick fast — by the 1890s it was writing broad accident and liability lines, and in 1897 it would issue one of the first American automobile liability policies, a story this course tells in Unit 7. The two pennies Bolter paid are still preserved as a company relic in Hartford.

Example 1. Dan earns $5,000 a month and owns a disability policy paying 60% of earnings with a 90-day elimination period and a five-year benefit period. He is totally disabled in an accident on April 1. How much is his monthly benefit, when do benefits begin to accrue, and about when does the first check arrive?

Show solution

1. Benefit amount: $0.60 \times \$5{,}000 = \$3{,}000$ per month.
2. Elimination period: 90 days from April 1 runs through April, May and June — benefits begin to accrue about July 1. Nothing is ever paid for those 90 days.
3. Payment in arrears: the first month of accrued benefits (July) is paid at its end, so the first $3,000 check arrives about August 1 — four months after the injury.
4. Benefit period: if the disability continues, checks can run five years from the start of benefits, in this example.

Answer: $3,000 per month; accrual begins about July 1; first check about August 1. The gap between injury and first check is the elimination period plus one month of arrears.

Example 2. Exam style. A commercial pilot loses an eye in an accident and can no longer hold a pilot's medical certificate, but he takes a job as a flight instructor at lower pay. His policy defines total disability as the inability to perform the duties of his own occupation. Is he totally disabled under the policy?

A. No, because he is working

B. No, because he can perform some occupational duties

C. Yes, because he cannot perform the duties of his own occupation as a pilot

D. Yes, but only if he stops working entirely

Show solution

1. Identify the definition: own-occupation — the test is his occupation at the time of disability, piloting.
2. He cannot meet the medical requirements to pilot, so he cannot perform his own occupation's duties.
3. Under own-occupation coverage, working in a different occupation does not defeat the claim — that is precisely what the insured paid extra for.
4. A and D state the any-occupation logic; B misreads the duties test, which looks at the substantial duties of the own occupation.

Answer: C. Under an own-occupation definition, inability to perform one's own occupation is total disability even while earning in another occupation.

Example 3. Rosa's policy pays a $4,000 monthly total disability benefit with a residual benefit provision. After an illness she returns to work part-time, earning $3,600 a month instead of her prior $6,000. What does the residual benefit pay?

Show solution

1. Income lost: $\$6{,}000 - \$3{,}600 = \$2{,}400$.
2. Percentage of income lost: $\$2{,}400 \div \$6{,}000 = 40\%$.
3. Residual benefit: $0.40 \times \$4{,}000 = \$1{,}600$ per month.
4. Contrast: a flat partial disability benefit would commonly pay 50% of $4,000 regardless of her actual earnings — residual tracks the real loss.

Answer: $1,600 per month — 40% of income lost means 40% of the benefit. Residual is proportional; partial is a flat fraction.

PRACTICE

1. Easy What does disability income insurance replace, and in what form are benefits usually paid?

   Show answer

   A portion of the insured's earned income — commonly 60–70% of gross earnings — paid as a monthly benefit while the insured is disabled under the policy's definition.

2. Easy Why is an elimination period called a time deductible, and how does lengthening it change the premium?

   Show answer

   The insured absorbs the first days of loss himself, just as a dollar deductible absorbs the first dollars; a longer elimination period means a lower premium.

3. Easy Name the losses that commonly trigger a presumptive total disability benefit.

   Show answer

   Loss of sight, hearing, speech, or the use of two limbs — the full benefit is paid, commonly without the usual ongoing proof and even if the insured works.

4. **Medium** A policy's total disability definition is own-occupation for two years, any-occupation thereafter. A disabled carpenter takes a desk job in year one. What happens to his benefit in year one, and what question decides year three?

Show answer

In year one he collects — he cannot perform his own occupation, and other work does not defeat an own-occupation claim. From year three the test becomes whether he can perform any occupation he is reasonably suited for; since he demonstrably can (he holds one), benefits would commonly stop.

5. **Medium** Benefits under an individual disability policy are capped at about 60–70% of earnings PRIMARILY to:

A. Lower the insurer's taxes

B. Keep benefits below earnings so recovery and work remain worthwhile

C. Comply with a federal benefit ceiling

D. Coordinate with the policy's elimination period

Show answer

B. The cap controls moral hazard — a benefit equal to or above pay would reward staying on claim. There is no federal ceiling (C), and the elimination period is a separate device (D).

6. **Medium** Distinguish the probationary period from the elimination period.

Show answer

The probationary period runs once, right after the policy is issued (commonly 15–30 days), and bars coverage of new sickness in that window — accidents are covered immediately. The elimination period runs at every claim, delaying benefits after a covered disability begins.

7. **Medium** Ana's employer pays the full premium for her group long-term disability coverage and deducts it as a business expense. Ana becomes disabled and collects $2,800 a month. How is the benefit taxed, and how would the answer change if Ana had paid the premium herself with after-tax dollars?

Show answer

Employer-paid premiums make the benefits taxable income to Ana. Had she paid with her own after-tax dollars, the benefits would be income-tax-free — the exam's standard taxation pairing.

8. Hard Blake, insured with a 60-day elimination period and a $3,500 monthly benefit paid in arrears, is disabled on September 1 and recovers November 30. What does the policy pay in total, and when?

Show answer

The elimination period consumes September and October; benefits accrue only for November — one month, $3,500, paid at the end of the benefit month (about December 1). Three months disabled, one month paid: the waiting period does exactly what it is priced to do.

9. Hard Two months after recovering from a nine-month disability, Blake's same condition returns and disables him again. His policy has a recurrent disability provision (six months). Must he satisfy a new elimination period, and why does the answer matter to the benefit period?

Show answer

No — a relapse within the stated time (commonly six months) is treated as a continuation of the original claim, so no new elimination period applies. But for the same reason it draws on the original claim's remaining benefit period rather than starting a fresh one.

10. Hard A group non-occupational disability plan and workers' compensation both exist at Marco's factory. Marco is disabled in a weekend car accident; his coworker Luis is disabled by a machine at work. Which coverage responds to each man, and why do group plans exclude work injuries?

Show answer

Marco's off-the-job disability is covered by the group non-occupational plan; Luis's on-the-job injury belongs to workers' compensation. Group plans exclude occupational disabilities precisely because workers' compensation already covers them — paying twice would push group premiums up and reward injury claims.

11. **Challenge** Design the trade-off: an insured can afford either a 30-day elimination period with a two-year benefit period, or a 90-day elimination period with a to-age-65 benefit period, at the same premium (in this example). Which risk is worse to leave uncovered, and what non-insurance asset makes the better policy workable?

    Show answer

    The catastrophic risk — a disability lasting decades — is the uninsurable-by-savings one, so the 90-day/to-age-65 design protects against ruin while the 30-day/two-year design protects only convenience. An emergency fund of three to six months' expenses bridges the longer wait, letting the family buy the deep protection.

12. **Challenge** From the story: Batterson's two-cent premium insured a four-block walk. Using the ideas of this lesson, explain in three sentences why insuring income for years is so much harder to price than insuring one short walk.

    Show answer

    Bolter's walk was a brief, verifiable exposure with a plain trigger — injury or none — so the premium followed simple accident frequencies. A multi-year income claim depends on definitions of disability, on medical judgment, and on the insured's own incentives, which change with the benefit's size and duration. That is why disability policies are built of caps, waiting periods, duty tests and residual formulas rather than a single two-cent price.

COMMON MISTAKES

- Reversing the premium rule: a LONGER elimination period means a LOWER premium — it is a deductible, not a benefit.
- Paying benefits during the elimination period in a calculation — nothing accrues until the waiting period is fully satisfied, and the first check arrives about a month later still, in arrears.
- Letting work defeat an own-occupation claim: under own-occupation, the insured can earn in another occupation and still collect.
- Confusing partial (flat percentage, commonly 50%) with residual (proportional to income actually lost).
- Swapping the taxation rule: employer-paid premiums → taxable benefits; self-paid after-tax premiums → tax-free benefits.

- Confusing the probationary period (one-time, after issue, sickness only) with the elimination period (every claim, all causes).

Make it a game · When Does the Check Come?. Write eight claim slips, each with a disability date, an elimination period and a monthly benefit (e.g., 'disabled May 1, 90 days, $2,000'). A parent draws a slip and reads it aloud; you have 30 seconds to announce three things: the date benefits begin to accrue, the approximate date of the first check (one month later — arrears!), and the first check's amount. One point each, and a bonus point for naming what the family lives on in the gap. Miss the arrears rule and the point goes to the house. Then trade roles, and let the parent face a slip with a recurrent relapse — does a new waiting period apply? Best of eight slips wins.

Scripture. “But if any provide not for his own, and specially for those of his own house, he hath denied the faith, and is worse than an infidel.” (1 Timothy 5:8, KJV)

Paul's standard for a household head is provision — not wealth, but faithful foresight for one's own. A working family's largest earthly asset is usually the earner's capacity to work, and guarding the household against its loss, by savings and by sound coverage, is one plain modern form of the duty Paul names.

5.3 Medicare, Medicaid and Long-Term Care

OBJECTIVES

- Name what Medicare Parts A, B, C and D each cover and who is eligible for Medicare.
- Describe Medicare's enrollment periods and the mechanics of Medigap (Medicare supplement) standardized plans.
- Explain how Medicaid differs from Medicare as a needs-based, state-and-federal program.
- Define the six activities of daily living and the common long-term care benefit triggers (2 of 6 ADLs or cognitive impairment).
- State the levels of long-term care — skilled, intermediate, custodial — and the exam's central fact: Medicare does not pay for custodial care.

> **Warm-up.** In five minutes, write what you think happens to a 70-year-old's medical bills: who pays the hospital, who pays the doctor, who pays the drugstore, and who pays if she someday needs help bathing and dressing every day for years. Mark each guess with a question mark if you are unsure — by the end of this lesson every question mark will have a name.

WATCH

Medicare Part A B C D Explained (and made simple!)

Medicare Specialist - Abt Insurance Agency · 10:05

https://www.youtube.com/watch?v=sshK1P7qkoc

> **WHEN TO WATCH**
> Watch after the big idea and build a four-row chart as he talks — A, B, C, D — with 'covers' and 'paid how' columns; treat any dollar figures as that year's examples.

BACKUP VIDEO

Long Term Care On The Insurance Exam

Insurance Exam Queen · 7:14

https://www.youtube.com/watch?v=8Rxl2DOCsS4

Watch before the trigger-card step of the project; recite the six ADLs with her, then write them from memory.

KEY TERMS

Medicare

The federal health insurance program for people 65 and over, certain disabled people under 65, and people with end-stage renal disease or ALS.

Medicare Part A

Hospital insurance — inpatient hospital care, skilled nursing facility care after a qualifying hospital stay, hospice and some home health — premium-free for most workers through payroll taxes.

Medicare Part B

Medical insurance — doctors' services, outpatient care, durable medical equipment and preventive services — carrying a monthly premium, an annual deductible and 80/20 cost sharing.

Medicare Part C (Medicare Advantage)

Private plans, commonly HMOs and PPOs, that contract with Medicare to deliver at least all Part A and Part B benefits, often adding extras.

Medicare Part D

Prescription drug coverage sold through private plans, with a late-enrollment penalty for those who delay without other creditable drug coverage.

Medigap (Medicare supplement)

A standardized private policy, identified by letter, that pays the gaps in Original Medicare — deductibles, coinsurance and copays — with a six-month open enrollment at 65 and Part B enrollment.

Medicaid

The needs-based medical assistance program for people with low income and limited assets, funded jointly by the federal government and the states and run by the states.

long-term care (LTC) insurance

Insurance paying for extended care — nursing home, assisted living, home care, adult day care — when the insured cannot perform activities of daily living or is cognitively impaired.

activities of daily living (ADLs)

The six basic self-care tasks used as benefit triggers: bathing, dressing, eating, toileting, transferring and continence.

custodial care

Non-medical help with daily living tasks, given by people without medical training — the most common long-term care, and the kind Medicare does not pay for.

skilled nursing care

Daily care that must be performed by licensed medical professionals under a doctor's orders, such as wound care or injections.

inflation protection

A long-term care policy option increasing the benefit over time, commonly 3–5% per year, so a benefit bought at 55 still means something at 85.

CORE IDEAS

The story. On July 30, 1965, President Lyndon Johnson flew to Independence, Missouri, to sign the new Medicare law in the town library of the man who had first asked Congress for national health coverage for the aged and been refused — former President Harry Truman, then eighty-one years old. Johnson handed Truman the pen and something better: **Medicare card number one.** Bess Truman received card number two. Behind the ceremony stood a cold actuarial fact this course has equipped you to see: the elderly were the one group private medical expense insurance struggled hardest to serve. Their claims were high and rising, their working incomes were gone, and underwriting them one by one priced most of them out entirely. Barely half of Americans over 65 had any hospital insurance. The 1965 law — amendments to the Social Security Act — answered with social insurance: hospital coverage earned through payroll taxes during working years, plus voluntary medical coverage for a modest premium. The same law created **Medicaid** for the poor of every age. Together they redrew the map every health agent works within.

How they figured it out. The designers of 1965 split the program along a line you already know from Lesson 5.1 — hospital bills versus doctors' bills, the old basic-hospital and basic-physicians distinction. **Part A**, hospital insurance, was made premium-free for workers who had paid payroll taxes long enough (40 quarters — about ten years), because it was earned coverage, not charity. **Part B**, medical insurance, was made voluntary with a monthly premium, and deliberately kept the

familiar private-policy machinery: an annual deductible, then roughly 80/20 coinsurance. Private insurers never left the field; they returned as partners. In time Congress let private plans deliver Medicare whole — **Part C**, now called Medicare Advantage (the modern version dates to 2003) — and added private prescription drug plans, **Part D**, effective 2006. Meanwhile insurers built **Medigap** policies to pay Original Medicare's deductibles and coinsurance, and after years of confusing variety, federal and state law standardized them into lettered plans so that a Plan G from one insurer has the same benefits as a Plan G from another — only price and service differ.

The big idea. Learn the four parts as a two-by-two of *what* and *who runs it*. **Part A — hospital:** inpatient hospital care (with a deductible per **benefit period**, not per year), **skilled nursing facility** care up to 100 days after a qualifying inpatient hospital stay of at least three days (fully paid days first — 20 in the classic design — then a daily copay), hospice, and some home health. **Part B — medical:** doctors' services, outpatient care, durable medical equipment, preventive care; monthly premium, annual deductible, then Medicare pays about 80% of approved charges. **Part C — Medicare Advantage:** a private plan, often an HMO or PPO, that must provide at least everything A and B provide, usually with networks, often with drug coverage and extras bundled in. **Part D — drugs:** private stand-alone prescription plans beside Original Medicare. The agent's one-sentence map: A is the hospital, B is the doctor, C is the private package deal, D is the drugstore.

Eligibility and enrollment are pure mechanics, and exams love them. Medicare serves those **65 and over**; younger people after **24 months** of Social Security disability benefits; and people with end-stage renal disease or ALS. The **Initial Enrollment Period** is seven months — the three months before the 65th-birthday month, that month, and the three after. Miss it without qualifying employer coverage and a **General Enrollment Period** (January 1 to March 31) catches you, commonly with late-enrollment premium penalties for Part B and Part D that never go away. Leaving employer coverage opens a **Special Enrollment Period**. For Medigap, the golden window is the **six-month open enrollment** that begins when the buyer is 65 or older and enrolled in Part B: during it, Medigap is guaranteed issue regardless of health. An agent who lets that window close on a sick client has cost him something no apology recovers — note, too, that Medigap pairs with Original Medicare only; it cannot be sold to someone in a Medicare Advantage plan.

Medicaid is the other 1965 program, and the exam tests the contrast relentlessly. Medicare is an *entitlement* keyed to age or disability, federal and uniform, blind to wealth. Medicaid is **needs-based**: eligibility turns on low income and limited assets, the program is funded jointly by Washington and the states, and each state runs its own version within federal rules — so benefits and thresholds differ by state, and you check your state's figures. For this unit, Medicaid's decisive feature is what it uniquely covers: **long-term custodial care**, including nursing homes, for those who qualify financially. Many elderly people reach Medicaid only by first exhausting their own savings on care — spending down — a path that long-term care insurance exists to make unnecessary.

That brings us to **long-term care** itself. Care comes in levels: **skilled** (daily care by licensed professionals under a doctor's orders), **intermediate** (occasional skilled care), and **custodial** (help with everyday living from people without medical training — by far the most common need). LTC policies also cover home health care, adult day care, assisted living, respite care for family caregivers, and hospice. Benefits trigger when the insured cannot perform, commonly, **two of the six activities of daily living** — bathing, dressing, eating, toileting, transferring, continence — *or* suffers a cognitive impairment such as dementia, which triggers benefits regardless of ADLs. The policy's levers echo disability insurance: a daily or monthly benefit amount, an elimination period, a benefit period or pool of money, and — because a policy bought at 55 may pay at 85 — **inflation protection**, commonly 3–5% compounded, which this course flags as the option that decides whether the promise keeps its value.

On the exam today. The single most-tested fact in this lesson: **Medicare does not pay for custodial long-term care.** Part A's skilled nursing benefit is short (up to 100 days), requires a prior three-day inpatient hospital stay, and must be *skilled* care — a question describing years of help with bathing and dressing is pointing at long-term care insurance, personal savings, or Medicaid for those who qualify, never at Medicare. Know the four parts cold, the 24-month disability pathway, the seven-month Initial Enrollment Period, and the six-month Medigap open enrollment with Part B. Expect the ADL list — bathing, dressing, eating, toileting, transferring, continence — and the 2-of-6-or-cognitive-impairment trigger. And keep the programs straight by their first principles: Medicare is age- and work-based, Medicaid is needs-based and state-run, Medigap is private and standardized by letter. Every dollar

figure — deductibles, premiums, copays — changes yearly: quote this year's handbook, not last year's memory.

PICTURE STUDY



Arrangement in Grey and Black No. 1 (Whistler's Mother), James McNeill Whistler, 1871 · Oil on canvas · Musée d'Orsay, Paris

Image: Wikimedia Commons, public domain

James McNeill Whistler titled this painting as a design problem — an arrangement of grey and black — but the world refused to see anything in it except what it is: a man's portrait of his aged mother, Anna, painted when she was sixty-seven and living in his London rooms. The picture became an icon of honor toward the old; the United States even set it on a postage stamp dedicated to mothers. It opens this lesson because the whole lesson is about what a society and a family owe the person in this chair — the hospital bill, the doctor's bill, and, hardest of all, the long years of daily care that no hospital ever cures.

Look closely

- Study her posture: upright, composed, hands folded. The painting shows age with dignity, not decline. How does that change how you think about planning for it?
- Find the austerity of the room — bare wall, plain footstool. What does the setting say about what mattered to the painter about her?
- Notice she is painted in profile, not facing us. She does not perform for the viewer. Who in this lesson's story — Truman at 81 receiving card number one — was similarly past needing to perform?

- Look at her hands. Imagine the six activities of daily living, one by one, becoming difficult for them. Which kind of care — skilled or custodial — does that picture of aging actually require?

Talk about it

1. Whistler painted his mother in his own home, where she lived with him. What forms of long-term care in this lesson are really just that arrangement with help added — and what do they cost a family in money and in strength?
2. Medicare answers the hospital and the doctor; it does not answer the years in the chair. Why is the most common need — custodial care — the one the famous program does not cover, and who is left to plan for it?
3. Scripture commands rising before the hoary head. How are an honest agent's work in this lesson — Medigap windows kept, LTC triggers explained truthfully — a form of honoring the old rather than merely selling to them?

PROJECT

The Medicare Map and the LTC Trigger Card

You will build two artifacts for the Pathway File. The first is a one-page Medicare map — the four parts, Medigap and Medicaid, laid out so clearly that a grandparent could use it. The second is a pocket-sized trigger card for long-term care: the six ADLs and the 2-of-6-or-cognitive rule, the single most-tested list in this unit.

You will need

- One sheet of unlined paper and one index card
- Two ink colors and a ruler
- The Medicare & You handbook page from the kit (for this year's real figures)

Steps

1. Divide the sheet into four labeled quadrants: PART A — HOSPITAL, PART B — MEDICAL, PART C — ADVANTAGE, PART D — DRUGS. In each, write what it covers in one line, how it is paid (payroll-tax-earned, premium, private plan), and one exam fact (A: benefit-period deductible and the 3-day/100-day skilled nursing rule; B: deductible then 80/20; C: must cover at least A + B; D: late penalty).
2. Across the bottom, add a MEDIGAP strip: standardized lettered plans, pairs with Original Medicare only, six-month open enrollment at 65 with Part B.
3. Add a MEDICAID box in a second color: needs-based, state-run with federal funds, the payer of custodial long-term care for those who qualify.
4. Look up two real current figures in Medicare & You (for example, this year's Part B deductible and Part A hospital deductible), write them in pencil with the year, and note 'changes yearly.'
5. On the index card, write the six ADLs — bathing, dressing, eating, toileting, transferring, continence — and the trigger: benefits commonly begin at 2 of 6, or cognitive impairment regardless of ADLs.
6. On the card's back, write the levels of care ladder (skilled, intermediate, custodial) and, in capitals, MEDICARE DOES NOT PAY FOR CUSTODIAL

CARE.

7. Date both, quiz yourself once from the blank side of each, and clip them into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the twelve key terms, plus one card listing the six ADLs with a tiny sketch for each (tub, shirt, fork, door, chair, clock).
2. Draw the Medicare house: foundation labeled PART A (hospital), walls PART B (doctor), a private wing labeled PART C containing A+B, a corner pharmacy PART D, and a Medigap umbrella over A and B only.
3. Write a five-line trap list titled 'Who pays for the nursing home?', ending with: Medicare — only short SKILLED care after a 3-day stay; custodial care = LTC insurance, savings, or Medicaid if poor enough.

KEY FORMULAS

$\text{Part B patient share} \approx \text{annual deductible} + 0.20 \times \text{approved charges above it}$ (figures change yearly — check the current handbook)

$\text{LTC policy pool} = \text{daily benefit} \times \text{benefit period in days}$

$\text{inflated daily benefit} = \text{benefit} \times (1 + r)^{n}$ for n years of compound inflation protection at rate r

From history. Standardized Medigap letters exist because of a scandal the exam quietly remembers: through the 1970s and 80s, agents sold confused seniors stacks of overlapping 'gap' policies — some elderly buyers held a dozen or more, paying premiums for coverage that could never pay twice. Federal law in 1990 required standardization into lettered plans and made it illegal to sell a duplicate Medigap policy, turning a bewildering market into one where plans compete only on price and service. It is a Unit 9 ethics lesson wearing a Unit 5 label.

Example 1. Eleanor, 68, on Original Medicare, has $2,260 of Part B approved charges this year. In this example the Part B annual deductible is $260. What do Medicare and Eleanor each pay (ignoring any Medigap)?

Show solution

1. Deductible first: Eleanor pays the first $260. Remaining approved charges: $2,000.
2. Part B coinsurance: Medicare pays about 80% — $0.80 \times \$2{,}000 = \$1{,}600$.
3. Eleanor's 20%: $400, plus the deductible = $660 in all.
4. A Medigap plan, if she owned one, would pay some or all of that $660 — that is exactly the gap it supplements.

Answer: Medicare about $1,600; Eleanor $660 (deductible plus 20%). The arithmetic is Lesson 5.1's channel wearing a federal uniform — and the dollar figures are this example's, not this year's.

Example 2. Exam style. After a fall, Harold spends four days as an inpatient in the hospital, then needs daily physical therapy and wound care in a skilled nursing facility. Later, his family asks whether Medicare will pay for years of help with bathing and dressing at home. Which statement is correct?

A. Medicare pays both: skilled facility care and long-term custodial care

B. Medicare can cover the skilled facility stay (up to 100 days after his qualifying 3-day stay), but not long-term custodial care

C. Medicare pays neither

D. Medicare pays custodial care once Harold's savings are exhausted

Show solution

1. Sort the care by kind: daily therapy and wound care by licensed professionals is skilled care; years of help bathing and dressing is custodial care.
2. Part A covers skilled nursing facility care after a qualifying inpatient stay of at least three days — Harold's four days qualify — for up to 100 days with cost sharing after the fully covered days.
3. Custodial care is not a Medicare benefit at any point, so A and D are wrong (D describes the Medicaid spend-down path, not Medicare).
4. C fails because the skilled stay is covered.

Answer: B. Skilled care after a qualifying stay — yes, briefly; custodial care — never. This is the most reliable trap on the health exam.

Example 3. A long-term care policy bought at age 55 pays $200 a day with 3% compound inflation protection. About what daily benefit will it pay at age 85, and why does the answer sell the option better than any brochure?

Show solution

1. Years of growth: $n = 30$.
2. Inflated benefit: $\$200 \times (1.03)^{30}$.
3. $(1.03)^{30} \approx 2.43$, so the benefit is about $485 a day.
4. Care costs also rise over thirty years; without the option, the policy would still pay $200 against the much higher costs of 2056 — a promise shrunk to a gesture.

Answer: About $485 per day. Inflation protection is what keeps a thirty-year-old promise the same size as the need.

PRACTICE

1. Easy Match each Medicare part to what it covers: A, B, C, D.

   Show answer

   A — hospital (inpatient, skilled nursing after a qualifying stay, hospice, some home health); B — doctors and outpatient care; C — Medicare Advantage, private plans delivering at least A and B; D — prescription drugs through private plans.

2. Easy List the six activities of daily living.

   Show answer

   Bathing, dressing, eating, toileting, transferring and continence — with benefits commonly triggered by the inability to perform 2 of the 6, or by cognitive impairment.

3. Easy Who is eligible for Medicare?

   Show answer

   People 65 and over; people under 65 after 24 months of Social Security disability benefits; and people with end-stage renal disease or ALS.

4. **Medium** Which statement about Medicaid is correct?

   A. It is a federal entitlement for everyone over 65

   B. It is needs-based, funded jointly by the federal government and the states, and run by the states

   C. It never covers nursing home care

   D. Its eligibility rules are identical in all fifty states

   Show answer

   B. Medicaid turns on low income and assets and is administered by each state (so D is wrong); it is the major public payer of custodial nursing home care for those who qualify (so C is wrong); A describes Medicare.

5. **Medium** Mrs. Alvarez turns 65 in June and enrolls in Part B that month. Until when does her Medigap open enrollment run, and what does the window guarantee?

   Show answer

   Six months from her Part B enrollment — through about the end of November. During it she may buy any Medigap plan sold in her state, guaranteed issue, regardless of her health; after it closes, insurers may underwrite her.

6. **Medium** A client in a Medicare Advantage plan asks an agent to add a Medigap policy 'to cover the copays.' What must the agent explain?

   Show answer

   Medigap supplements Original Medicare only — it cannot be sold to pair with a Medicare Advantage plan. The client's choices are Advantage with its own cost-sharing rules, or a return to Original Medicare (when enrollment rules allow) with a Medigap policy.

7. Medium Which of the following does Medicare Part A skilled nursing coverage require?

   A. A prior inpatient hospital stay of at least three days, and daily skilled care
   B. Only a doctor's note
   C. That the patient first exhaust Part B
   D. That care be custodial

   Show answer

   A. The classic gatekeeping facts: a qualifying 3-day inpatient stay, skilled (not custodial) daily care, and a maximum of 100 days per benefit period with cost sharing after the fully covered days. D is the opposite of the rule.

8. Hard An LTC policy pays $180 per day for a three-year benefit period with a 90-day elimination period. The insured enters custodial care costing $210 per day. Compute the policy's total pool and the family's daily and 90-day gaps.

   Show answer

   Pool: $\$180 \times 1{,}095 \approx \$197{,}000$. The family pays all of the first 90 days — about $\$18{,}900$ — and $\$30$ a day thereafter. The elimination period and the daily-benefit shortfall are both family money; an agent quotes them out loud.

9. Hard A 79-year-old with worsening dementia can still, on good days, perform all six ADLs. Her LTC policy triggers at 2 of 6 ADLs or severe cognitive impairment. Does she qualify for benefits, and why does the policy include the second trigger?

   Show answer

   Yes — cognitive impairment is an independent trigger precisely because dementia can make a person unsafe alone while the body still manages the ADLs. A policy with only an ADL trigger would fail the most feared cause of long-term care.

10. Hard Explain 'spend-down' in one or two sentences, and name the two honest ways this lesson offers a family to avoid it.

Show answer

Spend-down is exhausting one's own savings on care until assets are low enough to qualify for Medicaid, which then pays for custodial care. The alternatives are long-term care insurance bought while insurable, or savings deliberately built to carry the care — commonly some of both.

11. Challenge A 60-year-old can buy a $150/day LTC policy with no inflation protection, or a $150/day policy with 3% compound protection at a meaningfully higher premium (in this example). If care is needed at 85, compare the daily benefits, and state the question that decides whether the cheaper policy is a bargain or an illusion.

Show answer

With protection: $\$150 \times (1.03)^{25} \approx \$314$ a day at 85; without it, still $150 against twenty-five years of risen care costs. The deciding question: is the policy meant to pay for care at tomorrow's prices, or only to gesture at today's? A benefit that cannot keep pace is a smaller promise than its page suggests.

12. Challenge Write a three-sentence explanation, suitable for a worried grandchild, of why Medicare, Medicaid, Medigap and LTC insurance all exist at once instead of one program doing everything.

Show answer

Medicare is earned, age-based coverage for hospitals and doctors, but it was never built to pay for years of daily custodial help. Medigap merely fills Medicare's own deductibles and coinsurance, while Medicaid is the needs-based safety net that pays custodial care only after a family's means are largely gone. Long-term care insurance is the private tool that fills the space between them — chosen and paid for in advance, so that the years in the chair are planned for rather than merely survived.

COMMON MISTAKES

- Saying Medicare pays for long-term custodial care — it never does; its skilled nursing benefit is short, skilled-only and requires a qualifying 3-day inpatient stay.

- Confusing Medicare (age- and work-based, federal) with Medicaid (needs-based, state-run with federal funds).
- Selling or describing Medigap alongside Medicare Advantage — Medigap pairs with Original Medicare only.
- Forgetting Part A's deductible runs per benefit period while Part B's runs per year.
- Missing the cognitive-impairment trigger: severe dementia qualifies for LTC benefits even when all six ADLs can still be performed.
- Quoting last year's Medicare deductibles and premiums as facts — every figure changes annually; cite the current handbook and label course numbers as examples.

Make it a game · A, B, C, D — or Nobody. Write twelve care slips: a hospital stay, a flu shot, a prescription refill, a wheelchair, hospice, three years of help with bathing, twenty days of skilled rehab after a four-day hospital stay, a doctor's office visit, an annual wellness check, dementia supervision at home, an ambulance, and a private room upgrade. A parent draws and reads each slip; you have ten seconds to call the payer: PART A, PART B, PART D, ADVANTAGE-COULD-BUNDLE-IT, or NOBODY-IN-MEDICARE (then name who: LTC insurance, savings or Medicaid). One point per correct call; the custodial-care slips are worth two. Swap roles for round two. Best of twelve wins.

Scripture. “Thou shalt rise up before the hoary head, and honour the face of the old man, and fear thy God: I am the LORD.” (Leviticus 19:32, KJV)

God ties honor for the aged directly to fear of Himself — how a people treats its old is a measure of its reverence. For an agent, this lesson's rules are where that honor becomes practical: windows not missed, triggers explained truthfully, and no policy sold to an elderly client that serves the seller more than the served.

5.4 The Uniform Provisions: How a Health Policy Behaves

OBJECTIVES

- Explain why states adopted a uniform model law for individual health policy provisions.
- Name the twelve mandatory uniform provisions and state the time limits built into each.
- Walk a claim through the mandatory clocks: notice of claim, claim forms, proof of loss, time of payment and legal actions.
- Describe the common optional provisions — change of occupation, misstatement of age, other insurance, illegal occupation — and whom each protects.
- Climb the renewability ladder from cancellable to noncancellable and state the insured's rights at each rung.

> **Warm-up.** In five minutes, imagine fifty different companies each writing health policies with their own fine print — different grace periods, different claim deadlines, different everything. Write two sentences: one on what could go wrong for a family moving from one policy to another, and one proposing your own fix. The states' actual fix is this lesson.

WATCH

12 Mandatory Health Policy Provisions Explained - Insurance Exam Prep

Insurance Exam Prep by JustInsurance · 4:21

https://www.youtube.com/watch?v=qzzWbqYp3fg

> **WHEN TO WATCH**
> Watch after the big idea with your notebook open; write each provision as a one-line entry with its number of days, and star the four deadlines of the claims clock.

BACKUP VIDEO

NAIC Model Uniform Health Insurance Policy Provisions Explained | Insurance License Exam Tips

The Insurance License Academy · 9:02

https://www.youtube.com/watch?v=sWWc-NUXt74

A second voice on the same twelve provisions; watch it the day after the first video and check your wall chart against every number he names.

KEY TERMS

Uniform Individual Accident and Sickness Policy Provisions Law

The NAIC model law, adopted in substance by the states, prescribing twelve mandatory provisions and several optional provisions for individual health policies.

entire contract provision

The policy plus the attached application is the whole agreement; nothing may be incorporated by reference, and only an executive officer — never the agent — may change it.

time limit on certain defenses

After the policy has been in force two years (commonly), the insurer may not void it or deny a claim for misstatements in the application, except fraudulent misstatements — health insurance's incontestability clause.

grace period

Time after the premium due date during which coverage continues: commonly 7 days for weekly-premium policies, 10 days for monthly, and 31 days for all others.

reinstatement

Restoring a lapsed policy; if the insurer requires an application and issues no notice, reinstatement is automatic after 45 days — accidents are covered at once, sickness only after 10 days.

notice of claim

The insured must notify the insurer within 20 days of a loss, or as soon as reasonably possible.

claim forms

The insurer must send claim forms within 15 days of notice; if it fails, the insured may submit proof of loss in any written form.

proof of loss

The insured must furnish written proof of loss within 90 days, or as soon as reasonably possible — never later than one year, absent legal incapacity.

legal actions provision

The insured may not sue on the policy sooner than 60 days after proof of loss, nor later than 3 years (commonly) after proof was due.

change of occupation provision

An optional provision adjusting benefits or premiums when the insured changes to a more or less hazardous occupation — benefits reduce for a riskier job, premiums refund in part for a safer one.

misstatement of age provision

An optional provision adjusting benefits to what the premium would have purchased at the insured's true age.

renewability

The policy's rules about whether and on what terms the insurer must continue coverage — the ladder from cancellable up to noncancellable.

The story. In the first years of the twentieth century, American accident and sickness policies were a jungle of private fine print. Each company wrote its own deadlines, its own exclusions, its own traps — a worker might carry three policies with three different claim rules and satisfy none of them on the day he was hurt. New York struck first: after its sweeping 1905–1906 investigations of the insurance business, the state enacted a **standard provisions law** for accident and health policies in 1912, dictating clauses every policy must carry. Other states copied it, each a little differently — which traded one jungle for fifty orderly but incompatible gardens. After the Second World War, with health insurance booming, the **National Association of Insurance Commissioners** — the organization of all the state regulators, which you met in Unit 1 — drafted a single model: the **Uniform Individual Accident and Sickness Policy Provisions Law** of 1950. State by state, legislatures enacted it, and ever since, every individual health policy in America has behaved the same way at its joints: the same grace periods, the same claim clocks, the same reinstatement rules. The jungle became a building code.

How they figured it out. The model law's design is worth noticing, because the exam tests its logic as much as its lists. Twelve provisions are **mandatory** — every individual health policy must contain them in substance, and an insurer may reword them only in ways *at least as favorable to the insured*. These twelve are shields for the policyholder: they guarantee his grace period, his claim rights, his protection from stale defenses. The **optional provisions** — eleven in the model — protect the *insurer*: a company may include them or not, and most address honesty and risk changes, like misstated age or a new, more dangerous job. Here is the pattern to carry into the exam room: **mandatory protects the insured; optional protects the insurer.** A question asking which list a provision belongs to is really asking whom the provision shields.

The big idea. Learn the twelve mandatory provisions as a story the policy tells in order. (1) **Entire contract**: the policy and attached application are everything; no agent can change them. (2) **Time limit on certain defenses**: after commonly two years, no misstatement in the application — except a fraudulent one — can void the policy or defeat a claim. (3) **Grace period**: 7 days for weekly-premium policies, 10 for monthly, 31 for all others. (4) **Reinstatement**: a lapsed policy revives when the insurer accepts premium; if an application is required and the insurer stays silent

for **45 days**, reinstatement is automatic — and the revived policy covers accidents immediately but new sickness only after **10 days.** (5) **Notice of claim:** 20 days. (6) **Claim forms:** the insurer sends them within 15 days or the insured may prove his loss in any written form. (7) **Proof of loss:** 90 days. (8) **Time of payment of claims:** immediately upon proof — with ongoing disability income paid at least monthly. (9) **Payment of claims:** to the insured, or to the beneficiary if the insured has died. (10) **Physical examination and autopsy:** the insurer may examine the insured at its own expense, and require an autopsy where the law allows. (11) **Legal actions:** no suit sooner than 60 days after proof of loss nor later than commonly 3 years. (12) **Change of beneficiary:** the insured may change the beneficiary unless a designation is irrevocable.

Four of those provisions form the **claims clock**, and the exam adores its arithmetic. A loss happens. Within **20 days** the insured gives notice. Within **15 days** the insurer must send claim forms. Within **90 days** the insured furnishes proof of loss. The insurer then pays immediately — disability income at least monthly — and if a dispute hardens, the insured must wait **60 days** after proof before suing, and must sue within **3 years.** Memorize the chain as 20–15–90–60–3 and say what each number belongs to. Notice the mercies built in: every insured deadline carries 'or as soon as reasonably possible,' because a man in a coma cannot mail a form, and the claim-forms rule means an insurer cannot win by losing the paperwork.

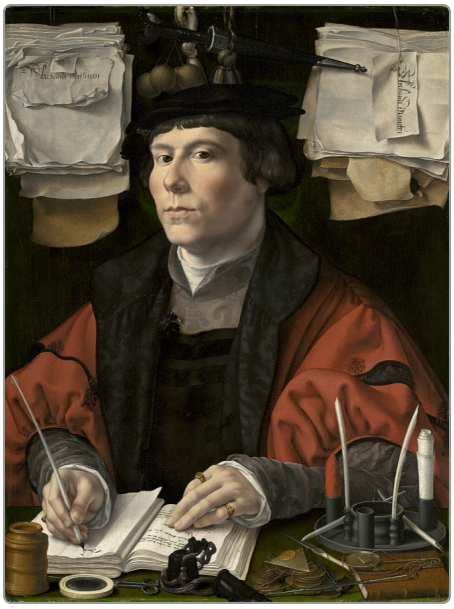
The **optional provisions** are the insurer's honest self-defense, and three carry formulas. Under **change of occupation**, an insured who took up a more hazardous job has his benefits reduced to what his premium would have bought at the riskier class — while one who moved to a safer job gets a premium refund for the difference. Under **misstatement of age**, benefits are adjusted to what the premium would have purchased at the true age — the policy is not voided, the arithmetic is simply corrected (this mirrors the life insurance provision from Unit 4). **Other insurance** provisions prorate benefits when the insured has stacked duplicate coverage, so no one profits by insuring the same hospital bill five times — indemnity again. **Illegal occupation** and **intoxicants and narcotics** provisions deny liability for losses sustained while committing a felony or, where the provision applies, losses resulting from the insured's intoxication or non-prescribed narcotics. **Unpaid premium** lets the insurer deduct any premium due from a claim payment, and **conformity with**

state statutes automatically amends any clause that conflicts with the law of the insured's state.

Last, the **renewability ladder** — five rungs, each giving the insured more security and costing more premium. (1) **Cancellable**: the insurer may cancel mid-term with notice and a refund of unearned premium — the weakest promise, banned for many policy types in many states. (2) **Optionally renewable**: the insurer may refuse renewal, or add restrictions, at each renewal or anniversary date for any reason. (3) **Conditionally renewable**: the insurer may refuse renewal only for reasons named in the policy — reaching a stated age, leaving an occupation — never for deteriorating health alone. (4) **Guaranteed renewable**: the insurer must renew to a stated age as long as premiums are paid, and may raise premiums only for an entire *class* of insureds, never for one person's bad health. (5) **Noncancellable** (often 'noncan'): the insurer must renew *and* may never raise the premium above the rate stated in the policy — the gold rung, common in quality disability income policies. The pair the exam loves: both of the top rungs guarantee renewal; only noncancellable also freezes the premium.

On the exam today. This is the most list-dense lesson of the unit, and the questions are mercifully literal. Know the claims clock — 20 notice, 15 forms, 90 proof, 60-days-to-3-years legal actions — and the grace periods 7/10/31 by premium mode. Know reinstatement's two numbers: 45 days of insurer silence makes it automatic, and revived coverage waits 10 days for sickness but zero for accidents. Expect 'which provision is MANDATORY/OPTIONAL' — answer by asking whom it protects. Expect the misstatement-of-age adjustment (benefits recomputed, not policy voided) and the change-of-occupation direction (riskier job → lower benefits; safer job → premium refund). On the ladder, the classic trap offers 'guaranteed renewable' as freezing premiums — it does not; premiums may rise by class, and only noncancellable locks the rate. And remember the two-year time limit on certain defenses never bars a defense of *fraudulent* misstatement in most states' individual policies.

PICTURE STUDY



Portrait of a Merchant, Jan Gossaert, circa 1530 · Oil on panel · National Gallery of Art, Washington, D.C.

Image: Wikimedia Commons, public domain

Jan Gossaert painted this Netherlandish merchant at the exact center of his paper empire: pen lifted over the ledger, letters spiked on the wall behind him in two labeled bundles — his drafts on one spike, miscellaneous letters on the other — twine, scissors, sand and sealing wax all within reach. In 1530 a merchant's rights lived or died in such papers, and only the man who kept them could say what he was owed. The picture opens this lesson because the uniform provisions ended exactly this advantage in health insurance: when every company kept its own fine print on its own spikes, the policyholder could never be sure what his contract said. The model law made the clauses, the clocks and the deadlines the same in every policy — paperwork the little man no longer has to out-file anyone to win.

Look closely

- Count the paper tools — spiked letters, twine, scissors, inkpot, sand shaker. What does this one desk say about how much of commerce is really record-keeping?
- Find the two labeled bundles of letters on the wall. The merchant files his own contract trail. Before uniform provisions, who in an insurance claim held this filing advantage?

- Study his eyes and the pause of the pen. Gossaert catches him mid-entry, weighing something. What might an honest entry cost him — and a dishonest one?
- Notice the coins among the papers. In this portrait, which looks more powerful: the money or the ledger that tracks it?

Talk about it

1. The twelve mandatory provisions are, in effect, fine print the state writes on the policyholder's side. Which two provisions from this lesson most protect the person who does NOT keep the files, and why?
2. The claims clock binds the insurer too — 15 days to send forms, immediate payment on proof. Why is a deadline on the powerful, well-filed party as important as a deadline on the weak one?
3. Christ said to let your yea be yea and your nay, nay. How is a standardized, plainly worded policy a form of truthful speech — and what does needless complexity in a contract say about its author?

PROJECT

The Provisions Wall Chart and the Renewability Ladder

You will build the single most quizzable page in your Pathway File: a wall chart of the twelve mandatory provisions with every number in a circle, the optional provisions in a sidebar, and the five-rung renewability ladder drawn as an actual ladder. Candidates who can reproduce this page from memory have banked eight to twelve exam questions before they sit down.

You will need

- One large sheet of paper (or two taped), ruler, pencil and two ink colors
- Your exam notebook
- This lesson's core ideas for checking

Steps

1. List the twelve mandatory provisions down the left in order, one line each, and circle every number as you write it: 2 years, 7/10/31 days, 45 days, 10 days, 20 days, 15 days, 90 days, 60 days–3 years.
2. Draw the claims clock as a horizontal chain across the top: LOSS → 20 (notice) → 15 (forms) → 90 (proof) → pay immediately / monthly → 60 days–3 years (suit). Say it aloud three times: twenty, fifteen, ninety, sixty, three.
3. In a second color, add the optional provisions sidebar: change of occupation (riskier → benefits down; safer → premium back), misstatement of age (benefits adjusted), other insurance (prorate), illegal occupation, intoxicants and narcotics, unpaid premium, conformity with state statutes.
4. Head the two columns MANDATORY — SHIELDS THE INSURED and OPTIONAL — SHIELDS THE INSURER.
5. Draw the renewability ladder up the right edge, bottom to top: cancellable, optionally renewable, conditionally renewable, guaranteed renewable, noncancellable. Beside the top two rungs write the premium rule: guaranteed renewable — premiums may rise BY CLASS; noncancellable — premiums frozen.
6. Cover the chart and reproduce the claims clock and the ladder from memory on scratch paper; mark any slip in red on the chart.

7. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for all twelve mandatory provisions with the provision on the front and its time limit alone on the back — drill until the numbers come without the names' help.
2. Draw the claims clock as a row of five clock faces labeled 20, 15, 90, 60, 3yr, each with one word under it: notice, forms, proof, wait, sue.
3. Write a five-line trap list titled 'The ladder,' ending with: GUARANTEED RENEWABLE raises premiums by class — only NONCANCELLABLE freezes them.

KEY FORMULAS

$$\text{adjusted benefit (misstated age)} = \text{benefit} \times \frac{\text{premium paid}}{\text{premium required at true age}}$$

$$\text{adjusted benefit (riskier occupation)} = \text{benefit} \times \frac{\text{premium paid}}{\text{premium required for new class}}$$

From history. The uniform provisions have a living guardian: the NAIC, founded in 1871, is the oldest association of state officials in the country, and its model-law machinery — draft, debate, adopt, then persuade fifty legislatures — remains how American insurance law stays roughly in step without a federal insurance code. The 1950 accident and sickness model replaced a patchier 1912-era generation of standard-provision laws; some state codes still number its twelve provisions in the original order, which is why exam outlines list them the same way from Maine to Arizona.

Example 1. Olivia's disability policy pays $2,400 a month. She bought it as a bookkeeper, then became a roofer — a class whose rate, in this example, is 1.5 times the bookkeeper rate — and never told the insurer. She is disabled in a roofing fall. Under the change of occupation provision, what does the policy pay?

Show solution

1. The provision adjusts benefits to what her actual premium would have bought in the riskier class.
2. Her premium buys $\frac{1}{1.5}$ of the benefit at roofer rates.
3. Adjusted benefit: $\$2{,}400 \times \frac{1}{1.5} = \$1{,}600$ per month.
4. Had she moved the other way — roofer to bookkeeper — the insurer would owe a refund of the premium difference instead, and benefits would stand.

Answer: $1,600 a month. Riskier occupation → benefits scaled down to what the premium honestly bought; safer occupation → premium refund.

Example 2. Exam style. Sam's individual health policy lapsed. He applied for reinstatement on March 1 and paid the premium; the insurer neither approved nor rejected the application. On April 20 he falls ill with pneumonia; on April 22 he breaks his wrist. What is covered?

A. Neither loss — the policy was never reinstated

B. Both losses in full

C. The wrist, and the pneumonia too, because both occurred more than 10 days after reinstatement

D. The wrist only, because sickness is covered just 10 days after reinstatement

Show solution

1. Reinstatement became automatic 45 days after the application — about April 15 — because the insurer stayed silent.
2. A reinstated policy covers accidents immediately from reinstatement; new sickness is covered only after 10 days.
3. The pneumonia begins April 20, only about 5 days after automatic reinstatement — inside the 10-day sickness wait, so not covered.
4. The wrist fracture on April 22 is an accident — covered regardless of the 10-day wait.

Answer: D. Accidents are covered at once upon reinstatement; sickness waits 10 days, and Sam's pneumonia fell inside the wait.

Example 3. Walk the claims clock: Maria is injured June 1 and gives notice June 12. The insurer never sends claim forms. She mails a written statement of her loss on August 15, and the insurer denies the claim September 1. What were each party's deadlines, and in what window may Maria sue?

Show solution

1. Notice of claim: due within 20 days of loss — June 12 satisfies it.
2. Claim forms: the insurer owed forms within 15 days of notice (by about June 27); having failed, it must accept proof in any written form — Maria's letter counts.
3. Proof of loss: due within 90 days of the loss (about August 30) — August 15 satisfies it.
4. Legal actions: Maria may not sue sooner than 60 days after proof (about mid-October) nor later than commonly 3 years after proof was due.

Answer: All of Maria's deadlines were met; the insurer's claim-forms failure waived the forms requirement. Her suit window runs from about 60 days after her proof to about 3 years after proof was due — the 20–15–90–60–3 chain in action.

PRACTICE

1. Easy Recite the claims clock: the four deadlines that run from a loss to a lawsuit.

   Show answer

   Notice of claim within 20 days; insurer sends claim forms within 15 days; proof of loss within 90 days; no suit sooner than 60 days after proof nor later than (commonly) 3 years.

2. Easy State the grace periods by premium mode under the uniform provisions.

   Show answer

   7 days for weekly-premium policies, 10 days for monthly-premium policies, and 31 days for all other modes.

3. Easy Who may change an insurance policy's terms under the entire contract provision?

Show answer

Only an executive officer of the insurer, in writing — never the agent. The policy plus the attached application is the whole agreement.

4. Medium Three years into his policy, an insurer discovers Ted innocently misstated his medical history on the application. It denies his current claim and moves to void the policy. What does the time limit on certain defenses say?

Show answer

After commonly two years in force, innocent misstatements can no longer void the policy or defeat a claim; only fraudulent misstatements remain a defense in most states. Ted's claim stands.

5. Medium Which provision is OPTIONAL rather than mandatory?

A. Grace period

B. Change of occupation

C. Proof of loss

D. Reinstatement

Show answer

B. Change of occupation protects the insurer, and the optional list is the insurer's shield; grace period, proof of loss and reinstatement are all among the twelve mandatory provisions protecting the insured.

6. Medium A policyholder who misstated her age paid premiums that, at her true age, would have purchased only $800 of her stated $1,000 monthly benefit. What happens at claim time?

Show answer

The misstatement of age provision adjusts the benefit to $800 — what the premium would have bought at the true age. The policy is not voided; the arithmetic is corrected.

7. Medium An insurer receives proof of loss on a disability income claim that will continue for months. How must it pay?

   A. In one lump sum at the disability's end

   B. Immediately for accrued benefits, and at least monthly thereafter

   C. Annually

   D. At whatever interval it chooses

   Show answer

   B. The time of payment of claims provision requires immediate payment of what has accrued and ongoing periodic payment — at least monthly — for continuing disability income.

8. Hard Rank these policies from least to most secure for the insured, and state each one's premium rule: guaranteed renewable, cancellable, noncancellable, conditionally renewable, optionally renewable.

   Show answer

   Cancellable (insurer may cancel mid-term with notice and unearned-premium refund) → optionally renewable (insurer may decline renewal for any reason at renewal dates) → conditionally renewable (nonrenewal only for stated conditions, never health alone) → guaranteed renewable (must renew; premiums may rise by class) → noncancellable (must renew and premiums frozen at the stated rate).

9. Hard Why would an insurer ever agree to write a noncancellable policy, and why do buyers of quality disability income coverage insist on it? Answer in two or three sentences.

   Show answer

   The insurer prices the frozen premium carefully up front and wins the business of the most safety-minded buyers, who tend to be good risks. The buyer insists because a disability policy exists for the decade when his health worsens — exactly when a lesser policy's insurer might raise class rates or walk away. The gold rung costs more precisely because it removes the insurer's exits.

10. Hard An insured was hurt in a remote accident and lay hospitalized, unconscious, for six weeks — well past the 20-day notice deadline. Is her claim barred? Name the phrase that answers.

Show answer

No. The uniform deadlines run 'or as soon as reasonably possible' (and proof of loss allows up to a year absent legal incapacity), so notice given promptly after she could reasonably act preserves the claim. The clocks discipline the careless, not the incapacitated.

11. Challenge A policy's mandatory provisions may be reworded by the insurer under one condition. State the condition, and explain in two sentences why the drafters allowed rewording at all.

Show answer

The wording may differ only if it is at least as favorable to the insured as the model provision. The drafters wanted uniform minimum rights, not uniform prose — an insurer remains free to be more generous than the model, and competition sometimes makes it so. The floor is fixed; only the ceiling is open.

12. Challenge From the story: the 1912 New York law fixed one state's jungle, yet the NAIC still needed a 1950 model law. Write three sentences on what problem remained after 1912 and how a model law — which is not itself a statute — solved it.

Show answer

After 1912, each state that copied New York adjusted the wording, so a national insurer faced fifty near-identical but conflicting requirements, and a family moving states changed rights without knowing it. A model law gave every legislature one carefully drafted text to enact, aligning the states without any federal takeover of insurance — the McCarran-Ferguson pattern from Unit 1. Uniformity came from voluntary adoption, which is why exams say policies contain these provisions 'in substance.'

COMMON MISTAKES

- Scrambling the claims clock — it is 20 (notice), 15 (forms), 90 (proof), then 60 days to 3 years for suits; drill the chain until it is reflex.
- Saying guaranteed renewable freezes premiums — it guarantees renewal only; premiums may rise for an entire class. Only noncancellable freezes the rate.

- Forgetting reinstatement's asymmetry: accidents are covered immediately, new sickness only after 10 days — and silence for 45 days makes reinstatement automatic.
- Treating a misstated age as grounds to void the policy — the remedy is adjusting benefits to what the premium would have bought at the true age.
- Assigning optional provisions to the mandatory list; sort by whom the clause protects — mandatory shields the insured, optional shields the insurer.
- Missing the fraud exception: the time limit on certain defenses bars innocent misstatements after two years, but fraudulent misstatements commonly remain a defense in individual policies.

Make it a game · Beat the Clock. Make thirteen cards: the twelve mandatory provisions and one wildcard labeled OPTIONAL. A parent shuffles and flips cards one at a time; for each provision you have ten seconds to shout its number (two years! twenty days! 7-10-31!) — and for the wildcard you must name any two optional provisions and whom they protect. One point per correct answer. Round two reverses it: the parent calls out a number of days and you name the provision it belongs to — beware 15 versus 20, the house's favorite trap. Round three is the ladder: five rungs recited bottom to top in under fifteen seconds, premium rules included. Best total over three rounds wins.

Scripture. “But let your communication be, Yea, yea; Nay, nay: for whatsoever is more than these cometh of evil.” (Matthew 5:37, KJV)

Christ's standard for speech is plainness — a promise that means what it says, with nothing hiding in the excess. The uniform provisions are law doing what honesty should have done freely: stripping the 'whatsoever is more' out of the fine print so a policy's yea is yea on the day of the claim.

5.5 Group Health, HSAs and the Specialized Policies

OBJECTIVES

- Explain how group underwriting differs from individual underwriting, and the roles of the master policy and certificates of insurance.
- State the COBRA continuation mechanics: covered employers, qualifying events, the 18- and 36-month periods, and the premium up to 102%.
- Describe the health savings account: HDHP requirement, the triple tax advantage, and the eligibility rules, with FSAs and HRAs for contrast.
- Compute AD&D benefits from the principal sum and capital sum, and outline dental and vision plan structures.
- Identify the limited policies — accident-only, hospital indemnity, critical illness, cancer — and the rule that they must be clearly labeled as limited.

> **Warm-up.** In five minutes, write why an insurer might charge less per person to cover three thousand warehouse workers at once than to cover any one of them alone. List at least three reasons — think about paperwork, about who joins, and about who decides to apply. Keep the list; the first core idea grades it.

WATCH

What is Group Insurance and Who is it for?

Insurance Exam Queen · 4:04

https://www.youtube.com/watch?v=nIF6FMBy6Is

> **WHEN TO WATCH**
> Watch after the first three core ideas; listen for who owns the master policy and what each worker receives instead, and write both answers before she finishes.

BACKUP VIDEO

[Insurance] 17, COBRA Coverage

Open Exam Prep · 4:00

https://www.youtube.com/watch?v=dNLMJoqovNw

Watch before writing the booklet's IF YOU LEAVE page; copy down the five COBRA numbers — 20, 18, 36, 102, 60 — as he confirms each one.

group health insurance

Coverage written on a group of people — commonly employees — under one master policy, underwritten on the group's characteristics rather than each member's health.

COBRA

The federal continuation law requiring employers of 20 or more to let qualified beneficiaries continue group health coverage at their own expense — up to 102% of the group premium — after qualifying events.

health savings account (HSA)

A tax-favored personal account, available only with a qualifying high-deductible health plan, whose contributions, growth and qualified medical withdrawals are all untaxed.

health reimbursement arrangement (HRA)

An employer-funded, employer-owned arrangement reimbursing employees' medical expenses — the worker contributes nothing and keeps nothing on leaving, except as the plan provides.

master policy and certificate

The employer or sponsor holds the master policy (the actual contract); each covered member receives a certificate of insurance describing his coverage.

qualifying event

An event that triggers COBRA rights: termination (except gross misconduct) or reduced hours (18 months); the employee's death, divorce, Medicare entitlement, or a dependent child aging out (36 months for dependents).

flexible spending account (FSA)

An employer-sponsored account funded by pre-tax salary for medical expenses, subject to annual limits and a use-it-or-lose-it rule softened only by small carryover or grace-period allowances.

accidental death and dismemberment (AD&D)

Coverage paying the principal sum for accidental death (and commonly for certain multiple losses) and a capital sum — a percentage of the principal — for lesser dismemberments or loss of sight.

principal sum

The AD&D policy's face amount, paid for accidental death and commonly for losses such as two limbs or the sight of both eyes.

capital sum

The percentage of the principal sum, commonly 50%, paid for a single dismemberment such as one hand or the sight of one eye.

limited policy

A policy covering only stated perils or expenses — accident-only, cancer, critical illness, hospital indemnity — which must be conspicuously labeled as limited.

hospital indemnity policy

A limited policy paying a flat dollar amount per day of hospitalization, regardless of actual expenses.

CORE IDEAS

The story. In 1910 the mail-order house Montgomery Ward & Co. of Chicago — the company whose catalog reached nearly every farm in America — went looking for something no insurer sold: one contract protecting its thousands of clerks, packers and bookkeepers against the income lost to sickness and injury. The Equitable Life Assurance Society agreed to try, and after two years of negotiation the plan went into effect in 1912, covering close to three thousand employees at once under a single agreement — benefits scaled to wages, premiums shared between company and workers. Insurance historians point to it as the first true **group insurance** contract in America, and the idea it proved was radical: an insurer could underwrite *the group itself* — its size, its trades, its ages, its turnover — without examining a single employee. No medical exams, no individual applications, no agent calling on three thousand kitchen tables. Within a decade group life and group health plans were spreading through American industry, and today most Americans under 65 with private health coverage have it exactly this way: through the job.

How they figured it out. Group underwriting works because the group assembles itself for reasons that have nothing to do with health — people take jobs to earn wages, not to collect benefits — so the pool arrives pre-mixed, healthy and sick in natural proportion. The classic guards keep it that way: the group must exist for a purpose *other than buying insurance*; coverage is offered to whole classes of employees, not hand-picked individuals; benefits are set by formula (a multiple of salary, a standard schedule) so no one selects a jackpot; and participation

requirements — commonly 100% for **noncontributory** plans the employer funds entirely, about 75% for **contributory** plans workers help pay — keep the healthy from opting out, defeating the adverse selection you met in Unit 2. The paper matches the theory: the employer holds the **master policy**; each worker holds a **certificate of insurance** — evidence of coverage, not a contract of his own. Insurers price large groups by **experience rating** (the group's own claims) and small ones by **community rating** (the area's pooled experience).

The big idea. Group coverage's weakness is that it is tied to the job — and the famous patch is **COBRA**, the federal continuation law of 1985 (the Consolidated Omnibus Budget Reconciliation Act, whose budget-bill name explains its odd acronym). Employers with **20 or more employees** must offer continued group health coverage to qualified beneficiaries after a **qualifying event**. Termination of employment (for anything short of gross misconduct) or a reduction in hours gives the employee and covered family up to **18 months** of continuation. Events that strip a *dependent* of coverage — the employee's death, divorce or legal separation, the employee's Medicare entitlement, or a child aging out of dependent status — give the affected dependents up to **36 months**. The beneficiary pays the full group premium plus a 2% administration charge — **up to 102%** — and must elect within the 60-day window; the price shock is that the worker now sees the whole premium the employer once quietly paid. One sentence of settled companion law: **HIPAA** (1996) protects the privacy of individually identifiable health information — insurers and agents may use and disclose it only as the rules allow — and it eased portability between group plans.

Now the tax-favored accounts, which exams test as a trio. The **health savings account** pairs by law with a qualifying **high-deductible health plan** and belongs to the individual — it moves with him from job to job, and unspent money rolls over forever. Its celebrated **triple tax advantage**: contributions go in untaxed, the account grows untaxed, and withdrawals for qualified medical expenses come out untaxed. Contribution ceilings are set yearly by the IRS (plus a $1,000 catch-up from age 55); non-medical withdrawals before age 65 cost income tax plus a 20% penalty. Eligibility has traps: no other non-HDHP coverage, not enrolled in Medicare, not claimable as another taxpayer's dependent. The **FSA** is the employer-plan cousin — pre-tax salary set aside for the year's medical expenses, use-it-or-lose-it apart from small carryover or grace allowances. The **HRA** is employer-funded and employer-

owned: the company reimburses expenses; the worker contributes nothing and takes nothing with him. Own the trio by ownership: HSA — the worker's forever; FSA — the worker's for the year; HRA — the employer's throughout.

AD&D is the simplest policy in the unit and the easiest exam points. It pays only for *accidental* death and dismemberment — sickness never triggers it. Accidental death pays the **principal sum**, the face amount. Dismemberment pays by schedule: the loss of one hand, one foot or the sight of one eye commonly pays the **capital sum**, typically 50% of the principal; the loss of two members — two limbs, or sight of both eyes — commonly pays the full principal sum. AD&D appears as a standalone policy, a group benefit, or the double-indemnity rider you met on life policies in Unit 4. Its honest limitation is the reason it is cheap: most people do not die by accident, so AD&D supplements life and disability coverage — it never replaces them, and an agent who sells it as 'life insurance' has misrepresented the product.

The specialized policies round out the shelf. **Dental** plans grade benefits in three tiers — preventive care (cleanings, exams) commonly at or near 100%, basic services (fillings, extractions) around 80%, major services (crowns, dentures) around 50% — with deductibles, annual maximums and waiting periods for major work. **Vision** plans cover exams and allowances toward lenses and frames on a schedule. Then the **limited policies**, a family the law watches because their names promise more than their coverage: **accident-only** (no sickness coverage at all), **hospital indemnity** (a flat dollar amount per hospital day — in this example $150 — regardless of the bill), **critical illness** (a lump sum on diagnosis of listed conditions), and **cancer or dread disease** policies (one disease only). Every one must be **conspicuously labeled as a limited policy**, and the agent's duty is to present it as a supplement to real medical expense coverage, never as a substitute.

On the exam today. COBRA is numbers: 20 or more employees; 18 months for termination or reduced hours; 36 months for the dependents' events (death, divorce, Medicare entitlement, a child aging out); up to 102% of the group premium; a 60-day election window — and gross-misconduct terminations get nothing. Group mechanics: the employer holds the master policy, the employee a certificate; the group must exist for another purpose; noncontributory plans commonly require 100% participation, contributory about 75%. The HSA questions test eligibility (qualifying HDHP, no other coverage, no Medicare, not a dependent) and the triple tax advantage — and the FSA/HRA contrast by ownership. AD&D: principal sum for

accidental death or double losses, capital sum (commonly 50%) for single losses, accidents only. And the limited-policy question is a labeling question: the policy is legal, but it must say what it is, and the agent must sell it as what it is. When a question quotes dollar limits for HSAs or per-day indemnities, treat them as that year's examples — the IRS resets the real ones annually.

PICTURE STUDY



The Country School, Winslow Homer, 1871 · Oil on canvas · Saint Louis Art Museum, St. Louis

Image: Wikimedia Commons, public domain

Winslow Homer, fresh from his years as a Civil War illustrator, spent the early 1870s painting the daylight world of American childhood, and this one-room Massachusetts schoolhouse is among the best-loved results: one teacher, one room, and every age of child gathered on the same benches in the same light. It opens this lesson because the lesson is about coverage that works exactly this way — not one policy per person but one roof over the whole room. A group plan insures the class, certificates go to every desk, and nobody is sent home for being small, slow or sickly; and it was a roomful of teachers like this one whose unpaid hospital bills started this unit's story back in Dallas.

Look closely

- Count the ages in the room — small children and nearly grown ones share the same benches. How is that mix like the pool a group plan insures?
- Find the teacher at her desk. One master book, many small slates: which is the master policy in this picture, and which are the certificates?
- Notice the boy wiping his eye. In a room this size everyone knows who is struggling. What does a group plan do with that knowledge that individual underwriting would do differently?

- Follow the sunlight across the floor. Homer floods the room with one light for everyone — find two other details that make the room feel shared rather than divided.

Talk about it

1. The school exists to teach, not to insure — and that is exactly why insuring it works. Explain, from this picture, why a group gathered for another purpose defeats adverse selection.
2. If the school closed, every child would lose the room at once. What does COBRA give a worker that these children's school cannot give them, and what does it cost?
3. Bearing one another's burdens is this lesson's scripture. Where does a healthy young worker's premium go in a group plan — and why is that arrangement something other than a bad deal for him?

PROJECT

The Benefits Booklet: One Pretend Company, Explained Honestly

You will write the four-page benefits booklet for a pretend employer — Harper Hardware, 38 employees — explaining its group health plan, its HSA option, its AD&D benefit and its one limited policy so plainly that a new 19-year-old stock clerk could understand every page. Writing benefits in plain English is a real agent's weekly work, and it will fix this lesson's numbers in your memory better than any drill.

You will need

- Four half-sheets of paper (or one document page per section)
- Your exam notebook and pen
- The Labor Department COBRA guide from the kit, for checking your continuation page

Steps

1. Page 1 — THE GROUP PLAN: state who holds the master policy, what the employee's certificate is, that the plan is contributory (employer pays 70% in this example), and the participation rule that applies (about 75% for contributory plans).
2. Page 2 — IF YOU LEAVE: write the COBRA paragraph for a 38-employee company: the qualifying events with 18 beside termination/reduced hours and 36 beside the dependents' events, the 60-day election, and the price formula (full premium × up to 102%) with a worked dollar example.
3. Page 3 — THE HSA OPTION: list the eligibility checklist (qualifying HDHP, no other non-HDHP coverage, not on Medicare, not a dependent), the triple tax advantage in three short lines, this year's example limits labeled 'set by the IRS yearly,' and the before-65 non-medical penalty (income tax + 20%).
4. Page 4 — AD&D AND THE EXTRAS: show a $50,000 principal sum with a three-line schedule (accidental death $50,000; two members $50,000; one member $25,000), a one-line dental tier note (preventive ~100%, basic ~80%, major ~50%), and the company's hospital indemnity offering with the words LIMITED POLICY — NOT MEDICAL EXPENSE INSURANCE in capitals.

5. Trade the booklet with a parent or sibling playing the stock clerk; have them ask two questions per page, and revise any sentence they stumble on.
6. Write a closing paragraph in your own words: what the group plan does well, what it cannot do, and why nobody should mistake the limited policy for major medical.
7. Date the booklet and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the twelve key terms; on the COBRA card put only five numbers on the back — 20, 18, 36, 102, 60 — and drill until you can name what each one counts.
2. Draw the three accounts as three jars labeled HSA (worker's forever — rolls over), FSA (worker's for the year — use it or mostly lose it), HRA (employer's jar — worker only draws), each with one line on who fills it.
3. Write a five-line trap list titled 'Limited means limited,' ending with: hospital indemnity pays per DAY, not per BILL — and every limited policy must say so on its face.

KEY FORMULAS

$$\text{COBRA premium} \le 1.02 \times \text{full group premium}$$

$$\text{capital sum} = 0.50 \times \text{principal sum (commonly, for a single dismemberment)}$$

$$\text{HSA tax saving on contribution} = \text{contribution} \times \text{marginal tax rate}$$

From history. Group insurance grew so fast after Montgomery Ward because employers discovered it answered a labor problem as much as an insurance one: in the tight factories of the 1910s and 1920s, benefit plans held skilled workers the way wages alone could not — the beginning of insurance through the job as an American habit. Wartime wage controls in the 1940s cemented it: companies that could not raise pay competed with benefits instead, and by mid-century the employer group, not the kitchen table, was where most working families met health insurance.

Example 1. Tom is laid off (not for misconduct) from a 160-employee firm. His group health premium was $650 a month, of which his employer paid $500. For how long may Tom continue coverage under COBRA, and at what maximum monthly cost?

Show solution

1. The employer has 20 or more employees and the layoff is a qualifying event: termination other than gross misconduct.
2. Continuation period: up to 18 months for termination or reduced hours.
3. COBRA price: the FULL group premium — both shares — plus up to 2%: $1.02 \times \$650 = \$663$ a month.
4. The shock to explain honestly: Tom's out-of-pocket cost jumps from $150 to $663 — not because the price rose, but because the employer's hidden $500 share is now his.

Answer: Up to 18 months at up to $663 per month (102% of the full $650 premium, in this example).

Example 2. Exam style. A group AD&D certificate carries a $100,000 principal sum with a standard schedule. Which loss pays $50,000?

A. Accidental death

B. Loss of sight in both eyes in an accident

C. Loss of one hand in an accident

D. Death from a sudden illness

Show solution

1. Accidental death pays the principal sum — $100,000 — so A pays double the asked amount.
2. Loss of two members (both eyes, two limbs) commonly also pays the full principal sum: B is $100,000.
3. A single dismemberment — one hand — pays the capital sum, commonly 50% of principal: $50,000.
4. D pays nothing at all: AD&D responds only to accidents, never sickness.

Answer: C. One hand = capital sum = 50% of $100,000. Sickness (D) is AD&D's permanent exclusion.

Example 3. Elena, 40, has a qualifying HDHP and contributes $3,000 to her HSA this year. Her marginal tax rate, in this example, is 22%. What does the contribution save her in tax now, and what happens to the money if she (a) pays a $1,200 dental bill, (b) leaves the rest invested for years, (c) spends $500 on a vacation at age 45?

Show solution

1. Contribution saving: $0.22 \times \$3{,}000 = \$660$ of income tax not owed — leg one of the triple advantage.
2. (a) The $1,200 dental withdrawal is a qualified medical expense: tax-free — leg three.
3. (b) The remaining balance grows untaxed and rolls over year after year — leg two; there is no use-it-or-lose-it.
4. (c) A non-medical withdrawal before 65 is taxed as income PLUS a 20% penalty: the $500 costs $110 tax and $100 penalty in this example — the account is a medical tool, not a piggy bank.

Answer: She saves $660 now; medical spending and growth stay untaxed; the vacation withdrawal loses $210 of $500 to tax and penalty. Triple advantage — but only on the medical path.

PRACTICE

1. Easy In group insurance, who holds the master policy and what does each covered employee receive?

   Show answer

   The employer (or sponsoring group) holds the master policy — the actual contract; each employee receives a certificate of insurance as evidence of coverage.

2. Easy Which employers does COBRA reach, and what may they charge a continuing beneficiary?

   Show answer

   Employers with 20 or more employees; the beneficiary pays the full group premium plus up to 2% — up to 102% in all.

3. **Easy** Name the three legs of the HSA's triple tax advantage.

Show answer

Contributions are untaxed going in, the account grows untaxed, and withdrawals for qualified medical expenses are untaxed coming out.

4. **Medium** Match the continuation period: (1) an employee laid off in a downsizing; (2) a spouse after the employee's death; (3) a dependent son turning too old for the plan; (4) an employee fired for stealing from the till.

Show answer

(1) 18 months — termination other than gross misconduct; (2) 36 months; (3) 36 months; (4) nothing — gross misconduct terminations are not qualifying events.

5. **Medium** Which person is eligible to contribute to an HSA?

A. A 67-year-old enrolled in Medicare with an HDHP

B. A 30-year-old with a qualifying HDHP and no other coverage

C. A 22-year-old claimed as a dependent on her parents' return, with an HDHP

D. A 45-year-old with an HDHP plus a traditional low-deductible plan from his spouse's employer

Show answer

B. Medicare enrollment (A), dependent status (C) and other non-HDHP coverage (D) each break eligibility — the exam's three standard disqualifiers.

6. **Medium** Contrast the FSA and the HRA by who funds, who owns, and what happens to unused money.

Show answer

An FSA is funded by the employee's pre-tax salary, is employer-sponsored, and unused balances are forfeited apart from small carryover or grace allowances. An HRA is funded and owned entirely by the employer, which reimburses expenses; the employee contributes nothing and keeps nothing on leaving except as the plan provides.

7. Medium Why do contributory group plans commonly require about 75% participation, and noncontributory plans 100%?

Show answer

High participation keeps the pool mixed — if joining were optional and sparse, mostly the sick would enroll (adverse selection). Where the employer pays everything, there is no reason to leave anyone out, so all eligible employees are covered.

8. Hard A group AD&D certificate has a $80,000 principal sum. Compute the benefit for: (a) accidental death; (b) loss of one foot; (c) loss of sight in both eyes; (d) death from a heart attack at a desk.

Show answer

(a) $80,000 — principal sum; (b) $40,000 — capital sum, commonly 50%; (c) $80,000 — two members commonly pay the full principal; (d) $0 — sickness never triggers AD&D.

9. Hard A hospital indemnity policy pays $200 per day. An insured spends 6 days hospitalized with a $19,400 bill, of which his major medical already pays most. What does the indemnity policy pay, to whom, and why is this not a violation of indemnity principles?

Show answer

It pays $6 \times \$200 = \$1{,}200$, in cash, to the insured, regardless of the bill. As a fixed-indemnity (per-day) benefit it pays a stated sum rather than reimbursing expenses — which is exactly why the law requires it to be labeled a limited policy and sold as a supplement, never as medical expense coverage.

10. Hard An agent tells a young family that a critical illness policy plus an accident-only policy 'adds up to full health coverage for half the price.' Name the two things wrong with the statement.

Show answer

First, it is false on coverage: neither policy pays routine or sickness-based medical expenses outside its narrow triggers — an ordinary pneumonia hospitalization would fall between them entirely. Second, it misrepresents limited policies as a substitute for major medical, defeating the labeling rule's purpose and the agent's duty of honest presentation.

11. **Challenge** Tom from the worked example can take COBRA at $663 a month or buy an individual silver-tier plan. List three factors an honest agent would have him compare before choosing, without recommending either.

    Show answer

    Whether his current doctors and in-progress treatments sit in the individual plan's network; how much of his deductible and out-of-pocket maximum he has already satisfied this year on the group plan (COBRA keeps the tally, a new plan restarts it); and total cost after any premium help he qualifies for in the individual market. The right answer is the client's arithmetic, not the agent's habit.

12. **Challenge** From the story: list three features of the 1912 Montgomery Ward plan that are still the textbook marks of group insurance, and name the underwriting problem its design had to defeat.

    Show answer

    One master contract covering a whole workforce; benefits set by formula (scaled to wages) rather than individual choice; and premiums shared by employer and employees with no individual medical examinations. The design defeats adverse selection: because the group exists to run a business and benefits follow formulas, no one can join or size his coverage because he expects to be sick.

COMMON MISTAKES

- Forgetting that the COBRA beneficiary pays the FULL premium (both shares) plus up to 2% — the employer's subsidy ends even though the plan continues.
- Assigning 36 months to a laid-off employee — termination and reduced hours carry 18; the 36-month periods belong to dependents' events (death, divorce, Medicare entitlement, aging out).
- Calling the employee's certificate 'his policy' — the master policy belongs to the employer; the certificate is evidence of coverage.
- Letting an HSA question slip past the eligibility traps: other non-HDHP coverage, Medicare enrollment, or dependent status each disqualify.
- Paying AD&D for a death by illness — accidents only, always; and mixing up principal sum (death, double losses) with capital sum (single losses, commonly 50%).

- Treating a hospital indemnity or cancer policy as medical expense insurance — limited policies pay stated sums for stated events and must be labeled as limited.

Make it a game · The Numbers Gauntlet. Write the lesson's numbers on ten cards: 20, 18, 36, 102, 60, 75, 100, 50, 2, 65. Shuffle. A parent flips cards one at a time and you have ten seconds to say what the number means in this lesson (20 — COBRA's employer threshold; 50 — the capital sum's usual percent; 65 — the age the HSA penalty ends; 100 — noncontributory participation…). One point each. Round two: the parent reads a mini-scenario ('fired for theft,' 'dependent turns 26,' 'bought a kayak with HSA money at 40') and you call the outcome. Watch for the trick card — 2 belongs to both COBRA's 2% and the 2-of-6 ADL trigger from Lesson 5.3, and naming both earns double. Best of two rounds wins.

Scripture. “Bear ye one another’s burdens, and so fulfil the law of Christ.” (Galatians 6:2, KJV)

Group insurance is burden-bearing built into arithmetic: the healthy majority's premiums quietly carry the few in crisis, and no one is examined at the door. Paul's command reaches further than any plan — it is personal, costly and chosen — but a mechanism that lets three thousand clerks carry one another's hospital bills is a shadow of the law of Christ in ledger form.

UNIT 5

Health Insurance

In 1929 the schoolteachers of Dallas had a problem as old as sickness itself: a hospital stay could swallow a month's pay, and nobody could say whose turn was next. A Baylor University administrator named Justin Ford Kimball offered them a strange new bargain — fifty cents a month, and the hospital would be there when the bill came — and from that little plan grew the whole world this unit explores. You will learn how **medical expense insurance** shares a big bill through **deductibles**, **coinsurance** and the **out-of-pocket maximum**, and how the HMO, PPO, EPO and POS networks differ. You will meet **disability income insurance** — the policy that pays when the paycheck stops — and the definitions that decide everything.

Then the unit turns to the promises society itself makes: **Medicare** with its four parts, **Medicaid** for those in need, and the **long-term care** policies built around six activities of daily living. You will memorize the twelve **uniform mandatory provisions** every individual health policy carries and the five-rung **renewability ladder**, and you will finish with group health, COBRA continuation, health savings accounts and the specialized policies — dental, vision, AD&D and the limited plans that must say so on their face. Health insurance is the most calculation-heavy and list-heavy part of the licensing exam; this unit gives you the stories that make the lists stick.

PREREQUISITES

- Can compute percentages of dollar amounts quickly and accurately (20% of $8,400 without hesitation)
- Can define premium, insurer, insured, peril and indemnity from Units 1 and 2
- Can explain utmost good faith and the agent's duty of honest applications from Unit 2
- Has completed Units 3 and 4, or can state what a beneficiary, a grace period and a reinstatement are

MASTERY CHECKLIST

- ☐ I can walk a medical bill through deductible, coinsurance and out-of-pocket maximum and compute exactly what the insured and the insurer each pay.
- ☐ I can contrast HMO, PPO, EPO and POS plans by network, gatekeeper and referral rules.
- ☐ I can explain own-occupation versus any-occupation disability, and why benefits are capped at about 60–70% of earnings.
- ☐ I can compute when a disability check actually arrives from the elimination period and the payment-in-arrears rule.
- ☐ I can name what Medicare Parts A, B, C and D each cover, what Medigap does, and how Medicaid differs from them all.
- ☐ I can state the six activities of daily living and the common 2-of-6 (or cognitive impairment) long-term care benefit trigger — and that Medicare does not pay for custodial care.
- ☐ I can list the twelve mandatory uniform provisions with their time limits and climb the renewability ladder from cancellable to noncancellable.
- ☐ I can state the COBRA continuation rules (18 and 36 months, employers of 20 or more, up to

102% of premium) and the HSA eligibility rules.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **HealthCare.gov Glossary of Health Coverage Terms**: Free, official. Plain one-paragraph federal definitions of deductible, coinsurance, out-of-pocket maximum and every network type. Keep it open beside Lessons 5.1 and 5.5 and check your flashcard definitions against it. Ages 14 and up.
- **Medicare & You (the official Medicare handbook)**: Free, official. The handbook the government mails to every Medicare household each fall, with the current year's real figures for Parts A, B, C and D. Use it with Lesson 5.3 to replace this course's example numbers with this year's actual ones. Ages 15 and up.
- **LongTermCare.gov (Administration for Community Living)**: Free, official. The federal government's plain-language site on what long-term care is, what it costs and who pays — including the fact, tested on every exam, that Medicare does not cover most custodial care. Read the basics pages with Lesson 5.3. Ages 15 and up.
- **An Employee's Guide to Health Benefits Under COBRA (U.S. Department of Labor)**: Free, official. The Labor Department's own guide to continuation coverage — qualifying events, election windows and premiums. Skim it with Lesson 5.5; its tables are the exam's COBRA questions in plainer clothes. Ages 15 and up.
- **NAIC Consumer Insurance Resources**: Free, official. The National Association of Insurance Commissioners' consumer guides on health coverage, Medicare supplements and long-term care, plus the directory of all fifty state insurance departments. Use it all unit long whenever a lesson says 'check your state.' Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

5.1 Medical Expense Insurance: Deductibles, Networks and the Big Bill

3 sessions of 50 minutes

5.2 Disability Income: Insuring the Paycheck — 3 sessions of 50 minutes

5.3 Medicare, Medicaid and Long-Term Care — 3 sessions of 50 minutes

5.4 **The Uniform Provisions: How a Health Policy Behaves** 3 sessions of 50 minutes

5.5 **Group Health, HSAs and the Specialized Policies** 3 sessions of 50 minutes

Unit 5 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example,” use the figures given, and remember that real deductibles, premiums, HSA limits and Medicare figures change yearly and live at your state insurance department, the official federal sites and the current Medicare handbook. A state licensing exam passes at 70% — 14 of 20 here — but aim higher. Choose the one BEST answer.

1. **5 pts**

   A major medical policy has a $500 calendar-year deductible and 80/20 coinsurance, and the insured has met nothing this year. Covered charges are $15,500 (no cap reached). The insured pays:

   A. $3,500

   B. $3,100

   C. $500

   D. $3,000

2. **5 pts**

   Which of the following accumulates toward a plan's in-network out-of-pocket maximum?

   A. Monthly premiums

   B. The deductible, in-network coinsurance and copays

   C. Charges for services the policy does not cover

   D. All money the insured spends on health care of any kind

3. 5 pts

A health plan requires members to select a primary care physician who coordinates care and issues referrals, but members may also go outside the network at a higher cost. This is:

A. An HMO

B. An EPO

C. A PPO

D. A POS plan

4. 5 pts

Under settled federal health-insurance law, a major medical insurer may NOT:

A. Charge different premiums by age within legal limits

B. Sell plans in bronze, silver, gold and platinum tiers

C. Impose a lifetime dollar limit on essential health benefits

D. Cover dependents on a parent's plan to age 26

5. 5 pts

A surgeon develops a hand tremor, can no longer operate, and takes a teaching post. Her disability policy defines total disability by the own-occupation standard. The insurer should:

A. Deny the claim because she is gainfully employed

B. Pay the claim, because she cannot perform the duties of her own occupation

C. Pay only a partial benefit

D. Pay only if she quits teaching

6. 5 pts

Compared with a 30-day elimination period, a 180-day elimination period on the same disability policy will:

A. Lower the premium, because the insured absorbs more of the early loss

B. Raise the premium, because the policy lasts longer

C. Not affect the premium

D. Raise the benefit amount automatically

7. 5 pts

Nora, whose policy pays $2,500 a month with a 90-day elimination period and benefits paid in arrears, is totally disabled on January 1. Her first benefit check arrives about:

A. January 1

B. April 1

C. May 1

D. July 1

8. 5 pts

An employer pays the entire premium for its group long-term disability plan and deducts the cost. When a worker collects benefits, they are:

A. Income-tax-free

B. Taxable income to the worker

C. Taxable to the employer

D. Tax-free up to 60% of salary

9. 5 pts

Doctors' office visits, outpatient services and durable medical equipment are covered under which part of Medicare?

A. Part A

B. Part B

C. Part C only

D. Part D

10. 5 pts

A family asks which program will pay for their grandmother's expected years of custodial nursing home care. She is 80, on Original Medicare, with modest savings. The accurate answer is:

A. Medicare Part A, for as long as care continues

B. Her Medigap policy

C. Medicare Part C, if she switches

D. Not Medicare — long-term care insurance, her own funds, or Medicaid if she qualifies financially

11. 5 pts

A Medigap (Medicare supplement) policy is guaranteed issue, regardless of health, during:

A. The six months beginning when the buyer is 65 or older and enrolled in Part B

B. Any January

C. The 24 months after any hospital stay

D. The buyer's entire lifetime

12. 5 pts

Which statement correctly contrasts Medicare and Medicaid?

A. Both are needs-based

B. Medicare is state-run; Medicaid is purely federal

C. Medicare is based on age or disability regardless of wealth; Medicaid is needs-based, state-run with federal funds

D. Medicaid covers only people over 65

13. 5 pts

Under the uniform mandatory provisions, written proof of loss is generally due within how many days of the loss?

A. 20

B. 15

C. 60

D. 90

14. 5 pts

Under the uniform provisions, the grace period on a monthly-premium individual health policy is commonly:

A. 7 days

B. 10 days

C. 31 days

D. 45 days

15. 5 pts

Ten days after his health policy is automatically reinstated, an insured breaks his leg; twenty days after reinstatement he contracts bronchitis. The reinstated policy covers:

A. Both losses — accidents immediately, and the sickness because it began after the 10-day wait

B. The leg only

C. The bronchitis only

D. Neither loss for 45 days

16. 5 pts

A disability policy that the insurer must renew to age 65 AND whose premium can never be raised above the rate stated in the policy is:

A. Guaranteed renewable

B. Conditionally renewable

C. Optionally renewable

D. Noncancellable

17. 5 pts

Carla is laid off (not for misconduct) from a company with 75 employees. Her COBRA rights are:

A. 36 months at the employer's expense

B. 18 months at up to 102% of the full group premium, elected within 60 days

C. 18 months at her old payroll-deduction price

D. None, because she was laid off

18. 5 pts

Which person may contribute to a health savings account?

A. A worker enrolled in Medicare

B. A college student claimed as a dependent on her parents' tax return

C. A worker covered only by a qualifying high-deductible health plan

D. A worker with an HDHP plus full low-deductible coverage under a spouse's plan

19. 5 pts

An AD&D policy carries a $60,000 principal sum with a standard schedule. The insured loses one hand in a covered accident. The policy pays:

A. $60,000

B. $15,000

C. Nothing — dismemberment requires two losses

D. $30,000, the capital sum

20. 5 pts

A policy pays $150 for each day the insured is hospitalized, regardless of actual charges, and covers nothing else. Which statement is TRUE?

A. It is a basic hospital expense policy

B. It may lawfully be sold as a substitute for major medical coverage

C. It is a hospital indemnity policy and must be conspicuously labeled a limited policy

D. It violates the principle of indemnity and cannot be sold

ANSWER KEY

1. A. Deductible first ($500), then 20% of the remaining $15,000 ($3,000), for $3,500 total. D forgets the deductible; B applies 20% to the whole bill.
2. B. Cost sharing on covered in-network care counts. Premiums never count (A), non-covered services never count (C), and D sweeps in out-of-network and non-covered spending that commonly does not accumulate.
3. D. Gatekeeper plus an out-of-network door is the point-of-service hybrid. The HMO has the gatekeeper but no out-of-network benefit (A); the PPO has out-of-network coverage but no gatekeeper (C); the EPO has neither gatekeeper nor out-of-network coverage (B).
4. C. Lifetime and annual dollar limits on essential health benefits are prohibited. A and B are how the market lawfully works, and D is a requirement, not a prohibition.
5. B. Under own-occupation, inability to perform one's own occupation is total disability even while earning in another field. A and D state the any-occupation logic; C confuses total with partial disability.
6. A. The elimination period is a deductible measured in time; the more loss the insured retains, the cheaper the coverage. B confuses the elimination period with the benefit period.
7. C. The elimination period runs January through March; benefits accrue beginning about April 1, and the first month's benefit is paid at its end — about May 1. B forgets payment in arrears.
8. B. Employer-paid premiums make the benefits taxable to the recipient. Benefits are tax-free when the insured paid the premiums with after-tax dollars — the pairing the exam loves to reverse.
9. B. Part B is medical insurance — physicians and outpatient care, with a premium, an annual deductible and roughly 80/20 cost sharing. Part A is hospital insurance; Part D is drugs; Part C is the private package that must include at least A and B.
10. D. Medicare does not pay for long-term custodial care; its skilled nursing benefit is brief, skilled-only and follows a qualifying hospital stay. Medigap only fills Medicare's own gaps (B), and Advantage plans must match A and B, which exclude custodial care (C).
11. A. The Medigap open enrollment window is six months from age-65-plus-Part-B enrollment; afterward insurers may underwrite. The other windows are

inventions.

12. C. Medicare is an age- and work-based federal entitlement; Medicaid serves people of any age with low income and assets, administered by the states within federal rules — and it, not Medicare, pays custodial long-term care for those who qualify.
13. D. The claims clock runs 20 days for notice of claim, 15 for the insurer to send forms, 90 for proof of loss, and 60 days to (commonly) 3 years for legal actions. A and B belong to the earlier links of the chain.
14. B. The trio is 7 days (weekly premiums), 10 days (monthly), 31 days (all other modes). 45 days belongs to automatic reinstatement, a different clock entirely.
15. A. Reinstated coverage applies to accidents at once and to new sickness after 10 days; both losses here fall on the covered side of their rules. The 45 days (D) is how long insurer silence may run before reinstatement becomes automatic, not a coverage wait.
16. D. Only noncancellable adds the frozen premium to guaranteed renewal. Guaranteed renewable (A) — the exam's favorite tempter here — guarantees renewal but allows premium increases by class.
17. B. Termination other than gross misconduct gives 18 months; the beneficiary pays the entire group premium plus up to 2%, electing within the 60-day window. The 36-month periods belong to dependents' events such as death, divorce or a child aging out.
18. C. HSA eligibility requires a qualifying HDHP and falls to three disqualifiers the exam rotates: Medicare enrollment (A), dependent status (B), and other non-HDHP coverage (D).
19. D. A single dismemberment commonly pays the capital sum — 50% of the principal. The full principal sum (A) is for accidental death or double losses such as two limbs or the sight of both eyes.
20. C. A per-day fixed benefit is hospital indemnity — lawful, useful as a supplement, and required to announce its limits on its face. Selling it as a major medical substitute (B) is misrepresentation, and A describes expense reimbursement, which this is not.

PORTFOLIO PIECE: MY PATHWAY FILE: THE HEALTH INSURANCE SECTION

Assemble the health section of your Pathway File from this unit's five projects: the Big Bill Walkthrough spreadsheet with its three plans and the two-by-two network grid (Lesson 5.1); the Paycheck Protection Chart with its three elimination-period timelines and definitions box (Lesson 5.2); the Medicare Map and the pocket ADL trigger card (Lesson 5.3); the Provisions Wall Chart with the claims clock and renewability ladder (Lesson 5.4); and the four-page Harper Hardware benefits booklet (Lesson 5.5). Open the section with a one-page cover sheet written for an imaginary first client: three short paragraphs explaining, in your own words, what health insurance shares and caps, what it deliberately leaves to the family (elimination periods, custodial care, limited policies), and why an agent who quotes the gaps out loud — citing the Samaritan's two pence and Galatians 6:2 — is worth trusting with the rest.

LOOK FOR	WHAT IT MEANS
Big Bill Walkthrough	All three plan columns compute correctly (deductible, coinsurance, cap), patient plus insurer totals reconcile to the bill, and the network grid sorts HMO, PPO, EPO and POS by gatekeeper and out-of-network rules without error.
Paycheck Protection Chart	Benefit range computed at 60–70%, all three timelines show the correct accrual start and first-check date in arrears, and the taxation footnote states the employer-paid versus self-paid rule correctly.
Medicare Map and trigger card	The four parts, Medigap and Medicaid are placed and described accurately, two current-year figures are penciled in with their source and year, and the card lists all six ADLs with the 2-of-6-or-cognitive trigger and the custodial-care warning.
Provisions Wall Chart	All twelve mandatory provisions appear with correct time limits, the claims clock reads 20–15–90–60–3, the mandatory/optional columns are sorted by whom each protects, and the renewability ladder states the premium rule at the top two rungs.
Benefits booklet	COBRA numbers (20, 18, 36, 102, 60), HSA eligibility and the triple tax advantage, the AD&D schedule, and the limited-policy labeling are all stated accurately in plain English a new employee could follow.

LOOK FOR	WHAT IT MEANS
Cover sheet and reflection	Explains cost sharing, the deliberate gaps and the agent's honest role in the student's own words, uses the unit's Scripture honestly rather than decoratively, and is dated and signed.

UNIT 6

Property Insurance: The Home

At 5:12 on the morning of April 18, 1906, the ground under San Francisco tore open, and the fires that followed burned for three days. When the smoke cleared, the city's families discovered that the fine print in their policies was now the most important writing in their lives — some insurers paid every dollar they had promised, and some did not. This unit teaches you to read that fine print before the fire. You will learn the grammar of all property insurance: the difference between a **peril** and a **hazard**, between **named-peril** and **open-peril** coverage, between a **direct loss** and the quieter **indirect loss** that follows it. You will master the three ways a policy prices a ruined roof — **actual cash value**, **replacement cost** and **agreed value** — and the **coinsurance formula** that punishes the family who insured a $300,000 house for half its worth.

Then you will walk through the most common policy an agent ever sells: the **homeowners policy**, with its property coverages A through D on one side and its liability coverages E and F on the other, and the famous gaps — flood and earthquake — that every agent must explain or answer for. You will meet the forms for everyone the standard policy leaves out: the landlord's **dwelling policy**, the **HO-4** for renters (likely the first policy you will ever buy yourself) and the **HO-6** for condominium owners. The unit ends where the promise is kept or broken: the claim — the insured's duties after a loss, the three kinds of adjusters, the appraisal clause, the **pro-rata** sharing of a loss between two insurers, and **subrogation**, the insurer's right to stand in your shoes. This is the most mathematical unit in the course; keep your calculator beside your notebook.

PREREQUISITES

- Can compute percents of large numbers quickly (10% of $280,000, 80% of $350,000) with and without a calculator
- Can state the principle of indemnity and define insurable interest from Unit 2
- Can explain what a deductible does and why it lowers a premium, from Units 1 and 5
- Has the exam notebook current, with the Unit 2 contract vocabulary (conditions, exclusions, endorsements) ready for review

MASTERY CHECKLIST

- ☐ I can define peril and hazard, tell named-peril from open-peril coverage, and say who bears the burden of proof under each.
- ☐ I can compute actual cash value as replacement cost minus depreciation, and apply the coinsurance formula with a deductible, capped at the policy limit.
- ☐ I can name the homeowners forms HO-2, HO-3, HO-5 and HO-8 and state how each treats the dwelling and the contents.
- ☐ I can compute Coverages B, C and D from Coverage A using the common percentages, and apply the special limits on money, jewelry and firearms.
- ☐ I can explain Coverage E and Coverage F, including why defense costs are paid in addition to the limit and why Coverage F pays without fault.
- ☐ I can name the great exclusions — flood and earth movement — and explain how the NFIP and an earthquake endorsement fill them.
- ☐ I can match a landlord, a renter and a condominium owner to the DP-3, HO-4 and HO-6, and state what each form covers.
- ☐ I can list the insured's duties after a loss, tell the three kinds of adjusters apart, compute a pro-rata

share, and explain subrogation and the appraisal clause.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Texas Department of Insurance: Homeowners Insurance Guide**: Free, official. A state insurance department explains homeowners coverage, named exclusions and claims in plain consumer language. Read it with Lessons 6.2 and 6.3, and compare it with your own state department's guide. Ages 15 and up.
- **Wisconsin OCI: Consumer's Guide to Homeowners Insurance**: Free, official. A second state's view of the same policy — useful proof that the forms are national but the details are state by state. Skim it with Lesson 6.4 for its renters and condominium pages. Ages 15 and up.
- **FloodSmart.gov — the National Flood Insurance Program**: Free, official. FEMA's consumer site for the NFIP: what flood insurance covers, what it costs and how the waiting period works. Use it during Lesson 6.3's project to build your flood fact sheet. Ages 14 and up.
- **Insurance Information Institute: How to File a Homeowners Claim**: Free. The industry's own consumer institute walks through notice, inventory, the adjuster's visit and the settlement check. Read it with Lesson 6.5 before you build your pretend claim file. Ages 14 and up.
- **Insurance Information Institute: Facts and Statistics on Homeowners and Renters Insurance**: Free. Real national figures on premiums, claim frequency and the most common causes of home losses. Dip in during Lesson 6.4 to see how few renters carry the inexpensive policy that would save them. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

6.1 Perils, Hazards and the Price of a Loss: ACV, Replacement Cost and Coinsurance

3 sessions of 50 minutes

6.2 The Homeowners Policy: Dwelling and Belongings — 3 sessions of 50 minutes

6.3 The Homeowners Policy: Liability and the Gaps — 3 sessions of 50 minutes

6.4 **Dwelling, Renters and Condominium Policies** 3 sessions of 50 minutes

6.5 **After the Fire: Claims, Adjusters and Subrogation** 3 sessions of 50 minutes

Unit 6 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example” or “commonly,” use the figures given — real limits, percentages and waiting periods vary by state, form and year, and the live ones are checked at your state insurance department and floodsmart.gov. A state licensing exam passes at 70% — 14 of 20 here — but aim well higher. Choose the one BEST answer, and keep a calculator handy: this unit's test does arithmetic.

1. **5 pts**

   Icy front steps that make a slip-and-fall more likely are BEST described as a:

   A. Peril

   B. Physical hazard

   C. Morale hazard

   D. Direct loss

2. **5 pts**

   Under an open-peril (special form) policy, a claim may be denied only if:

   A. The insurer proves an exclusion applies

   B. The insured fails to prove a listed peril caused the loss

   C. The loss was partial rather than total

   D. The property was personal rather than real

3. 5 pts

A 6-year-old sofa is destroyed by a covered fire. A new like-kind sofa costs $3,000 , and sofas last about 12 years. Ignoring the deductible, the actual cash value settlement is:

A. $3,000

B. $2,500

C. $1,500

D. $500

4. 5 pts

A building worth $500,000 at the time of loss is insured for $300,000 under a policy with an 80% coinsurance clause and a $1,000 deductible. A covered loss of $60,000 occurs. The insurer pays:

A. $60,000

B. $59,000

C. $45,000

D. $44,000

5. 5 pts

The same underinsured building ($300,000 limit, 80% coinsurance, $500,000 value) burns to the ground — a total loss. Ignoring the deductible, the insurer pays:

A. $500,000

B. $300,000

C. $375,000

D. $240,000

6. 5 pts

After a covered kitchen fire, a family pays for a rental apartment during repairs. The apartment cost is an example of:

A. Direct loss, covered under Coverage A

B. Direct loss, covered under Coverage C

C. Indirect loss, covered under Coverage D

D. An excluded consequential loss

7. 5 pts

On an HO-3 special form, coverage is:

A. Open peril on the dwelling and other structures, named peril on personal property

B. Named peril on the dwelling, open peril on personal property

C. Open peril on both dwelling and personal property

D. Named peril on both dwelling and personal property

8. 5 pts

A homeowners policy carries Coverage A of $350,000. Using the common percentages, the limit for Coverage B — Other Structures is:

A. $17,500

B. $35,000

C. $70,000

D. $105,000

9. 5 pts

A burglar steals $600 in cash and a $5,000 diamond ring from an insured home. Under an unendorsed homeowners form with common special limits, the policy pays at most:

A. $5,600

B. $5,200

C. $2,100

D. $1,700

10. 5 pts

A covered loss forces a family out for three months. Normal living costs are $3,000 a month; costs while displaced are $4,100 a month. Coverage D pays:

A. $3,300

B. $12,300

C. $9,000

D. $21,300

11. 5 pts

An insured with $100,000 of Coverage E is sued after a guest's fall; the insurer spends $30,000 on defense and pays a $100,000 judgment. Which statement is TRUE?

A. The insurer pays $100,000 total, because defense costs erode the limit

B. The insured must reimburse the defense costs

C. The insurer pays $130,000 total, because defense is in addition to the limit

D. The claim exceeds the policy and is wholly denied

12. 5 pts

Coverage F — Medical Payments to Others pays:

A. Only when the insured is legally liable

B. Small medical bills of injured non-residents without regard to fault

C. The insured family's own medical bills after a covered loss

D. Funeral benefits for any injured person up to $100,000

13. 5 pts

During a hurricane, wind tears a hole in the roof and rain pours in; storm surge also fills the basement. Under an unendorsed HO-3:

A. Both losses are covered

B. Both losses are excluded

C. The basement is covered; the roof and rain are excluded

D. The roof and rain damage are covered; the basement flood is excluded

14. 5 pts

Which statement about the National Flood Insurance Program is TRUE as taught, with figures as common examples?

A. Created by the National Flood Insurance Act of 1968, run by FEMA, commonly $250,000/$100,000 maximum limits and a 30-day waiting period

B. Created after the 1906 earthquake and run by the states

C. A private program with unlimited building coverage and no waiting period

D. Automatic coverage included in every homeowners policy

15. 5 pts

The HO-4 contents broad form provides a tenant with:

A. Dwelling coverage, contents coverage and liability

B. Contents coverage only, with no liability

C. Contents coverage, loss of use and full Section II liability — but no dwelling coverage

D. Liability coverage only

16. 5 pts

Hail damage to a condominium's common roof exceeds the association's master policy, and each unit owner is assessed $1,800. The HO-6 coverage designed for this is:

A. Coverage B — Other Structures

B. Loss assessment coverage, commonly $1,000 built in and raised by endorsement

C. Fair rental value

D. The personal articles floater

17. 5 pts

The standard dwelling policy forms (DP-1, DP-2, DP-3) are notable for EXCLUDING which two coverages unless added?

A. Fire and windstorm

B. Loss of rents and vandalism

C. Replacement cost and extended coverage

D. Theft and personal liability

18. 5 pts

The ONLY adjuster who represents the policyholder rather than the insurer is the:

A. Public adjuster

B. Independent adjuster

C. Staff adjuster

D. Umpire

19. 5 pts

A covered $40,000 loss is insured under two policies: $150,000 with Insurer A and $50,000 with Insurer B. Under pro-rata liability, Insurer A pays:

A. $40,000

B. $20,000

C. $30,000

D. $10,000

20. 5 pts

After an insurer pays a fire claim caused by a careless contractor, the insured signs the contractor's $500 “full release of all claims.” The insured has:

A. Exercised the right of salvage

B. Properly abandoned the property

C. Triggered the appraisal clause

D. Impaired the insurer's subrogation rights, jeopardizing the claim

ANSWER KEY

1. B. A hazard is a condition increasing the chance or severity of loss, and ice is a physical one; the peril would be the fall itself as a cause of injury. Morale hazard is carelessness bred by being insured.
2. A. Open-peril coverage reverses the burden of proof: all direct physical loss is covered unless the insurer points to an exclusion. B states the named-peril rule — the classic swap the exam loves.
3. C. Depreciation is $\frac{6}{12} \times \$3{,}000 = \$1{,}500$, and ACV is replacement cost minus depreciation: $\$3{,}000 - \$1{,}500 = \$1{,}500$. A is the replacement-cost answer, not ACV.
4. D. Should: $0.80 \times \$500{,}000 = \$400{,}000$; did over should is $\$300{,}000 / \$400{,}000 = 0.75$; then $0.75 \times \$60{,}000 - \$1{,}000 = \$44{,}000$. C forgets the deductible; B forgets the coinsurance penalty.
5. B. The policy never pays more than its limit, and at a total loss the limit governs — the coinsurance formula's $375,000 (C) is capped. The penalty genuinely bites only on partial losses.
6. C. Loss of use is the textbook indirect (consequential) loss, and the homeowners policy covers it under Coverage D — commonly 30% of Coverage A on an HO-3, paying expenses above the family's normal cost of living.
7. A. The HO-3's signature split. C describes the HO-5 comprehensive form and D the HO-2 broad form; B reverses the HO-3 and exists on no standard form.
8. B. Coverage B is commonly 10% of Coverage A — $0.10 \times \$350{,}000 = \$35{,}000$ — as additional insurance for detached structures. C is the 20% figure of no standard coverage; D is Coverage D's common 30%.
9. D. Money is commonly capped at $200 and theft of jewelry at $1,500: $\$200 + \$1{,}500 = \$1{,}700$. The cure for the ring was a scheduled personal property floater, which would have carried its appraised value.
10. A. Coverage D pays the increase over normal living expense: $(\$4{,}100 - \$3{,}000) \times 3 = \$3{,}300$. B pays the whole displaced cost and D adds both — the family would have eaten and housed itself anyway.
11. C. Defense costs are paid in addition to the Coverage E limit, so the insurer pays the full judgment plus the lawyers. A states the trap; nothing requires reimbursement (B), and limits cap payment, not coverage (D).
12. B. Coverage F is the small no-fault goodwill coverage — commonly $1,000 to $5,000 per person — for guests and others, never for insureds or regular

residents. A describes Coverage E.

13. D. Wind is a covered peril and the rain entering through the wind-made opening follows the covered chain; rising surface water is flood, excluded and insurable only through the NFIP or a private flood policy.
14. A. Congress created the NFIP in 1968 after Hurricane Betsy exposed the flood gap; FEMA administers it, with commonly $250,000 building and $100,000 contents maximums and a 30-day wait (loan closings excepted). Verify live figures at floodsmart.gov.
15. C. The renter owns no building, so Coverages A and B are omitted; the form keeps personal property, loss of use (commonly 30% of C) and Coverages E and F. The landlord's policy never covers the tenant's goods.
16. B. Loss assessment pays the unit owner's share of an assessment arising from a covered loss to common property that outruns the master policy. Assessments for maintenance are never covered; C belongs to the dwelling program and D to valuables.
17. D. The dwelling program insures the building (and optionally contents) for landlords and non-owner-occupants, but standard forms carry no theft coverage and no liability — both added by endorsement or separate policies. Fair rental value, by contrast, is a dwelling-program feature.
18. A. The public adjuster is hired by the insured, commonly for a percentage of the settlement. The independent adjuster is a contractor for insurers — the exam's favorite distractor — the staff adjuster is the insurer's employee, and the umpire decides appraisal amounts for neither side.
19. C. Total limits are $200,000, and A's share is $\frac{150}{200} \times \$40{,}000 = \$30{,}000$; B pays the remaining $10,000. Each insurer pays the proportion its limit bears to all limits, and the insured collects the loss exactly once.
20. D. Payment transferred the claim against the wrongdoer to the insurer, and the policy forbids the insured to impair that right — a private release does exactly that. Salvage is the insurer's option over paid-for property, and abandonment is never the insured's right.

PORTFOLIO PIECE: MY PATHWAY FILE — THE PROPERTY PAGES

Assemble the property-insurance section of your Pathway File: the settlement calculator with its ACV and coinsurance panels tested against the lesson examples (6.1), the Whitfield house coverage map with Coverages A–D, the special-limits table and your two endorsement recommendations (6.2), the gap sheet with its seven gaps and cures plus the dated flood fact sheet from floodsmart.gov (6.3), the Four Doors chart matching the DP-3, HO-4, HO-6 and HO-8 to their households (6.4), and the complete pretend claim file — notice, inventory excerpt, proof-of-loss summary, pro-rata worksheet and subrogation memo — together with the real one-room home inventory you built for your own family (6.5).

Close the section with a one-page cover memo to a pretend first client: in your own words, explain why insuring to value is honest arithmetic rather than salesmanship, name the two gaps — flood and liability above the limits — you will always raise unasked, and quote Exodus 22:6 on who, in the end, makes restitution. Date every page. These artifacts return in Unit 8, when the same grammar goes to work on Main Street's commercial risks.

LOOK FOR	WHAT IT MEANS
Settlement calculator	The ACV and coinsurance panels reproduce the lesson's worked examples exactly ($12,000; $29,500; $240,000), both caps work, and each cap carries a one-line reason for its existence.
Whitfield coverage map	Coverages B, C and D are computed correctly from Coverage A with the common percentages labeled as examples, the special limits are applied to the cash, ring and firearm, and both endorsement recommendations state honest costs and benefits.
Gap sheet and flood facts	All seven gaps are paired with their named cures, and every flood figure is dated and traceable to floodsmart.gov.
Four Doors chart	Each household is matched to the right form — DP-3, HO-4, HO-6, HO-8 — with its signature feature (fair rental value; no A or B; walls-in plus loss assessment; modified settlement) stated in one line.
Claim file and home inventory	The six duties after loss appear in order, the pro-rata worksheet's shares sum exactly to the loss, the subrogation memo names the one thing never to sign, and the real one-room inventory is complete with its off-site storage note.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it names both always-raise gaps — flood and liability above the limits — and connects insuring to value and Exodus 22:6's restitution to honest dealing without canned language.

UNIT 6 · PROPERTY INSURANCE: THE HOME · LESSON 6.1 OF 50 · 3 SESSIONS OF 50 MINUTES

6.1 Perils, Hazards and the Price of a Loss: ACV, Replacement Cost and Coinsurance

OBJECTIVES

- Define peril and hazard, and classify hazards as physical, moral or morale.
- Contrast named-peril and open-peril (special form) coverage and state who bears the burden of proof under each.
- Distinguish direct loss from indirect (consequential) loss with examples.
- Compute actual cash value as replacement cost minus depreciation, and contrast it with replacement cost and agreed value settlement.
- Apply the coinsurance formula — did insure over should insure, times the loss, minus the deductible, capped at the limit — to exam-style problems.

> **Warm-up.** Your family's television cost $800 new five years ago, and televisions last about ten years. A new one like it costs $1,000 today. In five minutes, write down what you think an insurer should fairly pay if it is destroyed — and one sentence defending your number. Keep the paper; by the end of this lesson you will be able to name your answer.

WATCH

Coinsurance on Homeowners Policies-How to do the math for the Insurance Exam

Insurance Exam Queen · 7:21

https://www.youtube.com/watch?v=9cMCURBfJqY

> **WHEN TO WATCH**
> Watch after the core ideas, with pencil out; pause at each step of the did-over-should fraction and work the example yourself before she finishes it.

BACKUP VIDEO

How To Get Your Insurance License: Loss Valuation - Replacement and Actual Cash Value, Agreed Value

Morton Schools · 13:13

https://www.youtube.com/watch?v=ivob9L4erpo

A second pass through the three settlement bases — ACV, replacement cost and agreed value — watch it before the project if the valuation panel of your calculator feels shaky.

KEY TERMS

peril

The cause of a loss — fire, lightning, windstorm, hail, theft, explosion.

hazard

A condition that increases the likelihood or severity of a loss from a peril — oily rags by the furnace, a fraudulent heart, a careless habit.

named-peril coverage

Coverage only for the perils listed in the policy; the insured must prove the loss was caused by a listed peril.

open-peril (special form) coverage

Coverage for all causes of direct physical loss except those excluded; the insurer must prove an exclusion applies to deny the claim.

direct loss

Physical damage to property from a peril, including damage from the proximate chain the peril sets off, such as smoke and water used to fight a fire.

indirect (consequential) loss

A loss of use, income or extra expense that follows a direct loss — the hotel bills while the burned kitchen is rebuilt.

actual cash value (ACV)

Replacement cost minus depreciation — the depreciated worth of the property at the time of loss, the purest expression of indemnity.

replacement cost

The cost to repair or replace damaged property with new materials of like kind and quality, with no deduction for depreciation.

agreed value

A settlement basis under which insurer and insured agree on the property's value when the policy is written and that amount is paid at a total loss — used for antiques, fine arts and other hard-to-price property.

coinsurance clause

A condition requiring the insured to carry at least a stated percentage of the property's value — commonly 80% — or share proportionally in any partial loss.

insurance to value

Carrying a limit at or near the property's full insurable value, so that partial losses are paid in full and the premium fairly matches the exposure.

depreciation

The loss of value from age, wear and obsolescence, often estimated as the property's age divided by its useful life, times its replacement cost.

CORE IDEAS

The story. At 5:12 a.m. on April 18, 1906, an earthquake of magnitude about 7.9 broke the streets of San Francisco, and the fires it loosed — from toppled stoves, cut gas lines and even a pot of ham and eggs on Hayes Street — burned for three days. Some 28,000 buildings and over four square miles of the city were destroyed. Then came the second drama, quieter and longer: the claims. More than a hundred insurance companies owed San Francisco roughly $235 million — several billions in today's money — and the world watched to see who would pay. Many policies excluded earthquake; the fire had done most of the destroying; whose peril was it? A number of insurers failed outright, and others bargained claims down — San Franciscans

scorned the “six-bit companies” that offered seventy-five cents on the dollar. But the Lloyd's underwriter Cuthbert Heath cabled his San Francisco agent a sentence still quoted in the industry: pay all policyholders in full, irrespective of the terms of their policies. Companies that paid in full earned decades of business; companies that did not were remembered just as long. Every idea in this lesson — which perils are covered, what a loss is worth, how much insurance is enough — was tested in those ashes.

How they figured it out. The 1906 disaster forced the industry to say precisely what it had promised. First: a policy does not insure property so much as it insures property *against causes of loss*, and so the causes had to be named and defined. The industry settled on a careful word, **peril** — the cause itself, fire or wind or theft — and distinguished it from **hazard**, any condition that makes a peril more likely or more severe. Second: when fire follows earthquake, which cause governs? American courts answered with the doctrine of **proximate cause**: trace the unbroken chain back to the peril that started it, and if a covered peril stands at the head of the chain, the loss that flows from it is covered. After 1906, insurers rewrote their forms to say exactly how fire following earthquake would be treated — and legislatures and underwriters alike learned that vague promises are the most expensive kind. Third: the industry learned to put the *value question* in writing before the loss, because afterward is too late for honest agreement. The settlement clauses you will learn in this lesson — actual cash value, replacement cost, agreed value — are the industry's standing answers to the question San Francisco asked all at once.

The big idea. Property coverage comes in two grammars. A **named-peril** form lists its perils — fire, lightning, windstorm and hail, explosion, riot, aircraft, vehicles, smoke, vandalism, theft and so on — and covers nothing else; the burden of proof sits on the *insured*, who must show the loss came from a listed peril. An **open-peril** form — the exam also says “special form” or the older “all-risk” — reverses the grammar: it covers all causes of direct physical loss *except* those excluded, and the burden of proof shifts to the *insurer*, which must point to an exclusion to deny. That burden shift is the whole practical difference, and the exam loves it. Cross it with the second distinction: a **direct loss** is physical damage to the property itself, while an **indirect loss** — also called consequential — is the cost that follows, such as the apartment rent while the house is rebuilt or the landlord's lost rents. Property

forms insure direct loss first and add specific indirect coverages, such as loss of use, by name.

Now the price of a loss. The oldest answer is **actual cash value**: replacement cost minus depreciation. Your five-year-old television with a ten-year life has used up half its usefulness; if a new one costs \$1,000, its ACV is $\$1{,}000 - \$500 = \$500$. ACV is indemnity in its purest form — it restores what you actually lost, an aging television, not a new one. But families cannot buy half-used televisions or five-year-old roofs, so insurers sell **replacement cost** coverage: the cost to repair or replace with new materials of like kind and quality, no deduction for depreciation, in exchange for a higher premium. Replacement cost settlement commonly requires the insured actually to repair or replace, and insurers often pay ACV first and the depreciation holdback after the work is done. Third, for property with no store price — a grandfather's violin, a painting — insurer and insured can set an **agreed value** when the policy is written, and that amount is paid at total loss, no argument afterward. Some states go further with valued-policy laws that require the face amount to be paid on a total fire loss; know that they exist and check your state.

Insurers can afford replacement-cost promises only if homeowners insure most of the home's value, because premiums are charged on the limit while most losses are partial. If everyone insured only the first \$50,000 of a \$300,000 house — the slice where nearly all losses fall — the rate for everyone would have to soar. The industry's cure is the **coinsurance clause**: carry at least a stated percentage of the property's value, commonly 80%, or become a co-insurer of your own partial losses. The formula the exam tests without mercy: $\text{payment} = \dfrac{\text{did}}{\text{should}} \times \text{loss} - \text{deductible}$, where “did” is the limit you carried and “should” is the required percentage times the property's value at the time of loss. The payment is also capped twice: never more than the actual loss, and never more than the policy limit. Homeowners forms apply the same idea to the dwelling: insure it to at least 80% of replacement cost and partial losses are settled at full replacement cost; fall short and the settlement drops toward the formula or ACV, whichever is greater.

Walk one through, slowly. A warehouse is worth \$500,000, in this example, and its policy carries an 80% coinsurance clause, so the owner *should* insure $0.80 \times \$500{,}000 = \$400{,}000$. He bought only \$300,000. A fire does \$80,000 of damage, and the deductible is \$1,000. The fraction is $\$300{,}000 / \$400{,}000 = 0.75$; the formula pays

$0.75 \times \$80{,}000 - \$1{,}000 = \$59{,}000$. The owner absorbs $21,000 for having underinsured — that is the coinsurance *penalty*, and notice it bites only on *partial* losses; at a total loss the policy simply pays its limit and the formula never exceeds it. One habit will save you on exam day: always compute "should" from the property's value *at the time of loss*, never from the limit, never from the loss. And one word of the trade: an insured who carries the full required amount has met **insurance to value**, the quiet discipline behind every fair property rate.

On the exam today. State exams open the property section exactly here. Expect a definition pair — peril versus hazard — with hazard subdivided into physical (the icy steps), moral (the dishonest insured who would burn for the money) and morale (the careless one who leaves doors unlocked because "insurance will pay"). Expect the burden-of-proof question: named peril, insured proves; open peril, insurer proves. Expect at least one ACV computation — replacement cost minus depreciation, with depreciation figured as age over useful life — and at least one full coinsurance problem with a deductible. The traps are standard: computing "should" from the policy limit instead of the property value; forgetting to subtract the deductible; applying a coinsurance penalty to a total loss; and calling the hotel bill after a fire a direct loss, when loss of use is the textbook indirect loss. Watch also for "which settlement basis pays with no deduction for depreciation" — replacement cost — and "which basis is set before the loss for hard-to-value property" — agreed value.

PICTURE STUDY



San Francisco in Ruins, George R. Lawrence, May 28, 1906 · Panoramic kite photograph · Library of Congress, Washington, D.C.

Image: Wikimedia Commons, public domain

George R. Lawrence was a Chicago photographer whose motto was "the hitherto impossible in photography is our specialty." Six weeks after the earthquake, he flew a 49-pound camera on a train of seventeen kites two thousand feet above San Francisco Bay — his "captive airship" — and tripped the shutter by a wire. The single enormous negative sold so many prints that it earned him a fortune, because the whole world wanted to see what the city's families and their insurers now had to price: a ruined city, block by block, loss by loss. It opens this lesson because every idea in it — peril, proof, value — begins with looking honestly at the damage.

Look closely

- Trace the straight streets through the ruins. The fire respected the street grid but almost nothing else — notice how few roofs remain between the avenues.
- Find the stone shells still standing. Fire is a peril that consumes wood and spares masonry walls; an adjuster reading this photograph would price those blocks differently.
- Look at the ships tied calmly at the piers in the foreground. The waterfront survived — partly because firefighters pumped bay water when the mains broke.
- Find the unburned district far to the left. A boundary line runs through the photograph: on one side total loss, on the other none. Chance, wind and

dynamited firebreaks drew it.

Talk about it

1. An insurer in 1906 had promised to pay for fire but not earthquake. Looking at this photograph, why was that distinction so hard — and so important — to apply?
2. If two neighbors owned identical ruined houses but one had insured for half its value, how would their recoveries differ under the clauses you learned today?
3. Companies that paid in full here were trusted for generations; the “six-bit” companies were not. What does Proverbs call a good name worth, and what did it cost an insurer in 1906 to keep one?

PROJECT

The Settlement Calculator

You will build the spreadsheet an adjuster carries in his head: one page that takes any property loss and prices it three ways — ACV, replacement cost and the coinsurance formula. This calculator returns in Lesson 6.5 and again in the commercial lines of Unit 8, so build it cleanly and label everything.

You will need

- Free spreadsheet software (Google Sheets or LibreOffice Calc)
- Your exam notebook and a pencil for checking the spreadsheet by hand
- This lesson's formulas and worked examples

Steps

1. Make an ACV panel with inputs for replacement cost, age and useful life; compute depreciation as age ÷ life × replacement cost, then ACV as replacement cost − depreciation.
2. Test it on the warm-up television ($1,000 new, 5 of 10 years used) — it must return $500 — and on the worked-example roof, which must return $12,000.
3. Make a coinsurance panel with inputs for property value at time of loss, coinsurance percentage, limit carried, loss and deductible.
4. Compute “should” as percentage × value, the fraction as carried ÷ should (capped at 1, since carrying more than required earns no bonus), then payment as fraction × loss − deductible.
5. Add the two caps with MIN functions: never more than the loss minus the deductible, never more than the limit. Write a one-line comment beside each cap saying why it exists.
6. Test against both worked examples: the partial loss must return $29,500 and the total loss $240,000.
7. Now insure a pretend house: pick a value, deliberately underinsure it at 60% of the requirement, and run losses of $10,000, $50,000 and total. Write three sentences below the table on what underinsuring actually cost at each size of loss.

8. Print or copy the page into your Pathway File, dated and titled “The Price of a Loss.”

EXAM NOTEBOOK

1. Make flashcards for every key term in this lesson, with peril/hazard and named-peril/open-peril as paired cards — front: the term; back: the one-line definition plus who bears the burden of proof.
2. Draw a two-branch tree: DIRECT LOSS (the burned kitchen) and INDIRECT LOSS (the hotel bills, the lost rents), with three examples on each branch.
3. Write a five-line trap list titled “Coinsurance,” ending with: SHOULD comes from the property's VALUE at the time of loss — never from the limit, never from the loss.

KEY FORMULAS

$$\text{ACV} = \text{replacement cost} - \text{depreciation}$$

$$\text{depreciation} = \frac{\text{age}}{\text{useful life}} \times \text{replacement cost}$$

$$\text{coinsurance payment} = \frac{\text{amount carried (did)}}{\text{amount required (should)}} \times \text{loss} - \text{deductible}$$

$$\text{amount required} = \text{coinsurance \%} \times \text{property value at time of loss}$$

From history. San Francisco's recovery became its own advertisement. Insurance money — roughly $235 million of it, the largest payout the industry had then known — poured into reconstruction, and within nine years the rebuilt city hosted the Panama-Pacific International Exposition of 1915 to prove it. Underwriters drew their own lesson: after 1906, fire policies nationwide gained carefully drafted earthquake and “fire following” language, and the modern science of catastrophe exposure — how much of one city should any single insurer carry? — dates from that hard schooling.

WORKED EXAMPLES

Example 1. A hailstorm destroys a roof that cost $24,000 to install 12 years ago. A new roof of like kind costs $30,000 today, and roofs of this type last about 20 years. In this example, what does an ACV policy pay (ignore the deductible), and what would a replacement-cost policy pay?

Show solution

1. Depreciation runs on today's replacement cost, not the old purchase price: $\frac{12}{20} \times \$30{,}000 = \$18{,}000$.
2. ACV = replacement cost − depreciation: $\$30{,}000 - \$18{,}000 = \$12{,}000$.
3. A replacement-cost policy pays the full $30,000 — no deduction for depreciation — commonly after the roof is actually replaced, with ACV advanced first and the holdback paid on completion.
4. Notice the gap: $18,000. That gap is exactly what the family buys when it pays the higher replacement-cost premium.

Answer: ACV pays $12,000; replacement cost pays $30,000. The 12-year-old roof had used up 60% of its life, and ACV makes the insured eat that depreciation.

Example 2. Exam style. A building worth \$400,000 at the time of loss is insured for \$240,000 under a policy with an 80% coinsurance clause and a \$500 deductible. Fire causes \$40,000 of damage. The insurer pays:

A. \$40,000

B. \$30,000

C. \$29,500

D. \$23,500

Show solution

1. Should: $0.80 \times \$400{,}000 = \$320{,}000$. Did: \$240,000.
2. Fraction: $\$240{,}000 / \$320{,}000 = 0.75$.
3. Apply to the loss: $0.75 \times \$40{,}000 = \$30{,}000$.
4. Subtract the deductible: $\$30{,}000 - \$500 = \$29{,}500$.
5. B is the trap for forgetting the deductible; A ignores coinsurance entirely; D divides by the building value instead of the required amount.

Answer: C. \$29,500 — did over should (0.75) times the loss, minus the deductible.

Example 3. Exam style. The same building, insured the same way, burns to the ground — a total loss of $400,000. Ignoring the deductible, the insurer pays:

A. $400,000

B. $320,000

C. $300,000

D. $240,000

Show solution

1. Run the formula first: $0.75 \times \$400{,}000 = \$300{,}000$.
2. Now apply the cap: the policy never pays more than its limit, $240,000.
3. So the formula's $300,000 is irrelevant — the limit governs. This is why examiners say the coinsurance penalty matters on partial losses: at total loss, the limit is the ceiling either way.
4. The insured's real penalty for underinsuring was paid in advance, in the form of a building worth $400,000 covered by only $240,000.

Answer: D. $240,000 — the policy limit caps every settlement, and a total loss simply exhausts it.

PRACTICE

1. Easy Fire is to peril as oily rags stored next to the furnace are to _____. Explain the difference in one sentence.

   Show answer

   Hazard. The peril is the cause of loss itself (fire); a hazard is a condition that makes the loss more likely or more severe (the rags).

2. Easy Under an open-peril (special form) policy, who must prove what before a claim is denied?

   Show answer

   The insurer must prove that an exclusion applies. Under a named-peril form the burden is reversed: the insured must prove a listed peril caused the loss.

3. **Easy** A couch cost $2,000 new, couches last about 10 years, and this one is 4 years old. A like-kind couch still costs $2,000. What is its actual cash value?

Show answer

Depreciation is $\frac{4}{10} \times \$2{,}000 = \$800$, so ACV is $\$2{,}000 - \$800 = \$1{,}200$.

4. **Medium** Which of the following is an indirect (consequential) loss?

A. Smoke damage to curtains during a kitchen fire

B. Water damage from the fire hoses

C. The family's motel bills while the kitchen is rebuilt

D. The burned cabinets themselves

Show answer

C. Loss of use follows the direct loss rather than being physical damage itself. A and B are direct losses too — smoke and water are part of the unbroken chain the covered fire began.

5. **Medium** A building valued at $250,000 carries an 80% coinsurance clause. The owner insures it for $200,000 and suffers a $60,000 loss with a $1,000 deductible. What is paid?

Show answer

Should is $0.80 \times \$250{,}000 = \$200{,}000$; did equals should, so the fraction is 1. Payment is $\$60{,}000 - \$1{,}000 = \$59{,}000$ — no penalty, because the insured met insurance to value.

6. **Medium** Which settlement basis pays the cost of new, like-kind property with no deduction for depreciation?

A. Actual cash value

B. Agreed value

C. Market value

D. Replacement cost

Show answer

D. Replacement cost waives depreciation in exchange for a higher premium. Agreed value (B) sets a fixed figure in advance for hard-to-price property; ACV (A) subtracts depreciation; market value is not a standard property settlement basis.

7. Medium Name the three classes of hazard and give an example of each in one line apiece.

Show answer

Physical — a condition of the property, like icy steps or frayed wiring; moral — dishonesty, like an insured willing to burn the building for the money; morale — carelessness bred by being insured, like leaving the house unlocked because “insurance will pay.”

8. Hard A building worth \$600,000 at the time of loss carries a 90% coinsurance clause and a \$500,000 limit. A storm causes \$108,000 of damage; the deductible is \$2,500. Compute the payment.

Show answer

Should: $0.90 \times \$600{,}000 = \$540{,}000$. Fraction: $\$500{,}000 / \$540{,}000 \approx 0.9259$. Payment: $0.9259 \times \$108{,}000 = \$100{,}000$, minus \$2,500 is \$97,500. Even a well-insured owner pays a small penalty when the clause is 90% and he carries a bit less.

9. Hard An insured carries 100% of the required coinsurance amount. A fire destroys the entire building. Why does the coinsurance clause not matter to this claim — for two separate reasons?

Show answer

First, the fraction is 1, so the formula pays the full loss regardless. Second, at a total loss the limit caps the payment anyway, and the formula can never pay beyond it — which is why the coinsurance penalty is said to bite only on partial losses by the underinsured.

10. Hard From the story: in 1906 many policies covered fire but excluded earthquake, and most of San Francisco burned rather than shook apart. Using the doctrine of proximate cause, explain why those claims were so bitterly disputed.

Show answer

Proximate cause traces the loss back along an unbroken chain to the peril that began it. Insurers argued the chain began with the excluded earthquake — which cut the gas lines and toppled the stoves — while insureds argued fire, a covered peril, actually consumed the property. The answer turned on policy wording and proof, which is why insurers rewrote their forms afterward to say exactly how fire following earthquake would be treated.

11. Challenge A family's agent recommends insuring their $350,000 house at $280,000, exactly 80% of value, “to save premium.” Two years later construction costs have risen and the house would cost $400,000 to rebuild; they suffer a $100,000 kitchen fire with a $1,000 deductible. Compute the payment and state the lesson about when “should” is measured.

Show answer

Should at the time of loss: $0.80 \times \$400{,}000 = \$320{,}000$. Fraction: $\$280{,}000/\$320{,}000 = 0.875$. Payment: $0.875 \times \$100{,}000 - \$1{,}000 = \$86{,}500$. Insurance to value is measured when the loss happens, not when the policy is bought — so limits must grow with construction costs, which is why insurers offer inflation-guard endorsements.

12. Challenge Write three sentences for a client who asks, “Why should I insure my whole house when a total loss almost never happens?” Use the words partial loss, coinsurance and rate.

Show answer

Most losses are partial, so if everyone insured only a slice of value, insurers would pay nearly the same claims while collecting premium on small limits, and the rate per hundred dollars would have to soar for everyone. The coinsurance clause keeps the bargain honest: carry at least 80% of value and your partial losses are paid in full; carry less and you share them. Insuring to value is not a trick to sell bigger policies — it is the arithmetic that keeps property insurance affordable and fair.

COMMON MISTAKES

- Computing the coinsurance “should” from the policy limit or the loss instead of from the property's value at the time of loss times the coinsurance percentage.
- Forgetting to subtract the deductible after applying the did-over-should fraction — the exam almost always offers the undeducted number as a tempting wrong choice.
- Applying a coinsurance penalty to a total loss; the limit caps the payment, and the penalty genuinely matters only on partial losses.
- Depreciating from the old purchase price instead of today's replacement cost when computing ACV.
- Calling smoke or fire-hose water damage indirect loss — both are direct, part of the covered peril's unbroken chain; loss of use is the classic indirect loss.
- Mixing up the burdens of proof: named peril, the insured proves a listed peril; open peril, the insurer proves an exclusion.

Make it a game · Did Over Should. One player is the underwriter and writes five property cards, each with a value, a coinsurance percentage, a limit carried, a loss and a deductible (keep the numbers round: values like $200,000, losses like $40,000). The other players race to compute the payment; first correct answer takes the card. Twist: two of the five cards must contain a trap — a total loss where the limit caps everything, or an insured who carried more than required (fraction capped at 1). Calling out the trap by name before solving earns a bonus point. Most cards after two rounds of dealing wins, and the loser reads the coinsurance formula aloud, twice.

Scripture. “For which of you, intending to build a tower, sitteth not down first, and counteth the cost, whether he have sufficient to finish it?” (Luke 14:28, KJV)

The Lord commends the builder who prices the whole work before laying a stone. Insurance to value is exactly that discipline: an honest count of what rebuilding would cost, made calmly in advance rather than desperately in the ashes. An agent who helps a family count the cost truly — not cheaply — is doing what this verse praises.

6.2 The Homeowners Policy: Dwelling and Belongings

OBJECTIVES

- State who is eligible for a homeowners policy and why the forms require an owner-occupant.
- Distinguish the HO-2, HO-3, HO-5 and HO-8 forms by how each treats the dwelling and the personal property.
- Define Coverages A, B, C and D and compute B, C and D from Coverage A using the common percentages.
- Apply the special limits on money, securities, watercraft, jewelry, firearms and silverware to claim scenarios.
- Explain how the replacement-cost endorsement changes the settlement of personal property.

> **Warm-up.** Set a timer for five minutes and list everything in your bedroom worth more than $50 — furniture, electronics, clothing, instruments, books. Total your estimate. Most people's lists stop embarrassingly short; keep yours, because in this lesson you will learn which coverage pays for all of it, and in Lesson 6.5 you will turn the list into a real home inventory.

WATCH

Pass the Homeowners Insurance Exam: Homeowner Coverages

Insurance Exam Queen · 6:31

https://www.youtube.com/watch?v=5_3_62nv_s4

> **WHEN TO WATCH**
> Watch after the big idea; each time she names a coverage letter, say its common percentage of Coverage A aloud before she does — B ten, C fifty, D thirty.

BACKUP VIDEO

Property & Casualty Exam Prep 17, Homeowners Forms HO-2, HO-3, HO-4, HO-5, HO-6, and HO-8

Open Exam Prep · 3:04

https://www.youtube.com/watch?v=YFRmULMNaHQ

A brisk three-minute drill on the form numbers; watch it right before the practice set and recite each form's dwelling and contents basis as it appears.

KEY TERMS

homeowners policy

A package policy for owner-occupants of one-to-four-family dwellings that combines property coverage (Section I) and personal liability coverage (Section II) in one contract.

HO-2 (broad form)

A homeowners form covering the dwelling and personal property against a list of named broad-form perils.

HO-3 (special form)

The most common homeowners form: open-peril coverage on the dwelling and other structures, named-peril (broad) coverage on personal property.

HO-5 (comprehensive form)

A homeowners form giving open-peril coverage on both the dwelling and the personal property.

HO-8 (modified coverage form)

A named-peril homeowners form for older homes whose replacement cost far exceeds market value; losses are commonly settled on a functional or market-value basis with limited theft coverage.

Coverage A — Dwelling

Covers the residence and structures attached to it, plus materials and supplies on site for its construction or repair.

Coverage B — Other Structures

Covers detached structures such as a garage, shed or fence, with a limit commonly 10% of Coverage A as additional insurance.

Coverage C — Personal Property

Covers the insured's belongings anywhere in the world, with a limit commonly 50% of Coverage A and special sublimits on certain classes of property.

Coverage D — Loss of Use

Pays additional living expenses and fair rental value when a covered loss makes the home unfit to live in; commonly 30% of Coverage A on an HO-3.

special (sub)limits

Dollar caps inside Coverage C on classes like money, securities, watercraft, theft of jewelry, theft of firearms and theft of silverware.

replacement-cost endorsement on contents

An endorsement changing personal-property settlement from actual cash value to replacement cost for a higher premium.

endorsement

A written amendment attached to a policy that adds, removes or changes coverage.

CORE IDEAS

The story. In September 1950, the Insurance Company of North America — the Philadelphia insurer founded in 1792, whose first policies had protected ships and whose fire marks had hung on colonial houses — introduced something no American family had seen before: a single **homeowners policy**. Before 1950, protecting one house meant a stack of separate contracts from separate companies: a fire policy here, a windstorm endorsement there, a theft policy from a casualty company, a

personal liability policy from a fourth — because state laws had long forced “fire” insurers and “casualty” insurers to stay in their own lanes. In the late 1940s the states passed multiple-line laws letting one insurer write both, and INA's underwriters saw the prize: package everything a homeowner needs into one policy, one premium, one renewal date — cheaper to sell, cheaper to buy, with no gaps where the separate policies failed to meet. The package sold spectacularly, competitors followed, and within a generation the homeowners policy became the most widely owned property contract in America. When you quote a family one policy that covers their house, their belongings, their hotel bills and their liability, you are selling INA's 1950 idea.

How they figured it out. A package needs a shared skeleton, or no agent could compare one company's policy with another's. The industry's answer was standard forms — numbered, lettered and eventually maintained for most insurers by the Insurance Services Office — so that “HO-3” means essentially the same promise everywhere. The skeleton has two halves. **Section I** is property: Coverage A for the dwelling, B for other structures, C for personal property, D for loss of use. **Section II** is liability: Coverage E for personal liability and F for medical payments to others — next lesson's subject. Eligibility guards the design: the homeowners forms are built for an **owner-occupant** of a one-to-four-family dwelling used principally as a residence. A landlord who lives elsewhere, a business operating out of the barn, a vacant flip — these break the assumptions the rates were built on and belong on other forms. The underwriting logic is worth saying aloud: people take better care of what they own and live in, and the package is priced on exactly that.

The big idea. The homeowners forms differ along one axis you already know: named peril versus open peril, applied separately to the buildings and the belongings. The **HO-2 broad form** covers both dwelling and contents against a list of named perils — fire, lightning, windstorm and hail, explosion, riot, aircraft, vehicles, smoke, vandalism, theft, falling objects, weight of ice and snow, accidental water discharge, freezing and more. The **HO-3 special form** — the standard answer to “what do most homeowners buy?” — covers the dwelling and other structures on an *open-peril* basis while keeping the *contents* on named perils. The **HO-5 comprehensive form** extends open-peril treatment to the contents as well, at a higher premium. And the **HO-8 modified form** serves the lovely old Victorian whose carved woodwork would cost far more to replace than the house would sell for: named perils, with settlement

commonly on a functional-replacement or market-value basis and tight theft limits, so the owner is made whole without creating a moral hazard — a house insured for triple its market value is a house someone might prefer burned.

Now the four property coverages, with the percentages the exam expects. **Coverage A — Dwelling** insures the house itself, structures attached to it (the attached garage, the deck) and building materials on site; the insured picks the limit, and everything else scales from it. **Coverage B — Other Structures** insures detached structures — garage, shed, fence, gazebo — commonly at 10% of A, as *additional* insurance, not carved out of A. A detached structure rented to a non-tenant or used for business is excluded. **Coverage C — Personal Property** insures the family's belongings *anywhere in the world* — the laptop stolen from a hotel in Rome is a Coverage C claim — commonly at 50% of A, with property usually kept at another residence limited to a slice of C. **Coverage D — Loss of Use** pays the extra cost of living elsewhere (and fair rental value of any rented portion) while a covered loss is repaired; commonly 30% of A on the modern HO-3. In this example: a house insured at $A = \$300{,}000$ commonly carries $B = \$30{,}000$, $C = \$150{,}000$ and $D = \$90{,}000$ — percentages vary by form and company, so read the declarations page.

Inside Coverage C live the **special limits**, and the exam tests them because clients misunderstand them. Certain classes of property are easy to steal, easy to overstate or properly the subject of their own insurance, so the form caps them. Common examples — label them examples, since editions differ: $200 on money and coin collections; $1,500 on securities and valuable papers; $1,500 on watercraft including trailers; $1,500 on *theft* of jewelry, watches and furs; $2,500 on *theft* of firearms; $2,500 on *theft* of silverware and goldware. Read the italics carefully: the jewelry, firearms and silverware caps apply to theft — a fire that melts the silver is paid as ordinary Coverage C property. A family whose ring collection is worth $20,000 cannot fix the gap by raising Coverage C; the cure is scheduling the items on a floater, which Lessons 6.3 and 6.4 introduce.

One more settlement distinction completes the picture. The dwelling under an HO-3 is settled at *replacement cost*, provided the insured carries a limit of at least 80% of the dwelling's replacement cost at the time of loss — the homeowners cousin of the coinsurance idea from Lesson 6.1; fall short and the settlement drops toward the proportional formula or ACV, whichever is greater. Personal property, by contrast, is settled at *actual cash value* under the unendorsed form — your five-year-old television

comes back as $500, not $1,000. For a modest additional premium, the **replacement-cost endorsement on contents** upgrades Coverage C to pay like-kind-new, usually requiring the insured actually to replace the item, with ACV advanced first. For most families this endorsement is the cheapest large improvement an agent can offer, and explaining it honestly — what it costs, what it changes, what it still will not do for the $20,000 ring — is a small daily exercise in the needs-based selling this course keeps preaching.

On the exam today. The homeowners section is dense with gift questions for the prepared. Know the forms cold: HO-2 named perils on everything; HO-3 open on dwelling, named on contents — the single most-asked distinction; HO-5 open on both; HO-8 for the old home settled on modified terms. Know eligibility: owner-occupant, one to four families. Expect arithmetic: given Coverage A, compute B, C or D with the common percentages, and expect the question to say “typically” or “in this example” because editions differ. Expect a special-limits scenario: a burglar takes $900 cash and a $6,000 watch — the exam wants $200 for the money and $1,500 for the watch, plus the observation that scheduling would have cured it. The traps: thinking Coverage B is carved out of A (it is additional); forgetting Coverage C follows the insured worldwide; applying theft sublimits to non-theft losses; and calling the HO-3's contents coverage open peril because the dwelling is. When a question says a family “rents out the detached garage to a neighbor for his business,” strike Coverage B and start thinking about other forms.

PICTURE STUDY



Interior with Women beside a Linen Chest, Pieter de Hooch, 1663 · Oil on canvas · Rijksmuseum, Amsterdam

Image: Wikimedia Commons, public domain

Pieter de Hooch painted the quiet wealth of the Dutch Golden Age not as treasure but as housekeeping: sunlight on a swept floor, linen counted and folded into the great chest that was often the most valuable piece of furniture a family owned. In 1663 a chest of fine linen represented years of saving, and households kept written inventories of it. This picture opens the lesson on Coverage C because it shows what "personal property" really is — not a percentage on a declarations page, but the accumulated, cared-for belongings of a particular family, worth listing before they are lost.

Look closely

- Find the linen chest and notice its size and carving — furniture built like architecture, meant to protect what it held for generations.
- Watch the two women counting the linen into the chest. An inventory is being kept; every careful household kept one, and Lesson 6.5 will ask you to do the same.
- Follow the light from the window across the marble floor and through the doorway — de Hooch builds the house room by room, the way Coverage A thinks of a dwelling.

- Find the child by the door. The house shelters people, not just property; next lesson adds the coverages that protect the family's responsibility to others.

Talk about it

1. If this household lost everything in a fire, which would be harder to prove: the house's value or the linen's? What does that suggest about Coverage C claims today?
2. The chest guards the linen, the house guards the chest, and insurance guards them all. Where should a family's real security rest, and where does Matthew 6 say treasure is safe?
3. The mistress and maid handle the goods together, carefully. What does faithful stewardship of ordinary things — linen, tools, savings — look like in your own house?

PROJECT

Insure the Maple Street House

You will write the Section I side of a homeowners quote for a pretend family — the Whitfields of 14 Maple Street — producing the one-page coverage map that anchors the property half of your Pathway File. Pretend family, pretend numbers; the skill is real.

You will need

- One sheet of paper or a spreadsheet page
- Your settlement calculator from Lesson 6.1
- This lesson's key terms and the special-limits list

Steps

1. Invent the facts: the Whitfields own and occupy a single-family house; give it a replacement cost between $250,000 and $400,000, a detached garage, and contents including $800 cash kept at home, a $5,000 ring and a $3,000 firearm.
2. Choose the form and defend it in one sentence: HO-3 for the standard case — open peril on the dwelling, named perils on the contents.
3. Set Coverage A at full replacement cost, and note beside it the 80% rule: why a limit below 80% would quietly change how partial losses settle.
4. Compute B, C and D with the common percentages (10%, 50%, 30%), labeling each “in this example.”
5. Build a special-limits table for the cash, the ring and the firearm: what an unendorsed policy would pay on theft of each, and what scheduling would do instead.
6. Recommend exactly two improvements — the replacement-cost endorsement on contents and scheduling the ring — and write one honest sentence per item on what each costs the family and what it buys.
7. Run one test claim through your Lesson 6.1 calculator: a $60,000 kitchen fire with a $1,000 deductible, dwelling insured to value. Show the settlement.

8. Date the page, title it “Section I — The Whitfield House,” and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for HO-2, HO-3, HO-5 and HO-8 — front: the form number; back: dwelling basis, contents basis, and the one family it fits best.
2. Draw the house map: a sketched house labeled A, a detached garage labeled B (10%), a pile of belongings labeled C (50%, worldwide) and a suitcase labeled D (30%, loss of use).
3. Write a trap list titled “Special limits are for THEFT (mostly),” listing the common caps for money, securities, watercraft, jewelry, firearms and silverware, each marked “example — read the form.”

KEY FORMULAS

$B \approx 0.10 \times A, \quad C \approx 0.50 \times A, \quad D \approx 0.30 \times A$ (common HO-3 percentages — check the form)

From history. Standard forms needed a standard keeper. For most of the twentieth century, rating bureaus in each state drafted policy language; in 1971 many of them merged into the Insurance Services Office (ISO), which has maintained the homeowners forms ever since — the reason an HO-3 in Ohio reads almost word for word like an HO-3 in Oregon. The familiar lettering, A through F, survives every revision: agents who learned the 1976 edition can still read the current one, and so can the examiners who write your test questions.

WORKED EXAMPLES

Example 1. A family insures its home on an HO-3 with Coverage A of $280,000. In this example, using the common percentages, what are the limits for Coverages B, C and D?

Show solution

1. Coverage B (other structures), commonly 10% of A:
   $0.10 \times \$280{,}000 = \$28{,}000$.
2. Coverage C (personal property), commonly 50% of A:
   $0.50 \times \$280{,}000 = \$140{,}000$.
3. Coverage D (loss of use), commonly 30% of A on an HO-3:
   $0.30 \times \$280{,}000 = \$84{,}000$.
4. Each of B, C and D is additional insurance alongside A, not a slice of it — the policy's total promise here is well above $280,000.

Answer: B $28,000, C $140,000, D $84,000 — all in addition to the $280,000 on the dwelling, and all “in this example,” since forms and companies vary.

Example 2. Exam style. A burglar breaks into an insured's home and takes $700 in cash, a watch appraised at $4,000 and a shotgun worth $3,200. Under an unendorsed homeowners form with common special limits, the MOST the policy pays for these items is:

A. $7,900

B. $4,200

C. $5,900

D. $200

Show solution

1. Apply each special limit separately. Money: capped at $200 (of the $700 taken).
2. Theft of jewelry and watches: capped at $1,500 (of the $4,000 watch).
3. Theft of firearms: capped at $2,500 (of the $3,200 shotgun).
4. Total: $\$200 + \$1{,}500 + \$2{,}500 = \$4{,}200$.
5. A ignores the sublimits; C mixes them up; D applies only the money cap. The cure the agent should have offered: schedule the watch and the gun on a floater.

Answer: B. $4,200 — $200 for money, $1,500 for theft of the watch, $2,500 for theft of the firearm, using common example limits.

Example 3. A kitchen fire makes a home unlivable for three months. The family's normal monthly costs are $3,400; living in a rented apartment while repairs run, their costs are $5,200 a month. What does Coverage D pay, and why not the full $5,200?

Show solution

1. Coverage D pays the *increase* in living expense, not the whole cost of living — the family would have fed and housed itself anyway.
2. Monthly increase: $\$5{,}200 - \$3{,}400 = \$1{,}800$.
3. Three months: $3 \times \$1{,}800 = \$5{,}400$, within the Coverage D limit.
4. Note the classification: the fire damage itself is the direct loss under Coverages A and C; these living expenses are the indirect loss — Coverage D is the homeowners form's built-in consequential coverage.

Answer: $5,400 — the additional living expense above the family's normal costs for the period of repair, a textbook indirect loss.

PRACTICE

1. Easy Who is eligible for a homeowners policy, and what two things does the policy package together?

   Show answer

   An owner-occupant of a one-to-four-family dwelling used principally as a residence. The policy packages property coverage (Section I, Coverages A–D) with personal liability coverage (Section II, Coverages E–F).

2. Easy On an HO-3, which property is covered open peril and which is covered named peril?

   Show answer

   The dwelling and other structures (A and B) are open peril; personal property (C) is named peril. The HO-5 extends open peril to the contents as well.

3. **Easy** Coverage A is $220,000. Using the common percentages, what is Coverage B?

Show answer

Commonly 10% of A: $0.10 \times \$220{,}000 = \$22{,}000$, as additional insurance for detached structures like a garage or fence.

4. **Medium** A student's laptop is stolen from her dorm room 400 miles from home. Her parents' homeowners policy is unendorsed. Is there coverage, and under which coverage part?

Show answer

Yes — Coverage C follows personal property anywhere in the world, so the laptop is covered (subject to the deductible and any away-from-premises percentage limit for property usually kept at another residence). Theft is a named peril on the HO-3's contents coverage.

5. **Medium** Which loss is NOT settled under Coverage B?

A. A windstorm flattens the detached garden shed
B. Fire damages the attached garage
C. A falling tree crushes the backyard fence
D. Hail damages the detached gazebo

Show answer

B. An attached garage is part of the dwelling and belongs to Coverage A. Coverage B exists for structures set apart from the dwelling — shed, fence, gazebo.

6. **Medium** A fire destroys a family's silverware worth $8,000 and a burglar later steals a coin collection worth $1,200. Using common special limits, what does the unendorsed policy pay for each, and why are the answers so different?

Show answer

The silverware burned, and the $2,500 cap applies only to theft of silverware — so the fire loss is ordinary Coverage C property, paid at ACV up to the limit. The coin collection falls under the money cap, commonly $200, regardless of its $1,200 value. The sublimits are peril-specific and class-specific; read both.

7. Medium Which family belongs on an HO-8?

A. A family in a new suburban house

B. A family in an 1890 Victorian whose replacement cost is triple its market value

C. A renter in an apartment

D. A condominium owner

Show answer

B. The HO-8 modified form serves older homes where full replacement-cost coverage would over-insure the market value and invite moral hazard; it uses named perils and commonly settles on a functional or market-value basis. C needs an HO-4 and D an HO-6 — next lessons.

8. Hard Coverage A is $320,000 and the family's detached workshop, valued at $45,000, burns down. The husband had been running a woodworking business from it, selling furniture. What two problems does the claim face?

Show answer

First, Coverage B is commonly only 10% of A — $32,000 — so even a covered loss is underinsured by $13,000. Second, and worse, Coverage B excludes structures used for business, so the claim may fail entirely. The honest cure was telling the agent about the business and insuring the exposure properly — a Unit 8 problem.

9. Hard A family carries Coverage A of $200,000 on a house whose replacement cost at the time of loss is $300,000. A kitchen fire does $30,000 of damage (replacement cost). Explain why the settlement will disappoint them even though $30,000 is far below their limit.

Show answer

The HO-3 pays full replacement cost on partial dwelling losses only if the limit is at least 80% of replacement cost — here $0.80 \times \$300{,}000 = \$240{,}000$, and they carry $200,000. The settlement drops to the proportional share ($\$200{,}000/\$240{,}000$ of the loss) or ACV, whichever is greater — the homeowners cousin of the coinsurance penalty.

10. Hard Why would an insurer deliberately refuse to sell full replacement-cost coverage on a house worth far less at market than it would cost to rebuild? Name the hazard and the form designed for the situation.

Show answer

Insuring a $90,000-market-value house for $270,000 of replacement cost creates moral hazard — the house could be worth more destroyed than standing. The HO-8 modified form answers with named perils and functional or market-value settlement, indemnifying the owner without making a fire profitable.

11. Challenge The Grants' HO-3 has A = $250,000 with common percentages and a $1,000 deductible. A tornado destroys the detached garage ($28,000), damages the house ($40,000) and forces four months in a rental costing $1,500 a month above their normal expenses. Itemize the claim by coverage and total it.

Show answer

Coverage B is $0.10 \times \$250{,}000 = \$25{,}000$, so the $28,000 garage claim pays only $25,000 and $3,000 goes unpaid. Coverage A pays the $40,000 dwelling damage, and Coverage D pays $4 \times \$1{,}500 = \$6{,}000$. Total before deductible $71,000; one deductible applies to the Section I property loss, so about $70,000 is paid in this example — and the $3,000 shortfall on the garage is the day's lesson in limits.

12. Challenge A client asks: “Why does my policy cap my wife's jewelry at $1,500 for theft but pay in full if it burns? That seems backwards.” Answer in three sentences an underwriter would endorse.

Show answer

Jewelry is the burglar's favorite cargo — small, valuable, easily sold — so theft losses are frequent, hard to verify and easy to overstate, and the cap keeps every family from paying premium for that concentrated risk. Fire losses of jewelry are rarer and come with the rest of the household's loss, so they sit inside ordinary Coverage C. The right cure for fine pieces is scheduling them on a floater: appraised, listed and insured by name — which is honest pricing, not a loophole.

COMMON MISTAKES

- Treating Coverages B, C and D as carve-outs of Coverage A — they are additional amounts of insurance computed from A, commonly 10%, 50% and 30% on an HO-3.
- Saying the HO-3 is open peril on everything; its personal property coverage is named peril — that is the exact line between HO-3 and HO-5.
- Applying the jewelry, firearms and silverware special limits to every peril; those caps apply to theft, while the money and securities caps apply to all covered perils.
- Forgetting Coverage C is worldwide — belongings stolen from a hotel or dorm are still Coverage C claims.
- Missing the eligibility rule: the homeowners forms require an owner-occupant of a one-to-four-family residence; landlords and renters belong on other forms.
- Quoting the common percentages as law — they are the standard ISO pattern, and the exam itself hedges with "typically," so hedge with it.

Make it a game · A Through D. Write twelve loss slips (a fence blown down, a stolen passport, hotel bills after a fire, a burned attached garage, a melted silver tea set, cash taken from a drawer…). A parent draws and reads each slip; players race to slap the table and call the coverage letter — A, B, C or D — plus one qualifier: the common percentage, a special limit, or "worldwide." Correct letter earns a point; correct qualifier doubles it; a wrong slap costs one. After the deck, reshuffle and replay for speed. Eleven of twelve correct crowns a Homeowner Laureate and earns the winner first pick of dessert.

Scripture. "Lay not up for yourselves treasures upon earth, where moth and rust doth corrupt, and where thieves break through and steal: But lay up for yourselves treasures in heaven, where neither moth nor rust doth corrupt, and where thieves do not break through nor steal:" (Matthew 6:19-20, KJV)

The Lord names the very perils this lesson prices — corruption and theft — and reminds us that no policy makes earthly goods permanent. Insurance is stewardship of treasure that remains temporary; it keeps a loss from becoming a catastrophe, but it cannot make a house into a treasure that lasts. An agent who knows the difference serves families better than one who sells fear.

6.3 The Homeowners Policy: Liability and the Gaps

OBJECTIVES

- Define Coverage E personal liability and explain why defense costs are paid in addition to the limit.
- Define Coverage F medical payments to others, including who it pays and why fault is not required.
- List the major homeowners exclusions — flood, earth movement, ordinance or law, neglect, intentional acts, business and motor vehicles — and state the cure for each gap.
- Describe the National Flood Insurance Program: its 1968 origin, its common limits and its waiting period, and where to verify them.
- Explain scheduled personal property and preview the personal umbrella as the answer to catastrophic liability.

> **Warm-up.** In five minutes, list four ways your family could owe money for harm to OTHER people or their property — think dog, bicycle, trampoline, a guest on icy steps. Beside each, guess whether your family's homeowners policy would defend and pay. Keep the list; by the end of the lesson you will grade your own guesses.

WATCH

Flood Insurance on the Property Insurance Exam

Insurance Exam Queen · 10:39

https://www.youtube.com/watch?v=WPi7pIvrvuo

> **WHEN TO WATCH**
> Watch after core idea five, and write down every number she flags — limits, waiting period — then check each one against floodsmart.gov during the project, since figures change.

BACKUP VIDEO

Property & Casualty Exam Prep 19, Homeowners Section II Liability Coverages

Open Exam Prep · 2:46

https://www.youtube.com/watch?v=6fmncRqKUlM

A quick second pass on Coverages E and F; watch it before the practice set and say the two hooks aloud with it — E legal liability, F no fault.

KEY TERMS

Coverage E — Personal Liability

Pays sums an insured is legally obligated to pay for bodily injury or property damage to others, commonly starting at $100,000, and defends the insured in addition to the limit.

Coverage F — Medical Payments to Others

Pays small medical bills — commonly $1,000 to $5,000 — for non-residents injured on the premises or by the insured's activities or animals, without regard to fault.

defense in addition to limits

The insurer's promise to hire and pay lawyers to defend covered claims, with those costs not reducing the liability limit.

exclusion

A policy provision removing coverage for a stated peril, property, person or activity.

flood

Rising surface water, mudflow or overflow of a body of water — excluded by homeowners forms and insured through the NFIP or private flood policies.

earth movement

Earthquake, landslide, sinkhole collapse and similar ground motion — excluded by homeowners forms and bought back by endorsement or a separate policy.

neglect

An insured's failure to use reasonable means to protect property at and after a loss — an excluded cause the insured controls.

personal umbrella policy

A separate liability policy of $1 million or more that sits above the homeowners and auto liability limits for catastrophic claims.

National Flood Insurance Program (NFIP)

The federal flood insurance program created by the National Flood Insurance Act of 1968 and run by FEMA, offering flood coverage in participating communities.

ordinance or law exclusion

Excludes the extra cost of rebuilding to current building codes beyond any small built-in allowance.

scheduled personal property endorsement

An endorsement (floater) listing valuables item by item at appraised values, with broader perils and commonly no deductible.

CORE IDEAS

The story. On the night of September 9, 1965, Hurricane Betsy drove the waters of Lake Pontchartrain and the Gulf over the levees and into New Orleans and the Louisiana lowlands. Thousands of homes stood in water to their eaves; the storm killed dozens and became the first hurricane to cost the United States a billion dollars — the newspapers called her “Billion-Dollar Betsy.” Then came the colder discovery: almost none of it was insured. Homeowners policies excluded flood, as they still do, and private insurers had long since concluded that flood could not be written at a premium anyone would pay — only the people most certain to flood

would buy it. Congress studied the wreckage and answered with the **National Flood Insurance Act of 1968**, creating the **National Flood Insurance Program**: the federal government would offer flood insurance in communities that agreed to manage their floodplains. The law is settled history now, administered by FEMA, and every property agent lives with its consequence daily: the most common catastrophe in America is covered by a separate policy the client must be told about, or the agent will one day stand in a wet living room explaining why the homeowners policy owes nothing.

How they figured it out. Why could private insurers not simply cover flood? Because flood breaks the machinery you learned in Unit 1. Insurance needs many independent exposures so the law of large numbers can work; flood losses are the opposite — they strike whole regions at once, and the people eager to buy are concentrated in the floodplain. That is **adverse selection** at its purest, stacked on catastrophic correlation. The 1968 design attacked both problems: spread the program across the whole nation's floodplains, price by mapped zones, and require participating communities to regulate building so tomorrow's houses sit above the base flood elevation. Later amendments added teeth — after 1973, federally backed mortgages on homes in special flood hazard areas must carry flood insurance. The same logic explains the earthquake exclusion: ground motion is regional, rare and ruinous, so it is sold separately — by endorsement or specialty policy, commonly with percentage deductibles of 10 to 20 percent of the dwelling limit. Exclusions, you begin to see, are not malice; they are the places where ordinary pooling fails and a different mechanism must carry the risk.

The big idea. Section II of the homeowners policy is liability — the family's legal responsibility to *other people*. **Coverage E, personal liability**, pays what an insured becomes legally obligated to pay for bodily injury or property damage to others — the guest down the icy steps, the foul ball through the neighbor's bay window, the dog bite at the park (Section II follows the insured's activities, not just the premises). The common base limit is $100,000, raised cheaply. Two features carry the exam weight. First, **defense in addition to limits**: the insurer hires and pays the lawyers, and those costs do not erode the limit. Second, liability coverage pays only when the insured is *legally liable*, which is why **Coverage F, medical payments to others**, exists beside it: a small, no-fault coverage — commonly $1,000 to $5,000 per person — that simply pays the medical bills of a neighbor's child who splits a lip on your porch, no

lawsuit, no admission, no fault. Coverage F never pays the insured or regular residents of the household; the family's own bills are health insurance's job.

Now walk the exclusions, each with its reason and its cure. **Flood** — rising surface water, mudflow, storm surge — excluded for the reasons above; cured by an NFIP or private flood policy. **Earth movement** — earthquake, landslide, sinkhole — excluded as regional catastrophe; cured by endorsement or separate policy. **Ordinance or law** — the extra cost of rebuilding to today's code beyond a small built-in allowance; cured by an ordinance-or-law endorsement, dear to owners of older homes. **Neglect** — failing to protect property at and after a loss; no cure but diligence, previewing Lesson 6.5's duties. **Intentional loss** — arson by the insured, the staged theft; uninsurable on principle, since insurance covers fortuitous events. **Business** — excluded on both sides of the policy; cured by a home-business endorsement or a Unit 8 commercial policy. **Motor vehicles** — the auto's liability belongs to Unit 7's personal auto policy. Add war and nuclear hazard, excluded everywhere. An agent who can recite the gaps and their cures is halfway to an honest practice; the lawsuits that follow hurricanes are full of clients who say nobody told them.

The NFIP itself, in the numbers the exam expects — all "commonly" and all checkable at floodsmart.gov. Coverage for a dwelling runs up to $250,000 on the building and $100,000 on contents, with contents settled at actual cash value; larger homes need **private flood** insurance above those caps, a growing market since the 2010s. A new policy commonly carries a **30-day waiting period** before it takes effect — Congress's answer to the family that buys coverage while the river rises — with exceptions, such as a policy bought in connection with a loan closing. Policies are sold through agents like you, either directly or through **Write Your Own** arrangements in which private insurers issue and service NFIP policies in their own names while the program bears the risk. Basements get limited treatment; detached garages a slice of the building limit; and the premium turns on the property's flood risk — elevation, distance to water, rebuild cost — under FEMA's current rating system. Numbers in this paragraph are examples that time will revise; the habit of verifying them at the official source is the permanent lesson.

Two more tools complete the lesson. The **scheduled personal property endorsement** — the trade says *floater*, from the old marine policies that floated with the goods — cures last lesson's special-limit problem: the $20,000 ring is appraised, listed by name and insured for its agreed amount, against broader perils (mysterious

disappearance included) and commonly with no deductible. Schedule the ring, the violin, the camera gear, the stamp collection. And above everything sits the **personal umbrella policy**: a separate liability contract of $1 million or more that begins paying when the homeowners or auto liability limits are exhausted. The era of large jury verdicts made it necessary; its mechanics — required underlying limits, the self-insured retention, drop-down coverage — wait for Lesson 7.4. For now, plant the picture: Coverage E is the first story of the family's liability house; the umbrella is the roof.

On the exam today. Section II questions cluster on four points. Coverage E: legal liability for BI and PD to others, defense *in addition to* the limit — expect a question where defense costs "reduce the limit" as the wrong answer. Coverage F: no fault required, small limits, never for insureds or regular residents — the exam's favorite is the neighbor child's cut requiring no lawsuit. The exclusions: given a loss, name the gap — water in the basement from a storm surge is flood, excluded, NFIP; the cracked foundation from a quake is earth movement, excluded, endorsement; the city's new code adding $30,000 to the rebuild is ordinance or law. And the NFIP facts: created 1968, run by FEMA, community participation, commonly $250,000/$100,000 limits, 30-day waiting period, mandatory purchase for federally backed mortgages in special flood hazard areas. Traps to flag in your notebook: sewer backup is a separate endorsement, not flood; water damage from a burst pipe inside the house is covered, while rising water from outside is not; and Coverage F pays even when the insured is blameless — that is its whole point, goodwill priced small.

PICTURE STUDY



Boat in the Flood at Port-Marly, Alfred Sisley, 1876 · Oil on canvas · Musée d'Orsay, Paris

Image: Wikimedia Commons, public domain

Alfred Sisley, the quietest of the French Impressionists, lived at Port-Marly on the Seine when the river rose in the spring of 1876 and turned the village streets into lagoons. He painted the flood again and again — not as catastrophe but as strange, silvery fact: the wine merchant's house standing to its knees in water, neighbors rowing where they had walked. The pictures are among his masterpieces. This one opens the lesson on the gaps because it shows the exact peril the homeowners policy declines: water that rises calmly, regionally, over everyone at once — the loss that needed a national program before it could be insured at all.

Look closely

- Find the waterline on the pink house. The building is not broken — it is simply surrounded. Flood damages differently than fire, which is partly why it is priced differently.
- Notice the boat where the street should be. Life adapts and continues; Sisley paints inconvenience and endurance, not disaster.
- Look at the reflections. The water is still — this is riverine flood, the slow rise the NFIP's maps are drawn to predict.

- Count how much of the canvas is water and sky. The flood is bigger than any one property — a whole region shares it, which is the underwriting problem in one image.

Talk about it

1. Every house on this street floods together. Using the law of large numbers, explain why a private insurer in 1876 — or 1965 — could not profitably sell flood insurance here.
2. If the wine merchant had the era's fire policy, what would it have paid for this scene, and what would he be owed today without a flood policy?
3. Noah was warned of a flood and built in faith while the sun still shone (Hebrews 11:7). What does prudent preparation before the water rises look like for a family — and for the agent advising one?

PROJECT

The Gap Hunt

You will build the two-column gap sheet that separates a careful agent from a careless one: every major hole in the Whitfields' homeowners policy from Lesson 6.2, each with its cure, plus a dated flood fact sheet built from the official source. This page joins the Whitfield quote in your Pathway File.

You will need

- The Whitfield coverage map from Lesson 6.2
- FloodSmart.gov from the kit, open in a browser
- One sheet of paper or a spreadsheet page, and your exam notebook

Steps

1. Rule two columns: THE GAP and THE CURE. Fill seven rows: flood, earth movement, ordinance or law, business in the home, the jewelry over the theft sublimit, catastrophic liability above Coverage E, and sewer backup.
2. For each row, write the cure by name — NFIP or private flood policy, earthquake endorsement, ordinance-or-law endorsement, home-business endorsement, scheduled personal property floater, personal umbrella, sewer-backup endorsement.
3. Invent one Whitfield fact per gap that makes it real (the $5,000 ring; a hobby woodshop that sells furniture; a house two blocks from a creek).
4. Now the flood fact sheet: from floodsmart.gov, record today's building and contents maximums, the waiting-period rule and one exception, and what the program says about basements. Date every figure and cite the page.
5. Write the Coverage E and F paragraph: in two sentences each, what the Whitfields' liability coverages would do about a guest injured on the trampoline, and why defense in addition to limits matters to a family of modest savings.
6. Grade your warm-up guesses from session one — mark each right or wrong and correct the wrong ones in a different ink.

7. Title the page “Section II and the Gaps — the Whitfield House,” date it, and file it.

EXAM NOTEBOOK

1. Make flashcards for Coverage E and Coverage F — front: the letter; back: what it pays, the common limit, and the two-word hook (E: “legal liability”; F: “no fault”).
2. Draw the liability house: a one-story house labeled COVERAGE E $100,000 with an umbrella over it labeled $1 MILLION+, and lawyers sketched OUTSIDE the walls with the caption “defense paid in addition.”
3. Write a trap list titled “Water is not water,” with three lines: burst pipe inside — covered; rain through wind-torn roof — covered; rising surface water — FLOOD, excluded, separate policy.

> **From history.** The great Mississippi flood of 1927 — a quarter of a million people displaced across the lower valley — had already taught private insurers their limits: after it, companies broadly abandoned writing flood on dwellings, and for four decades American families simply had no flood coverage to buy. Betsy in 1965 did not create the gap; she exposed it to television cameras. When the 1968 act finally passed, it borrowed its central bargain — insurance in exchange for land-use discipline — from decades of engineers' reports written in the mud of 1927.

Example 1. Exam style. A guest slips on the insured's icy walk and sues, winning a judgment of $90,000. The insurer also spends $40,000 defending the suit. Coverage E is $100,000. How much does the policy pay in total, and how much Coverage E remains against other claims that policy period?

Show solution

1. Coverage E pays the judgment: $90,000, within the $100,000 limit.
2. Defense costs are paid in addition to the limit: the $40,000 of lawyers' bills does not draw down Coverage E.
3. Total paid by the insurer: $\$90{,}000 + \$40{,}000 = \$130{,}000$.
4. Remaining limit for this occurrence is exhausted only by damages: $10,000 of Coverage E was unused. Had the judgment been $130,000, the policy would still have paid full defense plus the $100,000 limit — and the family's assets would owe the last $30,000, which is the umbrella's argument.

Answer: The insurer pays $130,000 in all — $90,000 of damages and $40,000 of defense that does not reduce the limit. Only damages erode Coverage E.

Example 2. Exam style. During a hurricane, the Parkers' house suffers: (1) roof torn open by wind, $45,000; (2) living room ruined by rain entering through the torn roof, $20,000; (3) basement flooded by storm surge, $35,000. Under an unendorsed HO-3, which losses are covered?

Show solution

1. Wind is a covered peril on the open-peril dwelling: the $45,000 roof is covered.
2. Rain entering through an opening the wind made is part of the covered chain — the $20,000 interior loss is covered.
3. Rising surface water is flood, excluded no matter what else the storm did: the $35,000 basement is not covered by the homeowners form.
4. The cure existed in advance: an NFIP or private flood policy. The exam loves this three-part storm because it tests proximate cause and the flood exclusion in one scenario.

Answer: Losses 1 and 2 are covered ($65,000, less the deductible); loss 3 is excluded as flood and would be paid only by a flood policy — commonly up to $250,000 building under the NFIP.

Example 3. A family in a mapped special flood hazard area buys a home on June 1 with a federally backed mortgage, and the lender requires flood insurance at closing. Their cousin in the same town, with no mortgage, buys an NFIP policy the same day. A flood strikes June 15. In this example, whose policy responds, and why?

Show solution

1. State the rule: a new NFIP policy commonly carries a 30-day waiting period before it takes effect.
2. Apply the exception: coverage bought in connection with a loan closing takes effect at closing — the homebuyers are covered June 15.
3. The cousin bought voluntarily with no closing: his policy is inside the 30-day wait on June 15 and pays nothing.
4. Name the reason: the waiting period defeats buying coverage only when the river is already rising — adverse selection in its rawest form. Real rules and exceptions live at floodsmart.gov; verify before advising anyone.

Answer: The homebuyers' loan-closing policy responds; the cousin's voluntary policy is still inside the common 30-day waiting period and does not. The wait exists to block buy-it-as-the-water-rises selection.

PRACTICE

1. Easy What does Coverage E pay for, and what is the common base limit?

   Show answer

   Sums an insured is legally obligated to pay for bodily injury or property damage to others — commonly starting at $100,000 — plus defense costs in addition to that limit.

2. Easy A neighbor's child cuts his hand on the insured's fence. Nobody was negligent. Which coverage can still pay his stitches, and what is its signature feature?

   Show answer

   Coverage F, medical payments to others — it pays small medical bills (commonly $1,000–$5,000) without regard to fault, and never pays the insured's own household.

3. Easy Name the federal program that insures flood, the year of the act that created it, and the agency that runs it.

Show answer

The National Flood Insurance Program, created by the National Flood Insurance Act of 1968 and administered by FEMA.

4. Medium Which claim is EXCLUDED by an unendorsed homeowners policy?

A. Rain damage through a roof opened by wind

B. A burst supply pipe flooding the kitchen

C. Storm surge filling the basement

D. Smoke damage from a kitchen fire

Show answer

C. Rising surface water is flood, excluded and insured separately through the NFIP or private flood. A and B are covered water losses — the source was a covered peril or an internal plumbing failure — which is why the trap list says water is not water.

5. Medium The insured's dog bites a jogger at the park, a mile from home. The insured is sued. Does Section II respond, and why or why not?

Show answer

Yes. Coverage E follows the insured's personal activities and animals, not just the premises, so it defends and pays up to the limit (absent a specific animal exclusion on the policy). Coverage F could also pay small medical bills without a suit.

6. Medium After an earthquake cracks their foundation, a family discovers their homeowners policy pays nothing. What exclusion applied, what would have cured it, and what deductible shape should they expect on the cure?

Show answer

The earth-movement exclusion. An earthquake endorsement or separate earthquake policy cures it, commonly carrying a percentage deductible — 10% to 20% of the dwelling limit in this example — so the insured shares the catastrophic loss.

7. Medium Why does a new NFIP policy commonly wait 30 days before taking effect, and name one exception.

Show answer

To defeat adverse selection — buying coverage only when the river is already rising. A common exception is coverage purchased in connection with a mortgage loan closing, which takes effect with the loan.

8. Hard A jury awards $350,000 against an insured whose Coverage E limit is $300,000. The insurer spent $60,000 on defense. State what the insurer pays, what the family owes, and the product that existed for exactly this day.

Show answer

The insurer pays the $300,000 limit plus the $60,000 defense (in addition to limits) — $360,000 total — and the family personally owes the remaining $50,000 of damages. A personal umbrella policy of $1 million would have paid that excess; Lesson 7.4 does its mechanics.

9. Hard The city's current code requires sprinklers and upgraded wiring, adding $40,000 to the rebuild of a fire-damaged older home. The unendorsed policy pays little of it. Name the exclusion, its small mercy, and its cure.

Show answer

The ordinance-or-law exclusion: the extra cost of rebuilding to current code is excluded beyond a small built-in allowance (commonly a modest percentage of Coverage A). The cure is the ordinance-or-law endorsement, which owners of older homes should hear about by name.

10. Hard Explain, using adverse selection and correlated losses, why Congress rather than the private market ended up insuring flood — and what participating communities must do in exchange.

Show answer

Only those nearly certain to flood would buy voluntary flood insurance, and when the peril strikes it strikes whole regions at once, so private pools could not spread the risk at a sellable premium. The 1968 act pooled floodplains nationally, priced by mapped zones, and required participating communities to manage their floodplains — steering new building above the base flood elevation — so the insured pool improves over time.

11. **Challenge** The Yarrows own a $600,000 home near a bayou. Their agent sells only the HO-3 and says nothing about water. A storm surge causes $300,000 of damage. Write three sentences: what the HO-3 pays, what an NFIP policy would have paid in this example, and what gap would have remained even with the NFIP.

    Show answer

    The HO-3 pays nothing for the surge — rising surface water is excluded flood. An NFIP policy would have paid up to its common $250,000 building maximum (contents at ACV up to $100,000), leaving the Yarrows $50,000 or more short on the building alone. Excess private flood insurance existed for exactly that layer — and the agent who never raised the subject will learn how E&O insurance works, a Unit 8 and Unit 10 topic.

12. **Challenge** A client wants to skip Coverage F: “If I'm not at fault, why should my policy pay anybody?” Answer in three sentences, naming what Coverage F buys that Coverage E cannot.

    Show answer

    Coverage E pays only when you are legally liable, which must be proven — often by a lawsuit against you. Coverage F pays a hurt guest's actual medical bills quickly, without fault, admission or lawyers, and small kindnesses settled early are often what keep neighbors from becoming plaintiffs. It is goodwill, priced small, and it protects relationships as much as money.

COMMON MISTAKES

- Saying defense costs reduce the Coverage E limit — defense is paid in addition to limits; only damages erode the limit.
- Letting Coverage F pay the insured's own family — medical payments to others never covers insureds or regular residents of the household.
- Calling every water loss “flood”: a burst pipe or rain through a wind-made opening is covered; rising surface water is the excluded flood.
- Forgetting the NFIP's common 30-day waiting period and its loan-closing exception — the exam tests both.
- Curing a jewelry sublimit with more Coverage C instead of a scheduled personal property floater.

- Treating sewer backup as flood — it is its own excluded cause with its own inexpensive endorsement.

Make it a game · Covered, Excluded, Cured. Write fifteen loss slips, mixing covered claims (wind-torn roof, dog bite at the park, guest's sprained ankle) with gap losses (storm surge, quake crack, code-upgrade costs, stolen $8,000 ring, sewer backup). The reader calls each slip; players shout COVERED or EXCLUDED within five seconds — one point — and for exclusions must name the cure (NFIP, earthquake endorsement, ordinance-or-law, floater, umbrella, sewer endorsement) for a second point. A wrong "covered" on a flood slip costs two points and a dramatic groan from the table. Highest score after the deck advises the family on dessert — no exclusions permitted.

Scripture. "And the rain descended, and the floods came, and the winds blew, and beat upon that house; and it fell not: for it was founded upon a rock." (Matthew 7:25, KJV)

The Lord's parable grades the builder before the storm arrives — the rock was chosen on a sunny day. Flood maps, elevation rules and policies bought thirty days early are small civic echoes of that wisdom: provision made in calm weather. The deeper foundation, of course, is not insurable at all; it is hearing and doing, and no storm reaches it.

6.4 Dwelling, Renters and Condominium Policies

OBJECTIVES

- Distinguish the dwelling forms DP-1, DP-2 and DP-3 by perils and settlement basis, and state what the dwelling program omits.
- Describe the HO-4 contents broad form for renters: what it covers, what the landlord's policy does not, and why it is commonly a young adult's first policy.
- Describe the HO-6 unit-owners form, including the walls-in Coverage A and loss assessment coverage.
- Trace inland marine insurance from its ocean-marine origins to the personal articles floater.
- Match households — landlord, tenant, condo owner, mobile-home owner — to the correct form.

> **Warm-up.** Imagine you move into your first apartment next fall with your laptop, phone, clothes, bicycle and kitchen gear. In five minutes, estimate what it would cost to replace everything you would bring, then write one sentence: whose insurance do you suppose covers those things today, and whose would cover them in the apartment? Keep it — this lesson answers with a form number.

WATCH

The Differences Between Dwelling vs Homeowners for the Insurance Exam

Insurance Exam Queen · 19:07

https://www.youtube.com/watch?v=lUV1yThwwXk

> **WHEN TO WATCH**
> Watch in two sittings if needed, after core idea four; keep a two-column page open — DWELLING PROGRAM and HOMEOWNERS PROGRAM — and sort every feature she names into a column as you hear it.

BACKUP VIDEO

Understanding HO-3, HO-5, HO-6 & Renters Insurance Policies!

Be A Claims Adjuster · 4:55

https://www.youtube.com/watch?v=RC1pywKeRPg

A five-minute second pass across the forms from an adjuster's angle; watch it before the project and note any difference in emphasis from the primary video in one margin line.

KEY TERMS

dwelling policy (DP)

A property form for dwellings that do not qualify for homeowners — chiefly rental houses and non-owner-occupied homes — covering the building and optionally contents, with no theft or liability coverage in the standard forms.

DP-1 (basic form)

The narrowest dwelling form: named perils such as fire, lightning and internal explosion, with extended coverage optional, settled at actual cash value.

DP-2 (broad form)

A dwelling form covering a longer list of named broad-form perils, with the dwelling commonly settled at replacement cost.

DP-3 (special form)

The widest dwelling form: open-peril coverage on the dwelling, named perils on contents — the standard landlord's choice.

fair rental value

Dwelling-program coverage paying the landlord the rent lost while a covered loss makes the property unfit to rent.

HO-4 (contents broad form)

The renters homeowners form: named-peril coverage on the tenant's personal property plus loss of use and full Section II liability, with no dwelling coverage.

HO-6 (unit-owners form)

The condominium owner's form: contents coverage plus a small walls-in Coverage A for the parts of the real property the unit owner must insure, plus liability.

loss assessment coverage

HO-6 (and homeowners) coverage paying the unit owner's share of an assessment the association levies after a loss exceeds the master policy — commonly $1,000 built in, more by endorsement.

master policy

The condominium association's own policy on the buildings and common elements, written bare-walls or all-in, which determines where the unit owner's HO-6 must begin.

improvements and betterments

Upgrades a tenant installs in rented premises — commonly covered under an HO-4 as a percentage of Coverage C.

inland marine insurance

The branch of property insurance, descended from ocean marine, that covers property in transit and movable or floating classes of property.

personal articles floater

An inland marine policy (or endorsement) scheduling valuables item by item at appraised values, open peril, worldwide, commonly with no deductible.

CORE IDEAS

The story. In October 1884, at Seventy-Second Street and Central Park West — so far from fashionable New York that people joked it might as well be Dakota Territory — the Dakota apartment building opened its doors, and respectable families did something scandalous: they moved into apartments. For generations, a proper household had meant a whole house; multiple families under one roof meant a tenement. The Dakota — with its courtyards, its own generators and its uniformed

staff — made renting grand, and the American city followed. Within two generations, millions of households were tenants in buildings someone else owned, and the insurance question split neatly in half: the *building* belonged to the landlord and his policy, but the *belongings* inside apartment 4-C — and the tenant's liability when his bathtub overflowed into 3-C — belonged to no policy at all unless the tenant bought one. The industry eventually built forms for every split the modern city invented: the dwelling policy for the landlord, the HO-4 for the tenant, and — after Puerto Rico's Horizontal Property Act of 1958 and the federal Housing Act of 1961 taught the mainland how to deed the air inside a building — the HO-6 for the condominium owner, who owns his unit's interior but shares the roof, the halls and the walls with his neighbors.

How they figured it out. The forms follow the property interests, and seeing that principle makes the whole lesson one idea instead of nine facts. Ask of any household: *what do these people own, and what could they be liable for?* The landlord owns a building he does not live in — so the dwelling program insures the structure and his lost rents, but not the tenant's goods and (in the standard forms) not liability, which he buys separately. The tenant owns only contents and his own liability — so the HO-4 drops Coverages A and B entirely and keeps C, D, E and F. The condominium owner sits between: the association's **master policy** covers the buildings and common elements, so his HO-6 carries a small Coverage A for the interior — the "walls-in" layer of cabinets, fixtures, flooring and any alterations the condo documents make his responsibility — plus contents and liability. Whether the master policy is written *bare walls* (the association stops at the bare structure) or *all-in* (it includes standard interior finishes) decides how large his walls-in layer must be, which is why the first document a good agent requests is the association's declarations and bylaws.

The big idea. The **dwelling program** serves properties the homeowners forms turn away — above all the rental house, and also the non-owner-occupied home and some modest owner-occupied dwellings. Its three forms echo the ladder you already know. The **DP-1 basic form** covers a short named-peril list — fire, lightning, internal explosion — with extended-coverage perils (windstorm, hail, riot, aircraft, vehicles, smoke) and vandalism addable, settled at actual cash value. The **DP-2 broad form** lengthens the peril list and commonly settles the dwelling at replacement cost. The **DP-3 special form** — the standard landlord's policy — goes open peril on the

dwelling, named peril on any scheduled contents. Two omissions define the program on the exam: standard dwelling forms include *no theft coverage* and *no liability coverage* — both bought by endorsement or separate policies. What the program adds for landlords is **fair rental value**: when fire empties the rental house, the policy pays the rent the landlord loses while it is rebuilt — his version of loss of use, and a textbook indirect loss.

Now the policy you will probably buy before any client does: the **HO-4 contents broad form**, the renters policy. The landlord's insurance covers his building and nothing of yours — a fact most tenants learn wet. The HO-4 covers the tenant's personal property against the broad named perils, with loss of use commonly at 30% of Coverage C, plus the full Section II — Coverage E liability and Coverage F medical payments — for the bathtub that ruins the ceiling below or the guest hurt at your door. It even covers **improvements and betterments**, the shelves or fixtures a tenant installs, commonly up to 10% of C. For a few hundred dollars a year in this example — renters coverage is famously inexpensive because there is no building to insure — a young adult protects everything the warm-up listed and every liability an apartment can breed. Industry surveys long showed barely half of renters carry it. When you are licensed, the HO-4 will be the cheapest good you regularly do; teach it warmly, starting with your own lease.

The **HO-6 unit-owners form** completes the city. Its Coverage A is small — commonly $5,000 built in, raised to fit the condo documents — and points *inward*: alterations, appliances, fixtures and interior finishes the association's master policy leaves to the owner. Contents, loss of use and Section II work as you expect. The distinctive piece is **loss assessment coverage**: when a loss to the common elements exceeds the master policy — a $2 million roof claim against a $1.5 million master limit, in this example — the association assesses every unit owner a share of the shortfall, and the HO-6's built-in $1,000 (raised cheaply by endorsement) answers the letter. The exam asks loss assessment almost every sitting because it exists nowhere else in personal lines. Round out the household map with the mobile home: insured under a homeowners policy with a mobile-home endorsement, reflecting different construction and the trip risk when the home moves.

One more lineage, because the exam names it: **inland marine**. Ocean marine insurance — the oldest line of all, born at Lloyd's — covered ships and cargo; as goods left the docks for canal boats, railroads and trucks, marine underwriters

followed them inland, and the broad freedom of marine forms came along. The states eventually fenced the line with the Nationwide Marine Definition (first adopted in 1933) saying what marine insurers may write: property in transit, bridges and tunnels and other instrumentalities of transportation, and classes of movable property. For families, the living descendant is the **personal articles floater** — the scheduling tool Lessons 6.2 and 6.3 kept promising. Each item is appraised and listed; coverage is open peril and worldwide, commonly with no deductible, and even *mysterious disappearance* — the ring simply gone — is covered, which no homeowners form touches. Jewelry, furs, cameras, musical instruments, silverware, fine art, stamps and coins: the classic floater classes. The word itself is the history: the policy *floats* with the property wherever it travels, as marine coverage floated with the cargo.

On the exam today. This is a matching lesson, and the exam writes it as matching. Given a household, pick the form: owner-occupant — HO-2/3/5/8; landlord of a rental house — DP (DP-3 if “special” or “open peril” appears); tenant — HO-4; condominium owner — HO-6; older home with replacement cost far above market — HO-8; mobile home — homeowners with the mobile-home endorsement. Know the dwelling program's two famous omissions — theft and liability — and that fair rental value is its landlord's loss-of-use. Know the HO-4 has no Coverage A or B but full liability, and that the landlord's policy never covers the tenant's goods. For the HO-6, expect walls-in Coverage A, the master-policy boundary (bare walls versus all-in) and a loss-assessment scenario by name. For inland marine, expect “which policy covers property in transit or scheduled valuables worldwide” and the floater's gifts: agreed/appraised values, open peril, no deductible commonly, mysterious disappearance covered. The traps: giving a DP form liability coverage; giving the HO-4 dwelling coverage; sending a condo owner's interior claim to the master policy when the documents put walls-in on the unit owner; and forgetting that scheduling an item removes it from the Coverage C sublimits entirely.

PICTURE STUDY



The Boulevard Montmartre on a Winter Morning, Camille Pissarro, 1897 · Oil on canvas · The Metropolitan Museum of Art, New York

Image: Wikimedia Commons, public domain

In the winter of 1897 Camille Pissarro, too troubled by an eye ailment to paint outdoors, took a room high in a hotel on the Boulevard Montmartre and painted the street below morning after morning — fourteen canvases of the same view in changing light. What he recorded, almost by accident, is the modern city this lesson insures: block upon block of apartments, families stacked above shops, nearly everyone a tenant or a unit owner, nobody owning the whole building he sleeps in. It opens the lesson on the HO-4 and HO-6 because every lit window in it is a separate bundle of belongings and liabilities waiting for the right form.

Look closely

- Count the floors of the apartment blocks. Above the ground-floor shops, each story holds households whose property interests stop at their own walls.
- Find the viewpoint — Pissarro is painting from a rented room himself, a tenant looking at tenants.
- Notice the shops below and the dwellings above: one building, many interests — the landlord's structure, the merchants' stock, the tenants' goods.
- Follow the boulevard to its vanishing point. The city repeats this block for miles; multiply the insurance questions in one building by all of them.

Talk about it

1. Pick one window and invent its household. What form do they need — HO-4 or HO-6 — and what three things do they own that the building's owner never insured?
2. If a fire started in one shop below, how many different policies might answer for one building's loss? What does that teach about why the forms must fit together without gaps?
3. Scripture says believers are “strangers and sojourners” whose true home is elsewhere. How might remembering that temper both a renter's envy and an owner's pride?

PROJECT

Four Doors on One Street

You will write the matching chart this lesson exists to build: four pretend households on one street, each matched to its form with limits and one honest recommendation apiece — then you will price the policy you will someday buy first, the HO-4, in detail. Pretend families, pretend numbers, exam-grade reasoning.

You will need

- One sheet of paper or a spreadsheet page, ruled into four columns
- Your Lesson 6.2 coverage map for comparison
- This lesson's key terms

Steps

1. Invent Elm Street: No. 10, a landlord's rental house; No. 12, a young tenant's apartment (over the garage of No. 10, if you like); No. 14, a condominium unit; No. 16, an 1890s house whose replacement cost towers over its market value.
2. Head each column with the household and write the form beneath it — DP-3, HO-4, HO-6, HO-8 — with one sentence of why.
3. For the DP-3: list what it covers (open-peril dwelling, fair rental value) and the two famous omissions (theft, liability) with their cures.
4. For the HO-4: set Coverage C from a realistic inventory of a first apartment, compute loss of use at the common 30% of C, and note Coverages E and F. Write the premium as “a few hundred dollars a year in this example.”
5. For the HO-6: invent the master policy's style (bare walls or all-in), size the walls-in Coverage A to match, and include loss assessment with its built-in limit and the endorsement that raises it.
6. For the HO-8: one sentence on why full replacement cost would be wrong here, and how the form settles instead.
7. Add a floater footnote: give one household a $6,000 instrument or ring, and show the scheduling cure — appraised value, open peril, no deductible

commonly, mysterious disappearance covered.

8. Date the chart, title it “Four Doors — the Right Form for Each,” and file it in your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for DP-1, DP-2, DP-3, HO-4 and HO-6 — front: the form; back: who it is for, perils basis, and its signature feature (fair rental value; no A or B; walls-in plus loss assessment).
2. Draw one apartment building in section view: the landlord's DP-3 wrapped around the structure, a tenant's HO-4 drawn as a box of belongings inside one unit, and the condo neighbor's HO-6 shading the interior finishes — label where each policy stops.
3. Write a trap list titled “What the dwelling program does NOT do,” with its two omissions and their cures, ending: the landlord's policy NEVER covers the tenant's goods.

> **From history.** The word condominium is lawyers' Latin — “ownership together” — and its American career began offshore: Puerto Rico's Horizontal Property Act of 1958 showed how to deed a cube of air on the sixth floor, and Section 234 of the Housing Act of 1961 let the FHA insure mortgages on such units, teaching mainland lenders to trust them. State condominium statutes followed within the decade, and the insurance industry answered with the unit-owners form. The HO-6 is thus one of the youngest personal-lines policies — younger than the interstate highways, younger than many of the buildings it insures.

Example 1. Exam style. Match each household to its form, one line of reasoning apiece: (1) the Nguyens rent out an inherited house across town; (2) their daughter rents an apartment downtown; (3) their son owns a sixth-floor condominium; (4) the grandparents own and occupy an 1895 farmhouse whose replacement cost is triple its market value.

Show solution

1. (1) Non-owner-occupied rental house: the dwelling program — a DP-3 for open-peril coverage on the building plus fair rental value; liability bought separately.
2. (2) Tenant owning only contents and liability: HO-4 contents broad form — no Coverage A or B, full Section II.
3. (3) Unit owner inside an association: HO-6 — walls-in Coverage A sized to the condo documents, contents, liability and loss assessment.
4. (4) Owner-occupants of an old home that must not be over-insured against market value: HO-8 modified form, named perils, functional or market-value settlement.

Answer: DP-3, HO-4, HO-6, HO-8 — in each case the form follows what the household actually owns and could be liable for.

Example 2. A tenant's kitchen fire does $12,000 of damage to her belongings and forces her into a hotel, costing $1,200 a month above normal expenses for two months. Her HO-4 carries Coverage C of $30,000 with a $500 deductible and the common loss-of-use percentage. In this example, what does the policy pay — and what does it pay the landlord for his scorched kitchen walls?

Show solution

1. Contents: $\$12{,}000 - \$500 = \$11{,}500$, within the $30,000 limit (ACV unless she bought the replacement-cost endorsement).
2. Loss of use: limit is commonly 30% of C — $0.30 \times \$30{,}000 = \$9{,}000$; she needs $2 \times \$1{,}200 = \$2{,}400$, fully payable.
3. The building belongs to the landlord and his own policy; her HO-4 has no Coverage A. But if her negligence caused the fire, his insurer may pursue her — and her Coverage E answers that claim, one more reason renters need liability.
4. Total to the tenant: $\$11{,}500 + \$2{,}400 = \$13{,}900$.

Answer: $13,900 — contents after the deductible plus additional living expense. The building is the landlord's claim; her liability coverage stands behind her if his insurer comes asking.

Example 3. Exam style. A hailstorm causes $900,000 of roof damage to a condominium's common buildings; the association's master policy pays $800,000 and the association assesses each of 50 unit owners $2,000 for the rest. A unit owner's HO-6 includes the common built-in loss assessment coverage. What does her policy pay, and what would have paid the remainder?

Show solution

1. Name the coverage: loss assessment — the HO-6 provision for the owner's share of an association assessment following a covered loss to common property.
2. Built-in limit, commonly $1,000: the policy pays $1,000 of her $2,000 assessment in this example.
3. The remaining $1,000 is hers — unless she had raised the limit by the inexpensive loss-assessment endorsement, the standard agent recommendation for condo clients.
4. Note the peril test: the assessment must arise from a loss by a peril her policy covers; an assessment to repave the parking lot is maintenance, never covered.

Answer: The HO-6 pays its common built-in $1,000; the endorsement raising loss assessment would have paid the rest. Assessments for maintenance rather than covered losses are never paid.

PRACTICE

1. Easy Name the standard dwelling program's two famous omissions and the cure for each.

   Show answer

   Theft coverage (added by endorsement or separate crime coverage) and liability coverage (added by endorsement or a separate liability policy). The DP forms insure the building and rents, not the landlord's lawsuits.

2. Easy Which homeowners form has no Coverage A or B at all, and who buys it?

Show answer

The HO-4 contents broad form — the renters policy. A tenant owns no part of the building, so the form carries only contents, loss of use and the Section II liability coverages.

3. Easy What does fair rental value pay, and under which program does it appear?

Show answer

The rent a landlord loses while a covered loss makes the property unfit to rent — the dwelling program's version of loss of use, and a classic indirect loss.

4. Medium A condominium association's documents say the master policy is written “bare walls.” What does that mean for the unit owner's HO-6?

Show answer

The association insures only the bare structure, so everything inward — flooring, cabinets, fixtures, interior walls' finishes — is the unit owner's to insure, and the HO-6's walls-in Coverage A must be sized well above the small built-in amount.

5. Medium Which claim belongs to loss assessment coverage?

A. The association repaves the parking lot and bills each owner $800
B. Hail damage to common roofs exceeds the master policy and each owner is assessed $1,500
C. A unit owner's own kitchen burns
D. The association raises monthly dues

Show answer

B. Loss assessment pays the owner's share of an assessment arising from a covered loss to common property that exceeds the master policy. A and D are maintenance and dues — never covered; C is the owner's own Coverage A and C claim.

6. Medium Why is renters insurance so inexpensive compared with a homeowners policy, and why do so many renters still go without it?

Show answer

There is no building to insure — only contents, loss of use and liability — so the premium is commonly a few hundred dollars a year in this example. Renters skip it because they underestimate what their belongings would cost to replace and assume, wrongly, that the landlord's policy covers them.

7. Medium From what line of insurance does the personal articles floater descend, and what three settlement features make it better than Coverage C for a $9,000 ring?

Show answer

Inland marine, descended from ocean marine as coverage followed cargo ashore. The floater schedules the ring at an appraised/agreed value, covers open peril worldwide — including mysterious disappearance — and commonly carries no deductible; none of the theft sublimits apply to scheduled items.

8. Hard A landlord insures his rental house on a DP-1 “to save premium.” A tornado (windstorm) destroys it, and a month later thieves strip the copper pipe from the ruins. Assess both claims.

Show answer

Windstorm is not in the DP-1's basic perils unless he bought extended coverage — the tornado claim may fail entirely on the cheapest form. The copper theft fails regardless: the dwelling program has no theft coverage. The premium he saved bought him both gaps; a DP-3 with the right endorsements was the honest quote.

9. Hard A tenant's overflowing bathtub ruins the apartment below. Her landlord's insurer pays the building repairs, then demands reimbursement from her. Which of her HO-4 coverages responds, and what is the insurer's demand called (preview of Lesson 6.5)?

Show answer

Her Coverage E personal liability defends her and pays her legal obligation. The building insurer's demand is subrogation — having paid its insured, it steps into his shoes against the negligent party. Tenants without an HO-4 face that demand with their savings.

10. Hard A client owns her condo outright and asks why she needs an HO-6 when "the association already insures the building." Give the three-part answer.

Show answer

The master policy stops at the boundary the condo documents set — commonly leaving walls-in property to her; it never covers her personal property or additional living expense; and it provides none of her personal liability. Add loss assessment for the day a common loss outruns the master policy, and the HO-6 earns its premium.

11. Challenge Design the insurance for one building: a house whose owner lives in the downstairs unit and rents the upstairs apartment to a tenant. Which forms serve the owner and the tenant, and name two exposures the owner must be sure his policy actually reaches.

Show answer

The owner-occupant of a one-to-four-family dwelling still qualifies for a homeowners form (HO-3), which covers the building including the rented unit; the tenant buys an HO-4 for his own goods and liability. The owner must confirm his policy contemplates the rental exposure — fair rental value for the lost rent if fire empties the unit, and liability arising from the rented premises — both standard questions for the agent, not assumptions.

12. **Challenge** Write the three-sentence speech you would give a 19-year-old friend moving into a first apartment, using one dollar figure, one form number and one liability example.

Show answer

Your landlord's policy covers his building, not one sock of yours — an HO-4 renters policy covers everything you own, commonly for a few hundred dollars a year in this example. It also carries liability, so if your forgotten stove or overflowing tub damages the building or a neighbor sues, the policy defends you instead of your savings. It will likely be the first policy you ever buy; buy it the week you sign the lease.

COMMON MISTAKES

- Giving the standard dwelling forms theft or liability coverage — the program's two famous omissions, added only by endorsement or separate policies.
- Assuming the landlord's policy covers a tenant's belongings; it never does — the tenant needs an HO-4.
- Sizing an HO-6's Coverage A without reading whether the master policy is bare-walls or all-in — the condo documents, not habit, set the walls-in layer.
- Paying a maintenance assessment under loss assessment coverage; it answers only assessments from covered losses to common property that exceed the master policy.
- Forgetting the DP ladder matches the HO ladder — DP-1 basic/ACV, DP-2 broad/replacement cost, DP-3 special/open peril on the dwelling.
- Leaving a scheduled-property question on Coverage C sublimits — once an item is scheduled on a floater, the sublimits no longer apply to it.

> **Make it a game · Who Needs What Form?.** Deal out twelve household cards you write in two minutes each round: “retired couple, own and occupy a 1902 farmhouse”; “college roommates renting a duplex”; “investor with three rental houses”; “young family in a sixth-floor condo”; “grandmother in a mobile home.” The dealer flips a card; players race to slap and name the form — HO-3, HO-8, HO-4, DP-3, HO-6, mobile-home endorsement. One point for the form, a second for naming its signature feature (fair rental value, loss assessment, walls-in, no A or B). Wrong slap sits out a card. First to ten points writes the next round's households — the real test, since inventing good cases is harder than answering them.

> **Scripture.** “The land shall not be sold for ever: for the land is mine; for ye are strangers and sojourners with me.” (Leviticus 25:23, KJV)
>
> God reminded Israel that even freeholders are tenants before Him — every deed is a leasehold under heaven. That truth levels the street this lesson walks: the landlord, the renter and the unit owner alike are sojourners, stewards of borrowed rooms for a little while. Insure the goods, keep the liabilities covered, and hold the whole arrangement with a sojourner's light grip.

6.5 After the Fire: Claims, Adjusters and Subrogation

OBJECTIVES

- List the insured's duties after a loss, from prompt notice through the sworn proof of loss and cooperation.
- Distinguish staff, independent and public adjusters by who employs each and whose interest each serves.
- Explain the appraisal clause for disputes over the amount of a loss.
- Compute an insurer's pro-rata share when other insurance covers the same loss.
- Explain subrogation, salvage and the rule against abandonment, and distinguish vacancy from unoccupancy.

> **Warm-up.** Pretend your family's kitchen burned last night and you must call the insurer this morning. In five minutes, write the first five things you think the family should do today, in order. Keep the list — by session three you will grade it against the policy's actual duties after loss, and the comparison is the lesson.

WATCH

What is Prorata and How to Solve for it on the Insurance Exam

Insurance Exam Queen · 9:39

https://www.youtube.com/watch?v=hsSKj_o6Zkk

> **WHEN TO WATCH**
> Watch after core idea five with pencil out; pause at each pro-rata example, compute the share yourself, and only then let her confirm it.

BACKUP VIDEO

Subrogation Explained (With Examples) | Insurance Definitions

Square One Insurance Services · 3:55

https://www.youtube.com/watch?v=uw-_iq8Wn5o

A four-minute second pass on subrogation with worked scenarios; watch it before practice problem 8 and retell one of its examples in your own words in the notebook.

notice of loss

The insured's duty to tell the insurer or agent promptly that a loss has occurred — and to notify the police when the loss is a theft.

proof of loss

The insured's sworn statement of the claim — commonly due within 60 days of the insurer's request — detailing the property, values, interests and the loss itself.

protection of property

The insured's duty to protect damaged property from further damage, making reasonable and necessary repairs, which the policy reimburses.

staff adjuster

A salaried employee of the insurer who investigates and settles its claims.

independent adjuster

A contractor hired by insurers, claim by claim or during catastrophes, to adjust claims on their behalf — independent in employment, but representing the insurer.

public adjuster

A licensed adjuster hired by the insured, commonly for a percentage of the settlement — the only adjuster who represents the policyholder.

appraisal clause

A policy condition for disputes over the amount of a loss: each side hires an appraiser, the appraisers select an umpire, and agreement of any two sets the amount.

pro-rata (other insurance) clause

When more than one policy covers a loss, each insurer pays the proportion its limit bears to the total of all limits.

subrogation

The insurer's right, after paying a loss, to step into the insured's shoes and recover from the third party who caused it — a right the insured must do nothing to impair.

salvage

The insurer's right to take over damaged property it has paid for and sell it to reduce the net loss.

abandonment

What the insured may NOT do: dump damaged property on the insurer and demand a total loss; property forms expressly refuse abandonment.

vacancy vs. unoccupancy

Vacant means empty of both people and property; unoccupied means furnished but the people are away — and extended vacancy (commonly 60 consecutive days) suspends certain coverages such as vandalism.

CORE IDEAS

The story. On the freezing night of December 16, 1835, fire broke out in a five-story warehouse on Merchant Street in lower Manhattan. The temperature stood near zero; the hydrants and even the East River were frozen; and the gale carried the flames through the dense blocks of the business district until nearly 700 buildings — the warehouses, countinghouses and the marble Merchants' Exchange itself — lay in ruins. Then came the quieter catastrophe: the city's fire insurers, whose capital stood exposed in those same blocks, began to fail. Of the twenty-six local companies, most were bankrupted outright — by some counts twenty-three — and their policyholders recovered pennies. One out-of-town company made the opposite legend. Eliphalet Terry, president of the Hartford Fire Insurance Company, drove by sleigh over the snow from Connecticut and announced that Hartford would pay every valid claim in full — pledging his personal fortune behind the promise. He paid, the news traveled, and Hartford, Connecticut began its long career as the insurance city. The lesson has not aged a day: a policy is worth exactly what happens after the fire — the claim honestly presented, honestly adjusted and honestly paid.

How they figured it out. A claim is a transaction between strangers at the worst possible moment, so the industry learned to script it in advance, in the policy's **conditions**. The insured's side of the script is the **duties after loss**; the insurer's side is the machinery of adjustment. Both grew from hard experience: 1835 and every great fire after it taught insurers that claims must be verified (hence the sworn proof of loss and the inventory), that damaged property must not be left to rot (hence the duty to protect it), and that disputes over value needed a cheaper referee than a courtroom (hence the appraisal clause, standard in American fire policies since the New York Standard Fire Policy of 1886 and its 1943 revision — the ancestor text of today's conditions). Two more doctrines came up from the common law of indemnity. If a negligent third party caused the loss, the insured should not collect

twice — once from the insurer and once from the wrongdoer — so payment transfers the claim to the insurer: **subrogation**. And if the insurer pays for goods as a total loss, the remains belong to it: **salvage**. Each rule keeps indemnity exact — the insured made whole, never enriched.

The big idea. Learn the duties after loss as a sequence you could perform the morning after. First, **prompt notice** to the insurer or agent — and to the police, if theft. Second, **protect the property** from further damage: tarp the roof, shut the water, move the undamaged goods; the policy reimburses these reasonable repairs, and *neglecting* them is an excluded cause (Lesson 6.3's quiet exclusion now makes full sense). Third, **prepare an inventory** of the damaged property — quantities, costs, values, with receipts and photographs where they exist; the home inventory your project builds today is this duty done in advance. Fourth, **exhibit the property** as often as reasonably required, and produce books and records. Fifth, submit the sworn **proof of loss** — commonly within 60 days of the insurer's request. Sixth, **cooperate**, including examination under oath if asked. These are conditions, not courtesies: an insured who refuses them can forfeit an otherwise valid claim, and the exam phrases exactly that as a question.

Across the table sits the adjuster, and the exam insists you know which kind. The **staff adjuster** is the insurer's salaried employee. The **independent adjuster** is a contractor — hired claim by claim, and by the thousand after hurricanes — but hired *by insurers*: independent describes his employment, not his allegiance. The **public adjuster** alone works for the insured, licensed by the state and paid commonly a percentage of the settlement, hired most often for large or disputed losses. (The agent, meanwhile, may take the first notice of loss but adjusts nothing.) When insurer and insured agree a loss is covered but disagree on the *amount*, the **appraisal clause** supplies the referee: each party selects a competent appraiser, the two appraisers select an **umpire**, and the agreement of any two binds the amount; each side pays its own appraiser and splits the umpire. Appraisal settles amounts, not coverage — whether the policy covers the loss at all is a question for negotiation or the courts, never the umpire.

Now the arithmetic of overlapping promises. Suppose a house is covered — by oversight, inheritance or a lender's error — under two policies at once. Indemnity forbids collecting the loss twice, so property forms carry an **other-insurance clause**, and the standard answer is **pro-rata liability**: each insurer pays the share of the loss

that its limit bears to the total of all limits. The formula: this insurer's share $=$ $\frac{\text{this policy's limit}}{\text{total limits, all policies}} \times$ loss. In this example: Policy A carries $300,000 and Policy B $100,000 on the same house; a $60,000 fire is shared $\frac{300}{400}$ and $\frac{100}{400}$ — Policy A pays $45,000, Policy B $15,000, and the insured collects exactly his loss, once. Casualty lines you will meet later sometimes share by equal shares or make one policy excess over another, but for property, pro rata by limits is the exam's answer.

Three last doctrines finish the claim. **Subrogation**: the neighbor's contractor burns your kitchen; your insurer pays you, then stands in your shoes to pursue the contractor — and the policy forbids you to impair that right, so never sign away claims against a wrongdoer or settle privately after payment; insurers commonly recover your deductible along the way. **Salvage and no abandonment**: the insurer that pays for the smoke-ruined inventory may take and sell it; but the insured may not abandon property to the insurer — you cannot shove the scorched piano across the table and demand its price; the insurer chooses whether to take salvage. And the **vacancy** rules: a *vacant* dwelling — empty of people *and* property — is a magnet for vandals and frozen pipes, so after a stated period, commonly 60 consecutive days, the policy suspends coverages such as vandalism and glass breakage. Merely *unoccupied* — furnished, family away for the summer — is not vacant. Agents meet the line constantly: the client's mother's house, empty since the funeral, is quietly losing coverage while the family decides — and saying so is the unglamorous faithfulness this profession runs on.

On the exam today. Claims questions are plentiful and mostly literal. Expect a which-duty-comes-first ordering (notice, protect, inventory, exhibit, proof of loss, cooperate) and the 60-day proof-of-loss figure flagged "commonly." Expect the three adjusters with the public adjuster as the only one representing the insured — the favorite distractor says the independent adjuster does. Expect an appraisal question: amount disputes only, each party an appraiser, the appraisers an umpire, any two bind, each pays his own appraiser and half the umpire. Expect one pro-rata computation — set up limit over total limits, times the loss, and do not let the question's deductible or coinsurance details distract you from the share it actually asks for. Expect subrogation in story form: the insured who signs a release with the at-fault party and voids his own claim, or the insurer recovering the deductible. And expect the pairs: salvage (insurer's option) versus abandonment (insured's forbidden

move), vacancy versus unoccupancy. The trap woven through all of it is agency: at every step, ask whose interest each person at the table is paid to serve.

PICTURE STUDY



View of the Great Fire in New York, as Seen from Williamsburgh, Nicolino Calyo, engraved by William J. Bennett, 1835–1836 · Hand-colored aquatint after Calyo's gouache · Published by Lewis P. Clover, New York; impressions in the Metropolitan Museum of Art and other collections

Image: Wikimedia Commons, public domain

Nicolino Calyo was a Naples-trained painter who had fled two revolutions before settling in New York — just in time to watch the city's business district burn on the freezing night of December 16, 1835. He painted the fire from across the East River and the ruins after it, and the engraver William J. Bennett turned his gouaches into aquatints that sold up and down the seaboard: the whole country wanted to see the disaster that bankrupted most of New York's fire insurers. It opens this lesson because every doctrine in it — the duties after loss, the adjuster's visit, subrogation, Eliphalet Terry's sleigh ride — begins on a night exactly like this one, with the claim still glowing on the horizon.

Look closely

- Find the column of smoke and the glow beneath it. The fire is a mile away across the river, yet it lights the whole sky — a single peril consuming hundreds of separately insured properties at once.
- Notice the ships riding safely on the dark water. The river that could not quench the fire — its hydrants and surface frozen — still protected everything that floated on it.

- Look at the watchers on the near shore. Among them, in fact and in imagination, stand merchants whose warehouses are burning and the agents who sold them their policies.
- Follow the light down to the waterline reflections. Calyo painted the fire's beauty honestly — and its distance: from here no one can yet tell a paid claim from a bankrupt insurer.

Talk about it

1. Tomorrow morning, every watcher on this shore who owned property in those blocks must begin the duties after loss. Which duty comes first, and why does the policy script them in advance?
2. Most of New York's local insurers failed because their whole capital sat in the blocks now burning; Hartford's Terry paid in full and won a century of trust. What does that teach about spreading risk — and about the price of a kept promise?
3. Exodus 22:6 says he that kindled the fire shall surely make restitution. When no one knows who kindled it, insurance organizes the restitution instead. What does that arrangement owe to the honesty of every single claimant — including the one holding this policy, and this pencil?

PROJECT

The Claim File — and the Inventory Done in Advance

You will do the insured's whole job once, calmly, with nothing burning: build a real home inventory of one room of your own house, then assemble a pretend claim file for the Whitfields of Maple Street — notice, protection notes, inventory excerpt, proof-of-loss summary and a pro-rata worksheet. This packet is the capstone artifact of the unit's Pathway File pages.

You will need

- A phone camera or pencil and paper for the room inventory
- Your settlement calculator from Lesson 6.1 and the Whitfield pages from Lessons 6.2 and 6.3
- One folder or spreadsheet workbook for the claim file

Steps

1. Inventory one real room: list every item over $25 with a short description, approximate purchase year and estimated replacement cost; photograph the room from two corners and any serial numbers. Total it — then compare the total against your Lesson 6.2 warm-up guess.
2. Write one sentence at the top of the inventory about where a family should keep such a list (anywhere but inside the house it describes — cloud storage or a relative's safe).
3. Now the pretend claim: a grease fire damages the Whitfield kitchen on a stated date — $48,000 to the dwelling, $9,000 of contents, two months of $1,400-a-month extra living expense.
4. Draft the notice: a five-line first report naming the insured, the property, the date, the peril and a callback number — and note the same-day duty to protect (water off, openings boarded), with those costs reimbursable.
5. Build the inventory excerpt for the $9,000 of contents — six items with ages, useful lives and ACV versus replacement cost, using your calculator.
6. Write the proof-of-loss summary: the sworn statement's key numbers in one table, dated inside the common 60-day window after request.

7. Add the pro-rata worksheet: assume by error the Whitfields also held a second $100,000 policy alongside their $280,000 one; share the dwelling loss by limits and show each insurer's payment.
8. Close the file with a three-line subrogation memo: the fire traces to a defective appliance — what the insurer may do, and the one thing the Whitfields must not sign. Date, title and file the packet.

EXAM NOTEBOOK

1. Make flashcards for the three adjusters — front: the title; back: who pays him, whom he represents, one exam hook (public = the only one for the insured).
2. Draw the claim as a six-step pipeline — NOTICE → PROTECT → INVENTORY → EXHIBIT → PROOF OF LOSS (60 days, commonly) → COOPERATE — with the appraisal clause drawn as a side valve labeled “amount disputes only.”
3. Write a trap list titled “After the fire,” ending with: the insured may NOT abandon property to the insurer, and may NOT impair subrogation — and vacant is empty of people AND property.

KEY FORMULAS

$$\text{pro-rata share} = \frac{\text{this policy's limit}}{\text{total of all policies' limits}} \times \text{loss}$$

From history. The insurers of the hand-pump era did not wait for claims; they tried to prevent them. From 1839 New York's fire insurance companies funded their own uniformed force — the Fire Patrol — which raced the municipal firefighters to blazes not to pump water but to spread waterproof covers over merchandise, salvaging property before it became a claim. The corps answered alarms for 167 years, finally disbanding in 2006, and its tarpaulins survive in every adjuster's phrase “protect the property from further damage” — a duty insurers once performed themselves.

WORKED EXAMPLES

Example 1. A warehouse is insured under three policies: Insurer X $200,000, Insurer Y $150,000, Insurer Z $50,000. A covered fire causes $120,000 of damage. Compute each insurer's pro-rata share.

Show solution

1. Total limits: $\$200{,}000 + \$150{,}000 + \$50{,}000 = \$400{,}000$.
2. Insurer X: $\frac{200}{400} \times \$120{,}000 = \$60{,}000$.
3. Insurer Y: $\frac{150}{400} \times \$120{,}000 = \$45{,}000$.
4. Insurer Z: $\frac{50}{400} \times \$120{,}000 = \$15{,}000$.
5. Check by adding: $\$60{,}000 + \$45{,}000 + \$15{,}000 = \$120{,}000$ — the insured is made whole exactly once, which is the whole point of the clause.

Answer: X pays $60,000, Y $45,000, Z $15,000 — each the proportion its limit bears to the $400,000 total.

Example 2. Exam style. A neighbor's brush fire, negligently left burning, destroys the Olsens' fence and shed: a $9,000 covered loss with a $1,000 deductible. Their insurer pays $8,000. The neighbor then offers the Olsens $2,000 “to call the whole thing settled,” and they sign his release. What have the Olsens done, and what was the proper course?

Show solution

1. Name the right at stake: having paid $8,000, the insurer owns the claim against the negligent neighbor by subrogation.
2. The signed release impairs that right — the policy condition forbids it, and the insureds may now owe their insurer the recovery they destroyed, or forfeit coverage.
3. The proper course: accept nothing beyond their uninsured loss without the insurer's consent, report the neighbor's offer, and let subrogation run.
4. Note the happy mechanics when it runs properly: the insurer recovers its $8,000 from the neighbor (or his liability insurer) and commonly recovers and returns the Olsens' $1,000 deductible too.

Answer: They impaired the insurer's subrogation rights, jeopardizing their claim. They should have reported the offer and signed nothing; properly run, subrogation even brings the deductible home.

Example 3. Exam style. After a kitchen fire, an insured and her insurer agree the loss is covered but sit $18,000 apart on what the repair should cost. The insured demands appraisal. Describe the procedure and what it can and cannot decide.

Show solution

1. Each party selects a competent appraiser; the insured pays hers, the insurer pays its own.
2. The two appraisers select an umpire; the parties split the umpire's cost.
3. Each appraiser states the amount of loss; agreement of any two — the appraisers, or one appraiser and the umpire — binds the amount.
4. Scope check: appraisal settles the amount of loss only. Whether the policy covers the loss at all is a coverage question for negotiation or the courts — an umpire has no power over it, and the exam tests exactly that limit.

Answer: Appraiser from each side, umpire chosen by the appraisers, any two bind the amount, costs shared — and the clause decides amounts only, never coverage.

PRACTICE

1. Easy List, in order, the insured's six duties after a property loss.

   Show answer

   Prompt notice (police too, if theft); protect the property from further damage; prepare an inventory; exhibit the property and records as reasonably required; submit the sworn proof of loss, commonly within 60 days of request; and cooperate, including examination under oath.

2. Easy Which adjuster works for the insured, and how is he commonly paid?

   Show answer

   The public adjuster — licensed by the state, hired by the policyholder, and commonly paid a percentage of the settlement. Staff and independent adjusters both represent the insurer.

3. **Easy** What question can the appraisal clause settle, and what question can it never settle?

Show answer

It settles disputes over the amount of a covered loss. It can never decide whether the policy covers the loss at all — coverage disputes belong to negotiation or the courts.

4. **Medium** Two policies cover the same house: $240,000 with Insurer A and $60,000 with Insurer B. A covered windstorm causes $25,000 of damage. Compute each insurer's pro-rata share.

Show answer

Total limits $300,000. A: $\frac{240}{300} \times \$25{,}000 = \$20{,}000$; B: $\frac{60}{300} \times \$25{,}000 = \$5{,}000$. The insured collects $25,000 exactly once.

5. **Medium** After a covered loss, an insured leaves the roof open to three weeks of rain, tripling the damage. What becomes of the added damage, and under what principle?

Show answer

The added damage is excluded as neglect — the insured's duty was to protect the property from further damage, with reasonable repair costs reimbursed by the policy. The original covered damage is paid; the rot he allowed is his.

6. **Medium** Which statement about independent adjusters is TRUE?

A. They represent the insured for a percentage fee
B. They are salaried employees of one insurer
C. They are contractors hired by insurers, especially after catastrophes
D. They are forbidden to handle homeowners claims

Show answer

C. Independent describes employment, not allegiance — insurers hire them claim by claim, and by the hundreds after hurricanes. A describes the public adjuster, B the staff adjuster.

7. Medium A family leaves a furnished lake house closed up for eight months each year. Vandals break in during February. Is the house vacant or unoccupied, and why does the difference decide the claim?

Show answer

Unoccupied — the people are away but the property remains. Vacancy requires the dwelling to be empty of people and property, and only extended vacancy (commonly 60 consecutive days) suspends coverages like vandalism. The unoccupied lake house keeps its coverage.

8. Hard An insurer pays a $14,000 water-damage claim caused by a plumber's negligence, and the insured's deductible was $1,000. Trace the subrogation: who pursues whom, for how much, and what does the insured commonly get back?

Show answer

Having paid, the insurer steps into the insured's shoes against the plumber (and his liability insurer) for the $14,000 it paid — and commonly presses the insured's $1,000 deductible as part of the recovery, returning it when collected. The insured's only duties are to cooperate and sign nothing that impairs the right.

9. Hard After a fire, an insured delivers her smoke-damaged furniture to the insurer's parking lot with a note: “It's yours — pay me the full value.” Name the doctrine she has misunderstood and state the rule correctly, including the right the insurer does have.

Show answer

Abandonment — property forms expressly provide that the insurer need not accept abandoned property, so she cannot force a total loss by surrender. The converse right belongs to the insurer: salvage — having paid for property, it may choose to take and sell the remains to reduce its net loss. The option runs one way, the insurer's way.

10. Hard In appraisal, the insured's appraiser says $52,000, the insurer's says $40,000, and the umpire says $45,000. The insurer's appraiser signs the umpire's figure. What is the award, who pays whom for the process, and is the result binding?

Show answer

The amount is $45,000 — agreement of any two (here, one appraiser and the umpire) binds the amount. Each party pays its own appraiser and the parties split the umpire's fee. It binds as to amount; any genuine coverage dispute would remain outside the award.

11. Challenge Combine the unit: a dwelling worth $400,000 at loss is insured for $240,000 with Insurer A and $80,000 with Insurer B, both policies carrying 80% coinsurance. Fire causes $64,000 of damage. Compute the coinsurance-adjusted recoverable loss, then each insurer's pro-rata share of it (ignore deductibles).

Show answer

Should: $0.80 \times \$400{,}000 = \$320{,}000$; did (combined): $320,000 — the requirement is met, so the full $64,000 is recoverable. Shares by limits: A pays $\frac{240}{320} \times \$64{,}000 = \$48{,}000$; B pays $\frac{80}{320} \times \$64{,}000 = \$16{,}000$. Two clauses, one aim: indemnity exactly once, shared fairly.

12. Challenge A client, angry after a fire, asks you to “bump the inventory a little — the insurer can afford it.” In three sentences, refuse — naming the legal word for his proposal, the clause that lets the insurer examine him under oath, and the duty you owe beyond the law.

Show answer

Padding an inventory is material misrepresentation in a claim — fraud — and the concealment-or-fraud condition voids coverage for insureds who lie about any material fact, with Unit 9's laws adding penalties of their own. The duties after loss include producing records and submitting to examination under oath, where padded numbers unravel quickly and expensively. Beyond the law, the whole pool of premium-payers funds every inflated claim, and my signature on his file is a promise to them and to God that the balance is just.

COMMON MISTAKES

- Saying the independent adjuster represents the insured — he is a contractor for insurers; only the public adjuster works for the policyholder.
- Letting the appraisal clause decide coverage — it binds the amount of loss only; coverage disputes go to negotiation or court.
- Computing pro-rata shares from premiums or losses instead of limits over total limits.
- Thinking the insured may abandon damaged property to the insurer — abandonment is refused; salvage is the insurer's option, not the insured's.
- Forgetting that settling privately with (or releasing) the at-fault party impairs subrogation and can forfeit the claim.
- Confusing vacant with unoccupied — vacancy means empty of people and property, and only extended vacancy (commonly 60 days) suspends vandalism and similar coverages.

Make it a game · Whose Side Are You On?. Shuffle and deal fifteen claim-scene slips you write first: “salaried employee inspects the roof”; “adjuster hired by the family for 10% of the settlement”; “contractor adjusting for six insurers after a hurricane”; “two appraisers pick a third person”; “insured signs the neighbor's release”; “furniture dumped on the insurer's lot.” For each slip, players have five seconds to call the term (staff, public, independent, umpire, impaired subrogation, abandonment) and one more point for calling whose interest that person serves — insurer, insured, or the amount alone. Wrong allegiance costs two points, because in claims, whose side everyone is on is the whole game. High score adjusts the family's dessert, fairly.

Scripture. “If fire break out, and catch in thorns, so that the stacks of corn, or the standing corn, or the field, be consumed therewith; he that kindled the fire shall surely make restitution.” (Exodus 22:6, KJV)

Three thousand years before the first subrogation clause, the law of Moses assigned a fire loss to the one whose carelessness kindled it. Subrogation is this verse in a business suit: the insurer pays the innocent neighbor first, then carries the claim of restitution to the one who let the fire loose. Insurance never abolished responsibility; it organized the payment while God's old question — who kindled it? — still gets asked.

UNIT 6

Property Insurance: The Home

At 5:12 on the morning of April 18, 1906, the ground under San Francisco tore open, and the fires that followed burned for three days. When the smoke cleared, the city's families discovered that the fine print in their policies was now the most important writing in their lives — some insurers paid every dollar they had promised, and some did not. This unit teaches you to read that fine print before the fire. You will learn the grammar of all property insurance: the difference between a **peril** and a **hazard**, between **named-peril** and **open-peril** coverage, between a **direct loss** and the quieter **indirect loss** that follows it. You will master the three ways a policy prices a ruined roof — **actual cash value**, **replacement cost** and **agreed value** — and the **coinsurance formula** that punishes the family who insured a $300,000 house for half its worth.

Then you will walk through the most common policy an agent ever sells: the **homeowners policy**, with its property coverages A through D on one side and its liability coverages E and F on the other, and the famous gaps — flood and earthquake — that every agent must explain or answer for. You will meet the forms for everyone the standard policy leaves out: the landlord's **dwelling policy**, the **HO-4** for renters (likely the first policy you will ever buy yourself) and the **HO-6** for condominium owners. The unit ends where the promise is kept or broken: the claim — the insured's duties after a loss, the three kinds of adjusters, the appraisal clause, the **pro-rata** sharing of a loss between two insurers, and **subrogation**, the insurer's right to stand in your shoes. This is the most mathematical unit in the course; keep your calculator beside your notebook.

PREREQUISITES

- Can compute percents of large numbers quickly (10% of $280,000, 80% of $350,000) with and without a calculator
- Can state the principle of indemnity and define insurable interest from Unit 2
- Can explain what a deductible does and why it lowers a premium, from Units 1 and 5
- Has the exam notebook current, with the Unit 2 contract vocabulary (conditions, exclusions, endorsements) ready for review

MASTERY CHECKLIST

- ☐ I can define peril and hazard, tell named-peril from open-peril coverage, and say who bears the burden of proof under each.
- ☐ I can compute actual cash value as replacement cost minus depreciation, and apply the coinsurance formula with a deductible, capped at the policy limit.
- ☐ I can name the homeowners forms HO-2, HO-3, HO-5 and HO-8 and state how each treats the dwelling and the contents.
- ☐ I can compute Coverages B, C and D from Coverage A using the common percentages, and apply the special limits on money, jewelry and firearms.
- ☐ I can explain Coverage E and Coverage F, including why defense costs are paid in addition to the limit and why Coverage F pays without fault.
- ☐ I can name the great exclusions — flood and earth movement — and explain how the NFIP and an earthquake endorsement fill them.
- ☐ I can match a landlord, a renter and a condominium owner to the DP-3, HO-4 and HO-6, and state what each form covers.
- ☐ I can list the insured's duties after a loss, tell the three kinds of adjusters apart, compute a pro-rata

share, and explain subrogation and the appraisal clause.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Texas Department of Insurance: Homeowners Insurance Guide**: Free, official. A state insurance department explains homeowners coverage, named exclusions and claims in plain consumer language. Read it with Lessons 6.2 and 6.3, and compare it with your own state department's guide. Ages 15 and up.
- **Wisconsin OCI: Consumer's Guide to Homeowners Insurance**: Free, official. A second state's view of the same policy — useful proof that the forms are national but the details are state by state. Skim it with Lesson 6.4 for its renters and condominium pages. Ages 15 and up.
- **FloodSmart.gov — the National Flood Insurance Program**: Free, official. FEMA's consumer site for the NFIP: what flood insurance covers, what it costs and how the waiting period works. Use it during Lesson 6.3's project to build your flood fact sheet. Ages 14 and up.
- **Insurance Information Institute: How to File a Homeowners Claim**: Free. The industry's own consumer institute walks through notice, inventory, the adjuster's visit and the settlement check. Read it with Lesson 6.5 before you build your pretend claim file. Ages 14 and up.
- **Insurance Information Institute: Facts and Statistics on Homeowners and Renters Insurance**: Free. Real national figures on premiums, claim frequency and the most common causes of home losses. Dip in during Lesson 6.4 to see how few renters carry the inexpensive policy that would save them. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

6.1 Perils, Hazards and the Price of a Loss: ACV, Replacement Cost and Coinsurance

3 sessions of 50 minutes

6.2 The Homeowners Policy: Dwelling and Belongings — 3 sessions of 50 minutes

6.3 The Homeowners Policy: Liability and the Gaps — 3 sessions of 50 minutes

6.4 **Dwelling, Renters and Condominium Policies** 3 sessions of 50 minutes

6.5 **After the Fire: Claims, Adjusters and Subrogation** 3 sessions of 50 minutes

Unit 6 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example” or “commonly,” use the figures given — real limits, percentages and waiting periods vary by state, form and year, and the live ones are checked at your state insurance department and floodsmart.gov. A state licensing exam passes at 70% — 14 of 20 here — but aim well higher. Choose the one BEST answer, and keep a calculator handy: this unit's test does arithmetic.

1. **5 pts**

   Icy front steps that make a slip-and-fall more likely are BEST described as a:

   A. Peril

   B. Physical hazard

   C. Morale hazard

   D. Direct loss

2. **5 pts**

   Under an open-peril (special form) policy, a claim may be denied only if:

   A. The insurer proves an exclusion applies

   B. The insured fails to prove a listed peril caused the loss

   C. The loss was partial rather than total

   D. The property was personal rather than real

3. 5 pts

A 6-year-old sofa is destroyed by a covered fire. A new like-kind sofa costs $3,000 , and sofas last about 12 years. Ignoring the deductible, the actual cash value settlement is:

A. $3,000

B. $2,500

C. $1,500

D. $500

4. 5 pts

A building worth $500,000 at the time of loss is insured for $300,000 under a policy with an 80% coinsurance clause and a $1,000 deductible. A covered loss of $60,000 occurs. The insurer pays:

A. $60,000

B. $59,000

C. $45,000

D. $44,000

5. 5 pts

The same underinsured building ($300,000 limit, 80% coinsurance, $500,000 value) burns to the ground — a total loss. Ignoring the deductible, the insurer pays:

A. $500,000

B. $300,000

C. $375,000

D. $240,000

6. 5 pts

After a covered kitchen fire, a family pays for a rental apartment during repairs. The apartment cost is an example of:

A. Direct loss, covered under Coverage A

B. Direct loss, covered under Coverage C

C. Indirect loss, covered under Coverage D

D. An excluded consequential loss

7. 5 pts

On an HO-3 special form, coverage is:

A. Open peril on the dwelling and other structures, named peril on personal property

B. Named peril on the dwelling, open peril on personal property

C. Open peril on both dwelling and personal property

D. Named peril on both dwelling and personal property

8. 5 pts

A homeowners policy carries Coverage A of $350,000. Using the common percentages, the limit for Coverage B — Other Structures is:

A. $17,500

B. $35,000

C. $70,000

D. $105,000

9. 5 pts

A burglar steals $600 in cash and a $5,000 diamond ring from an insured home. Under an unendorsed homeowners form with common special limits, the policy pays at most:

A. $5,600

B. $5,200

C. $2,100

D. $1,700

10. 5 pts

A covered loss forces a family out for three months. Normal living costs are $3,000 a month; costs while displaced are $4,100 a month. Coverage D pays:

A. $3,300

B. $12,300

C. $9,000

D. $21,300

11. 5 pts

An insured with $100,000 of Coverage E is sued after a guest's fall; the insurer spends $30,000 on defense and pays a $100,000 judgment. Which statement is TRUE?

A. The insurer pays $100,000 total, because defense costs erode the limit

B. The insured must reimburse the defense costs

C. The insurer pays $130,000 total, because defense is in addition to the limit

D. The claim exceeds the policy and is wholly denied

12. 5 pts

Coverage F — Medical Payments to Others pays:

A. Only when the insured is legally liable

B. Small medical bills of injured non-residents without regard to fault

C. The insured family's own medical bills after a covered loss

D. Funeral benefits for any injured person up to $100,000

13. 5 pts

During a hurricane, wind tears a hole in the roof and rain pours in; storm surge also fills the basement. Under an unendorsed HO-3:

A. Both losses are covered

B. Both losses are excluded

C. The basement is covered; the roof and rain are excluded

D. The roof and rain damage are covered; the basement flood is excluded

14. 5 pts

Which statement about the National Flood Insurance Program is TRUE as taught, with figures as common examples?

A. Created by the National Flood Insurance Act of 1968, run by FEMA, commonly $250,000/$100,000 maximum limits and a 30-day waiting period

B. Created after the 1906 earthquake and run by the states

C. A private program with unlimited building coverage and no waiting period

D. Automatic coverage included in every homeowners policy

15. 5 pts

The HO-4 contents broad form provides a tenant with:

A. Dwelling coverage, contents coverage and liability

B. Contents coverage only, with no liability

C. Contents coverage, loss of use and full Section II liability — but no dwelling coverage

D. Liability coverage only

16. 5 pts

Hail damage to a condominium's common roof exceeds the association's master policy, and each unit owner is assessed $1,800. The HO-6 coverage designed for this is:

A. Coverage B — Other Structures

B. Loss assessment coverage, commonly $1,000 built in and raised by endorsement

C. Fair rental value

D. The personal articles floater

17. 5 pts

The standard dwelling policy forms (DP-1, DP-2, DP-3) are notable for EXCLUDING which two coverages unless added?

A. Fire and windstorm

B. Loss of rents and vandalism

C. Replacement cost and extended coverage

D. Theft and personal liability

18. 5 pts

The ONLY adjuster who represents the policyholder rather than the insurer is the:

A. Public adjuster

B. Independent adjuster

C. Staff adjuster

D. Umpire

19. 5 pts

A covered $40,000 loss is insured under two policies: $150,000 with Insurer A and $50,000 with Insurer B. Under pro-rata liability, Insurer A pays:

A. $40,000

B. $20,000

C. $30,000

D. $10,000

20. 5 pts

After an insurer pays a fire claim caused by a careless contractor, the insured signs the contractor's $500 “full release of all claims.” The insured has:

A. Exercised the right of salvage

B. Properly abandoned the property

C. Triggered the appraisal clause

D. Impaired the insurer's subrogation rights, jeopardizing the claim

ANSWER KEY

1. B. A hazard is a condition increasing the chance or severity of loss, and ice is a physical one; the peril would be the fall itself as a cause of injury. Morale hazard is carelessness bred by being insured.
2. A. Open-peril coverage reverses the burden of proof: all direct physical loss is covered unless the insurer points to an exclusion. B states the named-peril rule — the classic swap the exam loves.
3. C. Depreciation is $\frac{6}{12} \times \$3{,}000 = \$1{,}500$, and ACV is replacement cost minus depreciation: $\$3{,}000 - \$1{,}500 = \$1{,}500$. A is the replacement-cost answer, not ACV.
4. D. Should: $0.80 \times \$500{,}000 = \$400{,}000$; did over should is $\$300{,}000 / \$400{,}000 = 0.75$; then $0.75 \times \$60{,}000 - \$1{,}000 = \$44{,}000$. C forgets the deductible; B forgets the coinsurance penalty.
5. B. The policy never pays more than its limit, and at a total loss the limit governs — the coinsurance formula's $375,000 (C) is capped. The penalty genuinely bites only on partial losses.
6. C. Loss of use is the textbook indirect (consequential) loss, and the homeowners policy covers it under Coverage D — commonly 30% of Coverage A on an HO-3, paying expenses above the family's normal cost of living.
7. A. The HO-3's signature split. C describes the HO-5 comprehensive form and D the HO-2 broad form; B reverses the HO-3 and exists on no standard form.
8. B. Coverage B is commonly 10% of Coverage A — $0.10 \times \$350{,}000 = \$35{,}000$ — as additional insurance for detached structures. C is the 20% figure of no standard coverage; D is Coverage D's common 30%.
9. D. Money is commonly capped at $200 and theft of jewelry at $1,500: $\$200 + \$1{,}500 = \$1{,}700$. The cure for the ring was a scheduled personal property floater, which would have carried its appraised value.
10. A. Coverage D pays the increase over normal living expense: $(\$4{,}100 - \$3{,}000) \times 3 = \$3{,}300$. B pays the whole displaced cost and D adds both — the family would have eaten and housed itself anyway.
11. C. Defense costs are paid in addition to the Coverage E limit, so the insurer pays the full judgment plus the lawyers. A states the trap; nothing requires reimbursement (B), and limits cap payment, not coverage (D).
12. B. Coverage F is the small no-fault goodwill coverage — commonly $1,000 to $5,000 per person — for guests and others, never for insureds or regular

residents. A describes Coverage E.

13. D. Wind is a covered peril and the rain entering through the wind-made opening follows the covered chain; rising surface water is flood, excluded and insurable only through the NFIP or a private flood policy.
14. A. Congress created the NFIP in 1968 after Hurricane Betsy exposed the flood gap; FEMA administers it, with commonly $250,000 building and $100,000 contents maximums and a 30-day wait (loan closings excepted). Verify live figures at floodsmart.gov.
15. C. The renter owns no building, so Coverages A and B are omitted; the form keeps personal property, loss of use (commonly 30% of C) and Coverages E and F. The landlord's policy never covers the tenant's goods.
16. B. Loss assessment pays the unit owner's share of an assessment arising from a covered loss to common property that outruns the master policy. Assessments for maintenance are never covered; C belongs to the dwelling program and D to valuables.
17. D. The dwelling program insures the building (and optionally contents) for landlords and non-owner-occupants, but standard forms carry no theft coverage and no liability — both added by endorsement or separate policies. Fair rental value, by contrast, is a dwelling-program feature.
18. A. The public adjuster is hired by the insured, commonly for a percentage of the settlement. The independent adjuster is a contractor for insurers — the exam's favorite distractor — the staff adjuster is the insurer's employee, and the umpire decides appraisal amounts for neither side.
19. C. Total limits are $200,000, and A's share is $\frac{150}{200} \times \$40{,}000 = \$30{,}000$; B pays the remaining $10,000. Each insurer pays the proportion its limit bears to all limits, and the insured collects the loss exactly once.
20. D. Payment transferred the claim against the wrongdoer to the insurer, and the policy forbids the insured to impair that right — a private release does exactly that. Salvage is the insurer's option over paid-for property, and abandonment is never the insured's right.

PORTFOLIO PIECE: MY PATHWAY FILE — THE PROPERTY PAGES

Assemble the property-insurance section of your Pathway File: the settlement calculator with its ACV and coinsurance panels tested against the lesson examples (6.1), the Whitfield house coverage map with Coverages A–D, the special-limits table and your two endorsement recommendations (6.2), the gap sheet with its seven gaps and cures plus the dated flood fact sheet from floodsmart.gov (6.3), the Four Doors chart matching the DP-3, HO-4, HO-6 and HO-8 to their households (6.4), and the complete pretend claim file — notice, inventory excerpt, proof-of-loss summary, pro-rata worksheet and subrogation memo — together with the real one-room home inventory you built for your own family (6.5).

Close the section with a one-page cover memo to a pretend first client: in your own words, explain why insuring to value is honest arithmetic rather than salesmanship, name the two gaps — flood and liability above the limits — you will always raise unasked, and quote Exodus 22:6 on who, in the end, makes restitution. Date every page. These artifacts return in Unit 8, when the same grammar goes to work on Main Street's commercial risks.

LOOK FOR	WHAT IT MEANS
Settlement calculator	The ACV and coinsurance panels reproduce the lesson's worked examples exactly ($12,000; $29,500; $240,000), both caps work, and each cap carries a one-line reason for its existence.
Whitfield coverage map	Coverages B, C and D are computed correctly from Coverage A with the common percentages labeled as examples, the special limits are applied to the cash, ring and firearm, and both endorsement recommendations state honest costs and benefits.
Gap sheet and flood facts	All seven gaps are paired with their named cures, and every flood figure is dated and traceable to floodsmart.gov.
Four Doors chart	Each household is matched to the right form — DP-3, HO-4, HO-6, HO-8 — with its signature feature (fair rental value; no A or B; walls-in plus loss assessment; modified settlement) stated in one line.
Claim file and home inventory	The six duties after loss appear in order, the pro-rata worksheet's shares sum exactly to the loss, the subrogation memo names the one thing never to sign, and the real one-room inventory is complete with its off-site storage note.

LOOK FOR	WHAT IT MEANS
Cover memo	Written in the student's own voice, it names both always-raise gaps — flood and liability above the limits — and connects insuring to value and Exodus 22:6's restitution to honest dealing without canned language.

UNIT 7

Casualty Insurance: Autos and Liability

Property insurance pays you when your own things burn or blow away. **Casualty insurance** faces the other direction: it pays the people you hurt. The key that unlocks this whole unit is **legal liability** — the law's judgment that one person must pay for another's loss — and the law's chief tool for assigning that blame is **negligence**, proved by four elements: a duty owed, a breach of that duty, proximate cause, and actual damages. You will learn the four elements from a fireworks package that fell on a Brooklyn train platform in 1924, and then you will carry them into the policy nearly every American family owns: the **personal auto policy**, part by part — liability and medical payments, uninsured and underinsured motorists, collision and other-than-collision. You will finally learn to read **split limits** like 100/300/50 aloud and to work the claim arithmetic the licensing exam loves best.

Above the auto and homeowners policies you will raise the **personal umbrella**, a million dollars or more of liability protection for the catastrophic day, and you will finish with the most remarkable bargain in American insurance law: **workers' compensation**, born in Wisconsin in 1911, by which workers gave up the right to sue their employers and received in exchange certain, no-fault benefits — and employers accepted automatic duty in exchange for peace. Casualty questions crowd every property and casualty licensing exam, and most of them are won with the four elements, the three numbers of a split limit, and the phrase *exclusive remedy*. By the end of this unit all three will be yours.

PREREQUISITES

- Has completed Unit 6, or can compute actual cash value (replacement cost minus depreciation) and apply a deductible to a loss
- Can work comfortably with percents and large numbers (find two-thirds of $900, find 30% of $80,000, keep thousands straight)
- Can read a short legal scenario twice and list its facts in order before answering anything
- Can keep a tidy, dated exam notebook and a growing flashcard box from the earlier units

MASTERY CHECKLIST

- ☐ I can name the four elements of negligence, define each in one sentence, and show which element fails in a given scenario.
- ☐ I can contrast contributory and comparative negligence, compute a comparative-negligence recovery, and define strict and vicarious liability.
- ☐ I can read a split limit like 100/300/50 aloud, apply it to a multi-victim claim, and contrast it with a combined single limit.
- ☐ I can name Parts A through F of the personal auto policy and say who counts as an insured under Part A.
- ☐ I can explain uninsured and underinsured motorists coverage and compute what Part C pays in an example.
- ☐ I can sort any loss into collision or other-than-collision — including the deer — and settle it at actual cash value minus the deductible.
- ☐ I can explain how a personal umbrella sits above underlying limits, when the self-insured retention applies, and stack a large judgment across the layers.

- ☐ I can tell the story of the workers' compensation bargain — statutory no-fault benefits in exchange for exclusive remedy — and compute a weekly disability benefit and an experience-modified premium.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Insurance Information Institute: Auto Insurance Basics**: Free consumer page from the insurance industry's own information institute, walking the same coverages as Lessons 7.2 and 7.3 in plain language. Read it after 7.2 and check that you can name the part of the policy behind each paragraph. Ages 14 and up.
- **Texas Department of Insurance: Automobile Insurance Guide**: Free, official. A real state insurance department's consumer guide to auto coverage, with that state's required minimums. Use it with Lessons 7.2 and 7.3 as your model, then find the matching guide from your own state's department — every state publishes one. Ages 14 and up.
- **Insurance Information Institute: What Is an Umbrella Liability Policy?**: Free consumer explainer on the personal umbrella — what sits beneath it and what it adds. Read it with Lesson 7.4 and compare its example limits with the ones in this unit, remembering that real figures vary by insurer and state. Ages 14 and up.
- **Wisconsin Department of Workforce Development: Worker's Compensation Division**: Free, official — and historic: Wisconsin's 1911 act was the first workers' compensation law in America to last. Browse the division's pages with Lesson 7.5 to see the great bargain still running, then look up your own state's workers' compensation agency. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

7.1 Negligence and the Four Elements: How the Law Assigns Blame

3 sessions of 50 minutes

7.2 The Personal Auto Policy: Liability and Medical Payments

3 sessions of 50 minutes

7.3	**The Personal Auto Policy: Uninsured Motorists and Physical Damage**	3 sessions of 50 minutes
7.4	**The Umbrella: Liability for the Catastrophic Day**	3 sessions of 50 minutes
7.5	**Workers' Compensation: The Great Bargain**	3 sessions of 50 minutes

Unit 7 test

Closed book. Twenty four-choice questions, 5 points each — the same style your state licensing exam uses, at about one minute per question, so set a timer for 25 minutes. Answer every question; an unanswered question is simply a wrong one. On a licensing exam 70% (14 of 20 here) is a pass, but aim higher — the real exam will be longer and you will be nervous. Remember that every dollar figure and state minimum marked «in this example» is exactly that: the live numbers for your state are at your state insurance department's website.

1. **5 pts**

   A claimant proves the defendant owed a duty, breached it, and that the breach proximately caused the harm — but can show no actual loss of any kind. The negligence claim:

   A. Succeeds, because three of four elements are proven

   B. Fails, because all four elements, including actual damages, are required

   C. Succeeds, but only nominal punitive damages are awarded

   D. Becomes a strict liability claim automatically

2. **5 pts**

   A jury finds $60,000 of damages and puts 40% of the fault on the claimant in a pure comparative negligence state. The claimant recovers:

   A. $0

   B. $24,000

   C. $36,000

   D. $60,000

3. 5 pts

A homeowner keeps a pet wolf that escapes — despite an expensive, well-built enclosure — and bites a neighbor. The homeowner's liability is best described as:

A. Strict (absolute) liability, regardless of his precautions

B. No liability, because he was not negligent

C. Vicarious liability

D. Negligence per se

4. 5 pts

Which damages punish the defendant rather than compensate the victim, and are therefore uninsurable in many states?

A. Special damages

B. General damages

C. Compensatory damages

D. Punitive damages

5. 5 pts

An insured carries split limits of 50/100/25. One at-fault accident injures two people, with claims of $70,000 and $30,000, and causes $30,000 of damage to the other car. The policy pays:

A. $100,000 BI and $30,000 PD

B. $80,000 BI and $25,000 PD

C. $100,000 BI and $25,000 PD

D. $130,000 total from a single pool

6. 5 pts

Under PAP Part A, defense costs the insurer incurs defending the insured are:

A. Paid in addition to the limits of liability

B. Paid from within the limits, reducing them

C. Paid only after a judgment

D. The insured's own responsibility once suit is filed

7. 5 pts

Which person is NOT an insured under Part A of a family's personal auto policy?

A. The named insured's resident 17-year-old son driving a borrowed car

B. A neighbor driving the covered auto with permission

C. A thief who takes the covered auto from the driveway

D. The named insured's spouse, who lives in the household

8. 5 pts

The named insured bumps her own garage wall, bruising her chin; no one else is involved. Which PAP coverage pays her medical bill?

A. Part A liability

B. Part C uninsured motorists

C. No coverage — she was at fault

D. Part B medical payments

9. 5 pts

The insured's car strikes a deer at night, then three weeks later is dented by hail. Under Part D these losses are, respectively:

A. Other-than-collision and other-than-collision

B. Collision and other-than-collision

C. Collision and collision

D. Other-than-collision and collision

10. 5 pts

An insured suffers $90,000 of bodily injury damages caused by a driver carrying 25/50 limits whose insurer pays its $25,000. The insured's UIM limit is $100,000, in a state where UIM pays damages minus the at-fault payment (in this example). UIM pays:

A. $100,000

B. $65,000

C. $90,000

D. $25,000

11. 5 pts

A hit-and-run driver injures the insured, who files under Part C. Which duty is specific to this claim?

A. Obtaining the insurer's consent before any medical treatment

B. Posting a bond for the phantom driver

C. Promptly notifying the police

D. Repairing the car before inspection

12. 5 pts

A covered auto with an actual cash value of $11,000 needs $12,500 of collision repairs; the collision deductible is $500. The insurer will pay:

A. $12,000

B. $11,000

C. $12,500

D. $10,500, and take the salvage

13. 5 pts

A personal umbrella policy is best described as:

A. Liability coverage of $1 million or more, excess over required underlying auto and homeowners limits

B. Property coverage for catastrophic damage to the insured's home and autos

C. A substitute for auto and homeowners policies

D. Health coverage for catastrophic injuries to the insured

14. 5 pts

A $1,000,000 umbrella has a $1,000 SIR. The insured's underlying auto policy pays its full $250,000 limit toward a $600,000 judgment. The umbrella pays:

A. $349,000 — the balance minus the SIR

B. $600,000

C. $350,000 — the SIR does not apply when an underlying policy has paid

D. Nothing until the insured pays $1,000

15. 5 pts

An umbrella requires 250/500 underlying auto limits, but the insured reduced his auto policy to 100/300. After a $400,000 one-victim judgment, the insured personally owes:

A. Nothing — the umbrella drops down

B. $150,000 — the gap between his actual and required underlying limits

C. $400,000 — the umbrella is void

D. $1,000 — the SIR only

16. 5 pts

Which claim could the umbrella cover from the first dollar above the retention, because the underlying policies do not cover it at all?

A. A three-car pileup the insured caused

B. Hail damage to the insured's roof

C. A guest's fall on the insured's stairs

D. A slander judgment against the insured

17. 5 pts

Under the workers' compensation «great bargain,» the employee receives no-fault statutory benefits and gives up:

A. The right to sue the employer for negligence

B. The right to statutory death benefits

C. The right to choose any doctor

D. The right to quit the job

18. 5 pts

A covered worker earning an average weekly wage of $750 is disabled for 6 weeks; the state pays two-thirds of AWW, below its maximum (in this example). Her weekly benefit is:

A. $750

B. $375

C. $250

D. $500

19. 5 pts

In which group of states must employers buy workers' compensation from the state's own monopolistic fund, as of 2026?

A. Texas, Florida, Georgia, Alabama

B. California, New York, Illinois, Pennsylvania

C. North Dakota, Ohio, Washington, Wyoming

D. Maine, Vermont, New Hampshire, Massachusetts

20. 5 pts

Which injured person is entitled to workers' compensation benefits?

A. An independent contractor hurt using his own tools on his own schedule

B. A stock clerk who carelessly cuts himself opening boxes at work

C. A cashier rear-ended during her ordinary drive to the store before her shift

D. An employee hurt in a weekend softball game unrelated to work

ANSWER KEY

1. B. Negligence requires duty, breach, proximate cause AND actual damages; a majority of elements is not enough, and strict liability (D) applies only to abnormally dangerous activities, not to failed negligence claims.
2. C. Recovery equals damages times the defendant's share: $60,000 × 0.60 = $36,000. A would be right only under contributory negligence, and B reverses the percentages — the classic arithmetic trap.
3. A. Keeping a wild animal is a classic strict liability activity: the keeper pays for the harm his extraordinary hazard causes, and the quality of his precautions is irrelevant — which is why B is the tempting wrong answer.
4. D. Punitive damages punish outrageous conduct; insuring them would shift the punishment to the pool, so many states forbid it. Special and general damages (A, B) together make up compensatory damages (C), which insurance exists to pay.
5. B. Cap each person first: min(70, 50) = $50,000 and min(30, 50) = $30,000; the $80,000 sum passes the $100,000 per-accident test. PD pays min(30, 25) = $25,000 from its separate pool. A and C forget the per-person cap or the PD limit; D describes a combined single limit.
6. A. The PAP pays defense costs and supplementary payments in addition to the stated limits; the duty to defend ends only when the limits are exhausted by payment of judgments or settlements.
7. C. A thief has no reasonable belief of permission and is no insured. Resident family members (A) and the resident spouse (D) are insureds for any auto, and the permissive user (B) is an insured for the covered auto.
8. D. Medical payments is no-fault coverage for insureds injured while occupying an auto, so her own clumsiness is irrelevant. Part A pays others, not the insured; C wrongly imports fault into a no-fault coverage.
9. A. Contact with a bird or animal and hail are both named other-than-collision perils. The deer becomes a collision question only when the driver swerves and strikes some other object instead.
10. B. The insured is entitled to min($90,000, $100,000) = $90,000, less the $25,000 received: UIM pays $65,000. A pays the limit regardless of damages, and C ignores the at-fault insurer's payment — both classic traps.
11. C. A hit-and-run claim requires prompt police notice, which protects the insurer against invented phantom-driver accidents. D is backwards — the insured must

permit inspection and protect the car from further damage, not repair it first.

12. D. Repair cost exceeds ACV, so the car is a total loss: the insurer pays ACV minus the deductible ($11,000 − $500 = $10,500) and takes the salvage. A and C pay repair figures the policy never promises once repairs exceed the car's value.
13. A. The umbrella is pure liability protection sitting above the underlying policies it requires. It never pays the insured's own property or medical losses (B, D), and it supplements rather than replaces the primary policies (C).
14. C. The umbrella pays the $350,000 excess over the exhausted underlying limit. The self-insured retention applies only on drop-down claims no underlying policy covers — A charges it in the wrong place, which is the exam's favorite umbrella trap.
15. B. The auto pays its actual $100,000; the umbrella attaches at the required $250,000 and pays $150,000; the $150,000 between $100,000 and $250,000 is the insured's own. Failure to maintain underlying limits moves the gap onto the insured, not onto the umbrella (A) and not into a void policy (C).
16. D. Slander is a personal injury offense the basic underlying forms lack, so the umbrella drops down, minus the SIR. A and C are covered by the underlying auto and homeowners liability first, and B is property damage to the insured's own home — no liability policy pays it.
17. A. Exclusive remedy is the bargain's other half: statutory benefits replace the negligence suit against the employer. B is a benefit received, not surrendered, and C and D are state-by-state details, not the bargain itself.
18. D. Two-thirds of $750 is $500 a week. A replaces the full wage, which no state formula does; B is one-half and C is one-third — misread fractions, the question's whole point.
19. C. North Dakota, Ohio, Washington and Wyoming run monopolistic state funds; private carriers there sell only stop-gap employers liability. The other lists are large or regional states with private and competitive markets.
20. B. Compensation is no-fault, so the careless employee at his task collects. The contractor (A) is not an employee; the commute (C) fails the going-and-coming rule; the weekend game (D) neither arises out of nor occurs in the course of employment.

PORTFOLIO PIECE: THE CASUALTY FILE

Assemble the five artifacts this unit built: the Liability Map of the four elements with its defenses and doctrines (7.1), the Split-Limits Claim Desk worksheet with its shortfall column (7.2), the Whole-Policy Map of PAP Parts A through F with twelve routed losses (7.3), the Tower Diagram stacking three claims through the umbrella (7.4), and the Great Bargain Ledger with its benefit and premium calculations (7.5). Clip them into the casualty section of your Pathway File in that order — blame, the policy, the policy's second half, the layer above, and the workplace bargain.

Then write the one-page cover sheet that proves the unit is yours: in your own words, trace a single $1,000,000 judgment from the four elements that created it, through the split limits that paid first, to the umbrella layer that finished it — with every number shown — and close with two sentences on why the workers' compensation bargain removed exactly this kind of lawsuit from the workplace.

LOOK FOR	WHAT IT MEANS
Complete file	All five artifacts are present, dated, and labeled with their lesson numbers, clipped in order behind the casualty divider.
Split-limits arithmetic	The Claim Desk worksheet applies the fences in the correct order — per person, per accident, then property damage — in every claim, with the insured's personal shortfall computed each time.
Umbrella mechanics	The Tower Diagram shows a correct attachment point, one correct drop-down claim with the self-insured retention, and one correct failure-to-maintain gap charged to the insured.
The great bargain	The Great Bargain Ledger states both sides of the bargain accurately and computes one disability benefit and one experience-modified premium without error.
Cover-sheet walk-through	The one-page judgment walk-through is arithmetically correct at every layer and uses duty, breach, proximate cause, damages, per-person limit, attachment point, and exclusive remedy correctly.
Honest figures	Every changeable figure on every page is flagged «in this example» or «commonly», with at least one note pointing to the state insurance department for live numbers.

7.1 Negligence and the Four Elements: How the Law Assigns Blame

OBJECTIVES

- Distinguish a tort from a crime and from a breach of contract, and define negligence as an unintentional tort.
- Name and define the four elements of negligence — duty, breach, proximate cause, and actual damages — and show which element fails in a scenario.
- Contrast contributory and comparative negligence and compute a recovery under pure and modified comparative rules.
- Define assumption of risk, strict (absolute) liability, vicarious liability, and negligence per se with one example each.
- Classify damages as special, general, or punitive, and explain why punitive damages are often uninsurable.

> **Warm-up.** In five minutes, list three things you did this week that could have hurt a stranger if you had done them carelessly — driving, walking a dog, leaving something on a step. Beside each, write one line: what would a careful person have done? Keep the paper; by the end of the lesson you will know the legal name for that careful person.

WATCH

Elements of Negligence

LawShelf · 9:45

https://www.youtube.com/watch?v=gN9b3sMEpfo

> **WHEN TO WATCH**
> Watch after reading the big idea; each time an element is named — duty, breach, causation, damages — hold up a finger, and do not put your hand down until all four are up.

BACKUP VIDEO

The Four Elements of Negligence: Duty, Breach, Causation, Damages

Law & Business · 6:37

https://www.youtube.com/watch?v=LediTBmEBbk

A brisk second pass through the elements with fresh examples; watch it before the project if you still hesitate naming which element a scenario attacks.

KEY TERMS

tort

A civil wrong against a person or property, other than breach of contract, for which the law awards money damages.

negligence

The failure to use the degree of care a reasonably prudent person would use under the same circumstances — the unintentional tort behind most liability claims.

duty of care

The legal obligation to act with reasonable care toward others who could foreseeably be harmed by your conduct — the first element of negligence.

reasonable person standard

The measuring stick for breach: whether conduct fell below what an ordinarily careful, prudent person would have done in the same situation.

proximate cause

An unbroken chain of events between the breach and the injury, without which the injury would not have occurred — the third element of negligence.

actual damages

Real, measurable loss or injury suffered by the claimant; without damages there is no negligence claim, however careless the conduct.

contributory negligence

A strict common-law defense under which a claimant whose own carelessness contributed to the loss in any degree recovers nothing; only a few jurisdictions still use it.

comparative negligence

The modern rule that reduces a claimant's recovery by his percentage of fault; modified versions bar recovery when his fault reaches 50% or 51%, depending on the state.

assumption of risk

A defense that applies when the claimant knew a danger and voluntarily exposed himself to it, as when a spectator sits along the foul line.

strict (absolute) liability

Liability imposed without any proof of negligence for abnormally dangerous activities, such as blasting with explosives or keeping wild animals.

vicarious liability

Liability imputed to one person for the acts of another, as when an employer answers for an employee's negligence within the scope of employment.

punitive damages

Damages awarded to punish outrageous conduct rather than to compensate the victim; many states forbid insuring them as against public policy.

CORE IDEAS

The story. On the morning of August 24, 1924, Helen Palsgraf stood on a Long Island Rail Road platform in Brooklyn, waiting with her daughters for the train to Rockaway Beach. Down the platform, a man running for a departing train was pushed and pulled aboard by two guards — and dropped his package. It was a plain bundle of newspaper, about fifteen inches long, and no one could have guessed that it held fireworks. It exploded on the rails, and the shock — so the jury found — knocked over a heavy penny scale at the far end of the platform, which struck Mrs.

Palsgraf. She sued the railroad and won twice below. But in 1928 New York's highest court, in *Palsgraf v. Long Island Railroad*, took her verdict away. Chief Judge Benjamin Cardozo wrote that negligence is not a wrong to the world at large: the guards may have been careless toward the package's owner, but they owed no duty to a woman standing far away, because no reasonable eye could have foreseen danger to her. Judge William Andrews dissented, arguing the real question was proximate cause. Law students have argued the case ever since — which is exactly why it opens this lesson: every liability policy you will ever sell pays only when the law, working through these ideas, assigns blame.

How they figured it out. English and American judges built the law of negligence case by case through the 1800s, and their master invention was an imaginary man: the **reasonably prudent person**. He is not perfect, not brilliant, not timid — just ordinarily careful, the sober neighbor who looks before backing out of the drive. Conduct is measured against him, not against the defendant's own habits or intentions; a driver who honestly did his clumsy best is still negligent if the reasonable person would have done better. The judges sorted civil wrongs, called **torts**, from crimes and contracts: a *crime* is a public wrong the state punishes; a *breach of contract* is the breaking of a promise the parties made to each other; a *tort* is a private wrong the law remedies with money damages, no promise and no prosecutor required. Torts divide into intentional wrongs — assault, libel, trespass — and the unintentional one that fills the casualty business: negligence. Insurance follows that line. Liability policies cover the careless day, never the intended wrong.

The big idea. To win a negligence case, a claimant must prove **four elements**, and he must prove them all. First, a **duty of care**: the defendant owed the claimant a legal obligation of reasonable care — every driver owes it to everyone else on the road. Second, a **breach** of that duty: the defendant's conduct fell below the reasonable person standard — he ran the stop sign. Third, **proximate cause**: an unbroken chain connects the breach to the harm — the running of the sign, and nothing else intervening, produced the crash. Fourth, **actual damages**: the claimant really lost something — a crumpled fender, a broken arm, lost wages. Strike out any one element and the claim dies. A breach that hurts no one owes nothing; an injury with no breach behind it is simply a misfortune. The exam will hand you little stories and ask, in effect, which element is missing — so practice saying the four in order until they come like the points of a compass: duty, breach, cause, damages.

Even when all four elements stand, the defendant may raise **defenses**. The old common-law rule, **contributory negligence**, was merciless: if the claimant's own carelessness contributed to his injury in any degree — even one percent — he recovered nothing. A few jurisdictions keep that rule, but most states have replaced it with **comparative negligence**, which divides the fault and reduces the award. Under *pure* comparative negligence the claimant recovers his damages minus his own percentage of fault, however large; under the common *modified* versions he recovers that reduced amount only if his fault stays below the state's bar — 50% in some states, 51% in others — and nothing once he reaches it. In this example, a jury finds $100,000 of damages and puts 30% of the fault on the claimant: he recovers $70,000 under any comparative rule, but $0 in a contributory state. The third defense, **assumption of risk**, applies when the claimant knew the danger and chose it freely — the fan who takes a seat along the foul line has assumed the risk of the foul ball.

The law also assigns blame without carelessness, and assigns one person's carelessness to another. **Strict liability** — the exam also says *absolute liability* — attaches to abnormally dangerous activities: a contractor blasting with dynamite, a keeper of wild animals. However careful they were, they pay for the harm their hazard causes, because they chose to create it. **Vicarious liability** imputes one person's tort to another who controlled or benefited from the actor: an employer answers for an employee driving on company business — the old phrase is *respondeat superior*, let the master answer — and in some states parents answer for teenage drivers under family-purpose doctrines. **Negligence per se** treats the violation of a safety statute as breach in itself: a driver who ran the red light need not be measured against the reasonable person, because the legislature already drew the line he crossed. Each of these doctrines widens the circle of people a liability policy must defend.

Finally, learn the anatomy of **damages**, because limits and umbrellas (Lesson 7.4) make no sense without it. **Special damages** are the measurable economic losses — medical bills, lost wages, the repair invoice. **General damages** compensate real but unpriceable harm — pain and suffering, disfigurement, loss of companionship — and in a serious injury case they often dwarf the specials. Together these are *compensatory*: they aim to make the victim whole. **Punitive damages** are different in kind: they punish willful, wanton or grossly reckless conduct and make an example

of the defendant. Because letting an insurer pay a punishment would blunt its sting, many states forbid insuring punitive damages as against public policy — commonly tested, and it varies by state. One more clock runs under everything: the **statute of limitations**, the deadline — commonly two or three years for injury suits, in this example — after which even a perfect claim can no longer be filed.

On the exam today. State licensing exams test this lesson with little fact patterns, and the first trap is the word *all*: a negligence claim requires all four elements, so watch for the story where the careless act caused no injury (no damages) or where the injury just happened near someone careful (no breach). The second trap swaps the defenses: contributory negligence bars recovery entirely; comparative only reduces it — and a modified-comparative question turns on whether the claimant's fault reached the state's 50% or 51% bar. Expect strict liability dressed as a trick: the blasting contractor who «took every precaution» still pays, because no negligence need be proven. Remember that punitive damages punish and are often uninsurable, while special and general damages compensate. And keep the frame around everything: casualty insurance responds to *legal liability* — what the insured becomes legally obligated to pay — not to sympathy, and not to accusations that fail an element.

PICTURE STUDY



Three Lawyers, Honoré Daumier, c. 1855–1857 · Oil on canvas · The Phillips Collection, Washington, D.C.
Image: Wikimedia Commons, public domain

Honoré Daumier spent his working life a few steps from the Paris law courts, and no artist ever watched lawyers more closely — their robes, their gestures, their delight in argument. He drew and painted them hundreds of times, sometimes mocking, always observing. In this small oil, three advocates confer in a courthouse corridor, papers in hand, each certain of his point. It opens this lesson because negligence law is exactly this: a long conversation of arguing men, case after case — a dropped package in Brooklyn, a mopped floor, a blast — out of which the four quiet elements of blame were slowly agreed.

Look closely

- Follow the hands and faces of the two lawyers in conversation. Who seems to be winning the point, and how can you tell without hearing a word?
- Find the bundle of papers under the arm. Cases are built from facts written down — the same facts you list before answering a scenario question.
- Notice the third lawyer looking out at you, as if inviting you into the argument. Daumier often used such a figure to make the viewer a witness.
- Look at the darkness of the corridor and the light on the faces. The law's machinery is shadowy; the argument is what Daumier illuminates.

Talk about it

1. Negligence law was built by thousands of arguments like this one, each case refining the rules. Why is a slowly argued rule — like the reasonable person standard — often wiser than one person's snap judgment?
2. Daumier sometimes painted lawyers as vain performers. What keeps an advocate — or an insurance agent explaining a claim — on the honest side of persuasion?
3. The law asks what a reasonably careful person would have done. Scripture asks more: to love your neighbor as yourself. How does the higher standard make the legal one easier to meet?

PROJECT

The Liability Map: Four Elements and Their Exits

You will build the one-page chart that anchors every casualty lesson to come: the four elements of negligence down the middle, the defenses and the special doctrines branching off, and six test scenarios proving you can use it. This page opens the casualty section of your Pathway File, and you will touch it again in Lessons 7.2, 7.4 and 7.5 — because an auto policy, an umbrella and the workers' compensation bargain are all answers to the blame this map assigns.

You will need

- One sheet of unlined paper turned sideways, ruler and pencil
- Two ink colors — one for elements, one for defenses and doctrines
- Your exam notebook and this lesson's key terms

Steps

1. Down the center of the page, draw four boxes in a column and label them DUTY, BREACH, PROXIMATE CAUSE, ACTUAL DAMAGES; under each, write its one-sentence definition in your own words.
2. Beside BREACH, sketch a small stick figure and label him THE REASONABLY PRUDENT PERSON — the measuring stick.
3. On the right margin, in your second color, add the three defenses — contributory (total bar), comparative (reduces; note the 50%/51% modified bars), assumption of risk — each with an arrow showing where it attacks the claim.
4. On the left margin add the three doctrines that change whose fault counts: strict liability (no negligence needed), vicarious liability (another's act imputed), negligence per se (statute violation = breach).
5. Below the map, write the damages ladder: SPECIAL (economic) + GENERAL (pain and suffering) = compensatory; PUNITIVE = punishment, often uninsurable.
6. Now test the map with six one-line scenarios of your own invention — one missing each element, one comparative split with the arithmetic worked,

one strict-liability case — and mark each with the element or doctrine that decides it.

7. Work this check: damages $60,000, claimant 25% at fault — write the recovery under pure comparative ($45,000) and under contributory ($0) at the bottom corner.
8. Date the page and clip it into your Pathway File behind the casualty divider.

EXAM NOTEBOOK

1. Make a flashcard for each key term in this lesson — twelve cards — and drill the four elements until you can recite them in under five seconds.
2. Draw a chain of four links labeled duty, breach, cause, damages, with a bolt cutter labeled «any missing element» snapping the chain.
3. Write a five-line trap list titled «Contributory vs. comparative», ending with: contributory BARS, comparative REDUCES — and the modified bars are 50% or 51% by state.

KEY FORMULAS

$$\text{Comparative recovery} = \text{Total damages} \times (1 - \text{claimant's share of fault})$$

$$\text{Compensatory damages} = \text{special (economic)} + \text{general (non-economic)}$$

From history. The four elements are older than the automobile. In Scott v. Shepherd (1773) — the famous «squib case» — a lit firework tossed into an English market house was batted from stall to stall by two frightened merchants before it exploded and injured young William Scott. The judges held the first thrower liable for the whole chain: the instinctive relays did not break causation. Law students still read the squib case for proximate cause, a century and a half before Palsgraf's penny scale.

WORKED EXAMPLES

Example 1. A jury finds $80,000 of damages from a two-car collision and decides the claimant was 30% at fault. In this example, what does the claimant recover under pure comparative negligence, under a modified 51%-bar rule, and under contributory negligence?

Show solution

1. Pure comparative: $\$80{,}000 \times (1 - 0.30) = \$80{,}000 \times 0.70 = \$56{,}000$.
2. Modified, 51% bar: his fault (30%) is below the bar, so the same reduction applies — $\$56{,}000$.
3. Contributory: any contributing fault bars recovery entirely — $\$0$.
4. Now flip the shares: if he were 60% at fault, pure comparative would still pay $\$80{,}000 \times 0.40 = \$32{,}000$, but both modified rules and contributory negligence would pay nothing.

Answer: $\$56{,}000$ under pure or modified comparative (fault below the bar); $\$0$ under contributory negligence. The rule in force decides the money, which is why the exam names it.

Example 2. Exam style. A grocer mops his floor and forgets the warning sign. A customer walks through, sees the wet gleam, crosses carefully anyway, and reaches the far side unharmed. She sues for negligence. The claim fails because of which element?

A. Duty — the grocer owed her none

B. Breach — mopping a floor is reasonable conduct

C. Proximate cause — her own walking intervened

D. Damages — she suffered no actual loss

Show solution

1. Run the four elements in order. Duty: a shopkeeper owes customers reasonable care — duty exists, so A is wrong.
2. Breach: mopping is fine; leaving a wet floor unmarked falls below the reasonable person standard — breach exists, so B is wrong.
3. Proximate cause and damages: she was never injured, so there is no loss for any chain of causation to reach.
4. Without actual damages there is no negligence claim, however careless the grocer was.

Answer: D. All the carelessness in the world creates no liability until it causes real, measurable harm — the fourth element.

Example 3. Exam style. A demolition contractor uses dynamite with every modern precaution, yet the blast cracks the foundation of a house nearby. The homeowner sues. The contractor's best description of his position is:
A. Not liable, because he was not negligent
B. Liable only if negligence per se applies
C. Strictly liable, because blasting is an abnormally dangerous activity
D. Vicariously liable for his employees' acts

Show solution

1. Identify the doctrine: blasting with explosives is the textbook abnormally dangerous activity.
2. Strict (absolute) liability attaches to such activities without proof of any breach — precautions do not matter.
3. A fails because «no negligence» is no defense here; B confuses negligence per se (violation of a statute as breach) with strict liability.
4. D is a real doctrine but answers a different question — whose act counts, not whether fault must be proven.

Answer: C. For abnormally dangerous activities the law skips the negligence test entirely: he who creates the extraordinary hazard pays for its harm.

PRACTICE

1. Easy Name the four elements of negligence in order.

Show answer

Duty of care owed, breach of that duty, proximate cause, and actual damages — and a claimant must prove all four.

2. Easy What is a tort, and how does it differ from a crime?

Show answer

A tort is a civil wrong against a person or property, remedied by money damages in a private suit; a crime is a public wrong prosecuted and punished by the state.

3. Easy Against whose conduct is a defendant's behavior measured when testing for breach?

Show answer

The reasonably prudent person — an ordinarily careful person in the same circumstances, not the defendant's own habits or best effort.

4. Medium A jury finds $50,000 in damages and puts 20% of the fault on the claimant. What does he recover under pure comparative negligence?

Show answer

$\$50{,}000 \times (1 - 0.20) = \$40{,}000$. Comparative negligence reduces the award by the claimant's share of fault.

5. Medium Which defense, where it still applies, completely bars a claimant who was even 1% at fault?
A. Comparative negligence
B. Contributory negligence
C. Assumption of risk
D. Negligence per se

Show answer

B. Contributory negligence is the old total bar, kept by only a few jurisdictions. Comparative (A) merely reduces recovery, and negligence per se (D) is not a defense at all but a shortcut for proving breach.

6. Medium An employee delivering flowers for his employer runs a stop sign and injures a cyclist. Under what doctrine may the employer be liable, and what is the old Latin phrase for it?

Show answer

Vicarious liability — respondeat superior, let the master answer. The employee's tort within the scope of employment is imputed to the employer.

7. Medium A spectator chooses a front-row seat along the third-base line and is struck by a foul ball. Which defense fits, and why?

Show answer

Assumption of risk: she knew the familiar danger of foul balls and voluntarily exposed herself to it by taking that seat.

8. Hard In a modified comparative state with a 51% bar, a jury finds $90,000 of damages and splits fault 50/50. What is recovered? What if the bar were 50%?

Show answer

With a 51% bar, a 50%-at-fault claimant still recovers: $\$90{,}000 \times 0.50 = \$45{,}000$. With a 50% bar, reaching 50% fault bars him entirely — $0. The one-point difference between the two modified rules is a favorite exam trap.

9. Hard A driver texting at the wheel swerves but hits no one; a pedestrian who saw it happen sues for negligence, claiming the fright of a near miss. Walk the four elements and name the weakest one.

Show answer

Duty and breach are present — texting falls below reasonable care owed to everyone nearby. But with no physical harm or measurable loss, actual damages fail (and courts are wary of fright alone), so the claim dies on the fourth element.

10. Hard Why do many states forbid insuring punitive damages, while freely allowing insurance for compensatory damages?

Show answer

Punitive damages exist to punish and deter outrageous conduct; if an insurer paid them, the punishment would fall on the pool instead of the wrongdoer and lose its sting. Compensatory damages merely make the victim whole, which is exactly what insurance is for.

11. Challenge In Palsgraf, Cardozo denied recovery for lack of duty to an unforeseeable plaintiff, while Andrews would have asked only whether the guards' act proximately caused the harm. Write three sentences: state each judge's test, then say which element of the modern four each argument lives in.

Show answer

Cardozo asked whether danger to this plaintiff was foreseeable — if not, the railroad owed her no duty, and the claim fails on element one. Andrews asked whether an unbroken natural chain ran from the careless shove to her injury — a proximate cause question, element three. The case endures because it shows the same facts failing at two different links of the chain, which is precisely how exam questions are built.

12. **Challenge** Deuteronomy 22:8 required a battlement around a new roof. Write three sentences connecting that command to duty, breach and negligence per se.

Show answer

The command creates a duty of care toward everyone who will walk on the roof, before any accident happens. Building without the battlement is breach — falling below the standard God's law set for a careful householder. And because the standard is written law, a fall from an unguarded roof is like negligence per se: the violation itself marks the builder's fault.

COMMON MISTAKES

- Forgetting that a negligence claim needs ALL four elements — careless conduct with no actual damages creates no liability.
- Writing that comparative negligence bars recovery; it reduces the award, and only the modified versions bar it once the claimant's fault reaches the state's 50% or 51% line.
- Treating «he took every precaution» as a defense to strict liability — precautions are irrelevant to abnormally dangerous activities.
- Confusing negligence per se (a statute violation supplies the breach) with strict liability (no breach need be shown at all).
- Calling punitive damages part of compensation; they punish the defendant, and many states forbid insuring them.
- Mixing up vicarious liability (another person's tort imputed to you) with joint fault (your own negligence alongside another's).

> **Make it a game · Element Out!.** Write the four elements — DUTY, BREACH, CAUSE, DAMAGES — on four cards per player. A parent reads a one-line scenario in which a negligence claim fails (a careful driver hit by hail; a careless mopper who hurt no one; a freak chain of events no one could foresee; a stranger with no connection to the defendant). Players have five seconds to slap down the card for the missing element; first correct card scores a point, and a wrong slap gives a point away. Mix in two strict-liability scenarios where the right move is to shout «STRICT — no elements needed!» Best of twelve rounds wins; the loser must recite all four elements in order, twice, fast.

> **Scripture.** “When thou buildest a new house, then thou shalt make a battlement for thy roof, that thou bring not blood upon thine house, if any man fall from thence.” (Deuteronomy 22:8, KJV)
>
> Three thousand years before Cardozo, God's law to Israel built the duty of care into a building code: flat roofs were used like porches, so a careful householder walled his edge before anyone fell. The verse teaches that foreseeing harm to a neighbor and preventing it is not merely prudence but righteousness — the reasonable person standard with a conscience behind it.

7.2 The Personal Auto Policy: Liability and Medical Payments

OBJECTIVES

- Name the six parts of the personal auto policy and state what each covers.
- Identify who is an insured under Part A: the named insured, resident spouse, family members, and permissive users.
- Read a split limit such as 100/300/50 aloud and apply it to a claim with several injured people.
- Contrast split limits with a combined single limit and explain that defense costs are paid in addition to the limits.
- Describe Part B medical payments: no-fault, who it covers, and its typically small limits.

> **Warm-up.** With pencil and paper, write the three numbers 25/50/25 and guess, in one line each, what the three numbers might limit on a car insurance policy. Then write what should happen if one crash injures three people whose claims are $30,000 each. Keep the guesses — by the end of the lesson you will grade them yourself.

WATCH

I'll Help You Pass the Auto Insurance Exam: Limits of Liability on Auto Policy Simply Explained

Insurance Exam Queen · 8:32

https://www.youtube.com/watch?v=7Rb9DGloNjE

> **WHEN TO WATCH**
> Watch after the big idea; every time a split limit is read, pause and say the three numbers aloud yourself — per person, per accident, property damage — before she does.

BACKUP VIDEO

Split Limit vs Single Limit (Auto Insurance)

Edspira · 6:01

https://www.youtube.com/watch?v=5fgjztvV_t4

Watch before the project for a clean second run at split versus combined single limits, working each of his examples on paper a beat ahead of the narration.

KEY TERMS

personal auto policy (PAP)

The standardized package policy covering a family's autos, built of Part A liability, Part B medical payments, Part C uninsured motorists, Part D damage to your auto, Part E duties, and Part F general provisions.

named insured

The person named on the declarations page; the policy treats the named insured's resident spouse as if named.

family member

A person related to the named insured by blood, marriage or adoption who is a resident of the household, including a ward or foster child.

permissive user

Any person using the insured's covered auto with a reasonable belief of permission — an insured for liability coverage while using it.

bodily injury (BI) liability

Coverage for the insured's legal obligation to pay for injury or death the insured causes others in an auto accident.

property damage (PD) liability

Coverage for the insured's legal obligation to pay for damage to others' property — their car, fence or storefront — never the insured's own.

split limits

Liability limits stated as three numbers — BI per person / BI per accident / PD per accident — such as 100/300/50, read in thousands.

combined single limit (CSL)

One pool of liability money per accident, applied to bodily injury and property damage together without a per-person cap.

financial responsibility law

A state law requiring a driver to prove ability to pay for accidents — usually by insurance — after an accident or violation, or lose driving privileges.

compulsory insurance law

A state law requiring minimum liability insurance before a car may be registered or driven, pioneered by Massachusetts in 1927.

medical payments coverage (Part B)

Small no-fault coverage paying reasonable medical and funeral expenses for insureds injured while occupying an auto or struck as pedestrians, regardless of fault.

supplementary payments

Amounts Part A pays in addition to the limit of liability, such as defense costs, up to $250 for bail bonds, and loss of earnings for attending trials (commonly up to $200 a day).

CORE IDEAS

The story. By the middle 1920s the assembly lines of Detroit had done their work: some twenty million motor vehicles were on American roads, driven fast by amateurs on streets laid out for horses. Crashes multiplied, and so did a bitter discovery — a judgment against a driver with no money was worth exactly nothing to the family he had injured. Connecticut answered first, in 1925, with a **financial responsibility law**: after an accident or serious violation, a driver had to prove he could pay — in practice, show insurance — or surrender his plates. Massachusetts went further. Its legislature made liability insurance a condition of registration itself, effective January 1, 1927 — the first **compulsory insurance law** in the nation. For nearly three decades Massachusetts stood alone; New York did not follow until

1956. Today nearly every state requires minimum auto liability limits or proof of financial responsibility, and the numbers an agent quotes — 25/50/25 in this example — descend straight from that 1920s bargain between the automobile and the law.

How they figured it out. The insurance industry's answer to the automobile grew piecemeal — a liability form here, a fire and theft form there — until insurers and rating bureaus standardized the package most families now own: the **personal auto policy**, the PAP. Learn its skeleton first and every exam question finds its shelf. **Part A** — liability, the promise to pay what the insured becomes legally obligated to pay for bodily injury and property damage, and to defend him. **Part B** — medical payments, small and no-fault. **Part C** — uninsured motorists (next lesson). **Part D** — damage to your auto, collision and other-than-collision (next lesson). **Part E** — the insured's duties after an accident. **Part F** — general provisions, the housekeeping. The eligible buyer is an individual or married couple with private passenger autos not used to carry people or property for a fee; the pizza-delivery and ride-for-hire uses need other treatment. Six parts, A through F — recite them until the alphabet does the remembering.

The big idea. Part A's first question in any claim is *who counts as an insured*, and the circle is wider than the name on the declarations page. The **named insured** and resident **spouse** are insureds for the ownership, maintenance or use of *any* auto — even a borrowed or rented one. **Family members** — relatives by blood, marriage or adoption living in the household — are likewise insureds for any auto. Then the circle widens again: *any person* using the covered auto with a reasonable belief of permission — the **permissive user** — is an insured for that use, and so is a person or organization held vicariously liable for an insured's use, as when an employer is sued because the named insured ran an errand in his own car. In this example, when your neighbor borrows your truck with your blessing and injures a cyclist, your Part A defends and pays for the neighbor. The exam will test the circle's edges: the thief who takes the car without any belief of permission is no insured at all.

Now the numbers. Liability limits come in two shapes. **Split limits** state three figures in thousands: in this example, **100/300/50** reads aloud as *$100,000 of bodily injury per person, $300,000 of bodily injury per accident, and $50,000 of property damage per accident*. The per-person number caps what any one injured victim can receive; the per-accident number caps the total for all victims of one crash; the third number is a separate pool for property damage. A **combined single limit** replaces the three

fences with one pool — $300,000 per accident, in this example, spent on bodily injury and property damage in any proportion. A CSL of $300,000 is more flexible than 100/300/50: one gravely injured victim could draw $250,000 from the single pool, but never more than $100,000 from the split limit's per-person fence. States write their required minimums as split limits — 25/50/25 is a common example — but the live figure for your state is at your state insurance department's website.

Part A gives more than its limits, and the exam loves the phrase: **defense costs are paid in addition to the limits of liability**. The insurer must defend the insured against suits seeking covered damages — hiring the lawyers, paying the court costs — and those dollars do not reduce the limit; the duty to defend ends only when the limit is exhausted by payment of judgments or settlements. Alongside defense ride the **supplementary payments**: up to $250 for a bail bond required because of an accident, premiums on appeal bonds, interest accruing after a judgment, loss of earnings for attending trials at the insurer's request (commonly up to $200 a day), and other reasonable expenses incurred at the insurer's request. Part A also carries the **out-of-state coverage** promise: drive into a state with higher required minimums, and the policy automatically provides that state's minimums — the policy never leaves the insured illegally bare on a lawful trip.

Part B, medical payments, is the small, kindly, no-fault corner of the policy. It pays reasonable medical and funeral expenses incurred for services rendered within three years of the accident (commonly), for an insured injured while *occupying* a motor vehicle — in, upon, getting in, on, out or off — or struck *as a pedestrian* by a motor vehicle. Fault never enters: the named insured who dents his own bumper against his own garage and bloodies his nose collects Part B. Limits are modest — $1,000 to $10,000 per person in this example — because Part B is first aid, not a health plan. Keep the borders crisp: Part B pays insureds' medical bills without fault; Part A pays *other people* when the insured is legally liable, including their medical bills as damages. In the states that use no-fault personal injury protection instead, PIP plays Part B's role with broader benefits — mechanics for the next lesson.

On the exam today. The split-limit claim problem is the most reliable arithmetic question on any property and casualty exam, and it is won by applying the fences in order: cap each victim at the per-person limit first, then test the capped sum against the per-accident limit, then handle property damage from its own separate pool — never let BI dollars and PD dollars mix in a split limit. Expect a who-is-an-insured

question at the circle's edge: the permissive user is covered, the thief is not. Know that defense costs are in addition to limits — a question offering «defense costs reduce the limit» is wrong for the PAP. Read Part B distractors carefully: medical payments is no-fault and covers the insured as a pedestrian struck by a vehicle, but it never pays the other driver's injuries — those belong to Part A. And when a question names a minimum like 25/50/25, treat it as that question's example; the real figure lives at your state insurance department.

PICTURE STUDY



Ford Assembly Line, 1913, Unknown photographer, 1913 · Photograph · Highland Park Ford Plant, Michigan

Image: Wikimedia Commons, public domain

An unknown company photographer took this picture inside Henry Ford's Highland Park plant in 1913, the year Ford's moving assembly line began turning out Model Ts faster than any carriage shop had ever dreamed. Every chassis in this row would soon be on an American road, driven by a farmer or a clerk who had never before controlled anything faster than a horse. It opens this lesson because the personal auto policy is the legal shadow of this photograph: mass-produced cars created mass-produced collisions, and within a dozen years Connecticut and Massachusetts were writing the first financial responsibility and compulsory insurance laws.

Look closely

- Count the identical cars in the row. Standardization is the picture's subject — and the PAP is a standardized policy for the same reason: millions of similar risks.
- Find the workers between the cars. Each station repeats one task, just as a claims office applies the same limits to crash after crash.
- Look at the belts and shafts along the ceiling, the power supply of 1913. Note how little in this factory would stop a runaway car once it was sold.

- Notice there are no seat belts, traffic lights or driver's licenses anywhere in this world yet — the machinery came first, and the law ran behind it.

Talk about it

1. Why did mass production of automobiles almost force states to invent financial responsibility laws within a generation?
2. A judgment against a penniless driver is worth nothing to the injured. How does compulsory liability insurance serve the victim even more than the insured?
3. The factory multiplied a good thing — mobility — and with it the power to harm a neighbor. What does responsible stewardship of any powerful tool require before the first accident, not after?

PROJECT

The Split-Limits Claim Desk

You will sit at a pretend claims desk and settle five multi-victim crashes on one worksheet, applying split limits in the examiner's order — per person, then per accident, then property damage — and recording the insured's personal shortfall each time. The finished worksheet is your Pathway File's proof that you own the most-tested arithmetic in the casualty lines, and its shortfall column sets up the umbrella in Lesson 7.4.

You will need

- One sheet ruled into a grid (or a simple spreadsheet): columns for victims' claims, per-person caps, per-accident test, PD, total paid, insured's shortfall
- Pencil and calculator
- Your exam notebook and this lesson's formulas

Steps

1. Head the worksheet THE CLAIM DESK — SPLIT LIMITS, and write the reading rule at the top: first/second/third = BI per person / BI per accident / PD, in thousands.
2. Claim 1 — limits 25/50/25: two victims at $30,000 and $15,000, plus $10,000 PD. Work the three fences in order and record every number.
3. Claim 2 — limits 100/300/50: the worked example's crash ($120,000, $80,000, $140,000, $30,000 PD). Confirm you reproduce the lesson's answer without peeking.
4. Claim 3 — limits 50/100/25: four victims at $60,000, $40,000, $30,000 and $20,000, plus $40,000 PD. Note that capped claims total $140,000 against a $100,000 per-accident fence — reduce them proportionally and say so in the margin.
5. Claim 4 — CSL $300,000: rework Claim 2 and write one sentence on what the single pool changed.
6. Claim 5 — invent your own crash that leaves the insured owing at least $50,000 personally, and label that column THE UMBRELLA'S JOB.

7. Below the grid, write the two sentences every adjuster knows: defense costs are in addition to the limits, and property damage never borrows from bodily injury in a split limit.
8. Date the worksheet and clip it into your Pathway File behind the Liability Map.

EXAM NOTEBOOK

1. Make flashcards for the six parts of the PAP — A through F, one card each with the part's one-line job on the back — and add cards for split limits and CSL.
2. Draw the three fences of 100/300/50 as three gates in a row — a person-sized gate, an accident-sized gate, and a separate property gate — with arrows showing a claim passing through in order.
3. Write a five-line trap list titled «Who is an insured under Part A», ending with: permissive user IN, thief OUT, defense costs ON TOP.

KEY FORMULAS

$$\text{BI paid per victim} = \min(\text{victim's claim},\ \text{per-person limit})$$
$$\text{BI paid per accident} = \min\left(\sum \text{capped claims},\ \text{per-accident limit}\right)$$
$$\text{PD paid} = \min(\text{property damage},\ \text{PD limit})$$

From history. Massachusetts paid a price for going first: with insurance compulsory, drivers and insurers fought over state-set rates for decades, and the commonwealth became famous for its annual auto-rate hearings. Most states drew the opposite lesson and chose financial responsibility laws instead; compulsory insurance did not become the national norm until the second half of the century. The three-number split limit, though, proved so convenient that agents still quote it the way the 1930s rating bureaus wrote it.

WORKED EXAMPLES

Example 1. An insured with split limits of 100/300/50 causes a crash injuring three people, with bodily injury claims of $120,000, $80,000 and $140,000, plus $30,000 of damage to the other car. In this example, what does Part A pay in total, and what does the insured still owe?

Show solution

1. Cap each victim at the per-person limit of $100,000: victim 1 — $\min(\$120{,}000, \$100{,}000) = \$100{,}000$; victim 2 — $\min(\$80{,}000, \$100{,}000) = \$80{,}000$; victim 3 — $\min(\$140{,}000, \$100{,}000) = \$100{,}000$.
2. Test the capped sum against the per-accident limit: $\$100{,}000 + \$80{,}000 + \$100{,}000 = \$280{,}000 \leq \$300{,}000$ — all capped amounts are paid.
3. Property damage from its own pool: $\min(\$30{,}000, \$50{,}000) = \$30{,}000$.
4. Total paid: $\$280{,}000 + \$30{,}000 = \$310{,}000$, and defense costs ride on top of this, outside the limits.
5. The insured's personal shortfall: victim 1 is short $20,000 and victim 3 is short $40,000 — $60,000 the insured owes from his own pocket.

Answer: Part A pays $310,000 ($280,000 BI + $30,000 PD), plus defense in addition. The insured personally owes the $60,000 above the per-person caps — the gap Lesson 7.4's umbrella exists to cover.

Example 2. Same crash, but the insured carries a $300,000 combined single limit and the claims are one injured person at $250,000 plus $30,000 of property damage. Compare what the CSL pays with what 100/300/50 split limits would have paid.

Show solution

1. CSL: one pool of $300,000 for BI and PD together. Total claims $\$250{,}000 + \$30{,}000 = \$280{,}000 \leq \$300{,}000$ — paid in full.
2. Split limits: the single victim is capped at the per-person fence — $\min(\$250{,}000, \$100{,}000) = \$100{,}000$ — even though $300,000 per accident sits unused above it.
3. Split PD: $\min(\$30{,}000, \$50{,}000) = \$30{,}000$.
4. Compare: CSL pays $280,000; the split limit pays $130,000, leaving the insured owing $150,000 personally.

Answer: CSL: $280,000, fully covered. Split 100/300/50: $130,000, with a $150,000 personal shortfall — the per-person fence is the whole difference, which is why the exam asks this comparison.

Example 3. Exam style. An insured's 19-year-old daughter, who lives at home, borrows a friend's car with permission and injures a pedestrian. The insured's PAP has Part A limits of 50/100/25. Which statement is TRUE?
A. There is no coverage, because the daughter was not driving a covered auto
B. The daughter is an insured as a resident family member using any auto, so Part A applies
C. Only the friend's policy can ever respond
D. Part B pays the pedestrian's medical bills regardless of fault

Show solution

1. Place the daughter in the circle of insureds: a resident family member is an insured for the ownership, maintenance or use of ANY auto — not only covered autos.
2. So A is false. B states the rule exactly.
3. C overstates: the friend's policy on the borrowed car is typically primary, but the daughter's family PAP still covers her as excess — «only...ever» kills it.
4. D confuses the parts: the pedestrian is not an insured, so Part B owes her nothing; her injuries are Part A liability damages.

Answer: B. Named insured, resident spouse and resident family members are insureds for any auto; the pedestrian's claim is a Part A liability matter, not Part B.

PRACTICE

1. Easy Read the split limit 50/100/25 aloud in words.

   Show answer

   $50,000 of bodily injury liability per person, $100,000 of bodily injury liability per accident, and $25,000 of property damage liability per accident.

2. Easy Name the six parts of the personal auto policy in order.

   Show answer

   Part A liability, Part B medical payments, Part C uninsured motorists, Part D coverage for damage to your auto, Part E duties after an accident or loss, Part F general provisions.

3. **Easy** Does Part A pay for damage to the insured's own car?

Show answer

No. Part A is liability — it pays others' bodily injury and property damage when the insured is legally liable. The insured's own car is Part D's business.

4. **Medium** With limits of 25/50/10, one victim has a $40,000 bodily injury claim and the other car needs $12,000 of repairs. What does the policy pay for each?

Show answer

BI: $\min(\$40{,}000, \$25{,}000) = \$25{,}000$. PD: $\min(\$12{,}000, \$10{,}000) = \$10{,}000$. The insured personally owes the $15,000 and $2,000 above the fences.

5. **Medium** Which state passed the nation's first compulsory auto liability insurance law, effective in 1927?

A. Connecticut

B. New York

C. Massachusetts

D. Michigan

Show answer

C. Massachusetts required liability insurance for registration from January 1, 1927. Connecticut's 1925 law (A) was a financial responsibility law — proof after an accident, not insurance before registration.

6. **Medium** A friend borrows the insured's covered auto with permission and causes an accident. Is the friend an insured under Part A? What about a thief who takes the car?

Show answer

The friend is an insured — any person using the covered auto with a reasonable belief of permission is covered. The thief has no belief of permission and is no insured.

7. Medium The insured trips getting out of her own parked car and breaks her wrist; no one else is involved. Which part of the PAP responds, and why?

Show answer

Part B medical payments: she is an insured injured while occupying (getting out of) an auto, and Part B pays reasonable medical expenses regardless of fault. Part A pays nothing because there is no liability to another.

8. Hard With 100/300/50 limits, a crash injures five people, each with a $90,000 claim. Walk the fences and state what is paid.

Show answer

Each claim is under the $100,000 per-person cap, so the capped sum is $5 \times \$90{,}000 = \$450{,}000$ — but the per-accident fence pays at most $300,000. The insurer pays $300,000, shared among the victims (in practice proportionally), and the insured owes the remaining $150,000.

9. Hard Why can a $300,000 combined single limit pay a single gravely injured victim more than 100/300/50 split limits, even though both say «300»?

Show answer

The CSL is one pool with no per-person fence, so one victim can draw up to the whole $300,000 (less any PD paid). Under split limits the same victim stops at the $100,000 per-person cap no matter how much per-accident room remains.

10. Hard An insured is sued for $200,000 after an accident; his limit is $100,000 and his legal defense costs $40,000. How much can the insurer end up paying in total, and why?

Show answer

Up to $140,000: the $100,000 limit toward damages plus the $40,000 of defense, because defense costs and supplementary payments are in addition to the limit of liability. The duty to defend ends once the limit is exhausted by judgment or settlement payments.

11. **Challenge** An insured with 25/50/25 limits (his state's example minimum) drives into a neighboring state whose minimum is 50/100/50 and has an at-fault accident there. What does his PAP provide, and what provision makes it so?

    Show answer

    The out-of-state coverage provision automatically raises his limits to the visited state's required minimums — here 50/100/50 — so the insured is never legally underinsured on a lawful interstate trip. It raises limits to the legal floor only; it never lowers them.

12. **Challenge** Exodus 21:33–34 makes the man who left the pit uncovered pay the owner of the fallen ox. Write three sentences mapping the verse onto Part A: who plays the negligent insured, what plays the damages, and what the money is for.

    Show answer

    The digger who left the pit open is the careless defendant — duty and breach in one act. The dead ox is the measurable damages, and the payment «unto the owner» is exactly what Part A promises: the sum the careless man is legally obligated to pay his neighbor. Liability insurance does not erase the duty; it guarantees the neighbor is actually made whole when the duty is broken.

COMMON MISTAKES

- Applying the per-accident limit before the per-person caps — always fence each victim first, then test the capped total.
- Letting property damage borrow from unused bodily injury dollars in a split limit; the PD pool is separate (only a CSL mixes them).
- Writing that defense costs reduce the limit of liability — on the PAP they are paid in addition to the limits.
- Paying the other driver's medical bills from Part B; medical payments covers insureds only, and other people's injuries are Part A damages.
- Forgetting the resident spouse and family members are insureds for ANY auto, while strangers are insureds only when using the covered auto with a reasonable belief of permission.
- Treating a question's 25/50/25 as the law everywhere — state minimums differ, and the live figure is at your state insurance department.

Make it a game · Read the Limits!. Write five split limits on slips — 25/50/25, 50/100/50, 100/300/50, 250/500/100, and one CSL $300,000 — and put them in a cup. A parent rolls two dice to build a crash: the first die is the number of victims, the second times $20,000 is each victim's claim, and property damage is always $15,000. Draw a slip, read it aloud correctly (one point), then race to compute what the policy pays and what the driver still owes (two points, checked with a calculator). Wrong reading of the three numbers forfeits the round. First to ten points wins and gets to invent the final catastrophe round, which must leave the driver owing something — then everyone says together what fixes that: the umbrella.

Scripture. “And if a man shall open a pit, or if a man shall dig a pit, and not cover it, and an ox or an ass fall therein; The owner of the pit shall make it good, and give money unto the owner of them; and the dead beast shall be his.” (Exodus 21:33-34, KJV)

The law of Moses states the whole logic of liability coverage in two verses: carelessness that harms a neighbor creates a debt, measured in money, owed to the one harmed. Part A of the auto policy exists so that the modern pit-digger's debt is actually paid. Notice the justice of the last clause — the payer keeps the dead beast, the ancestor of the insurer's salvage right.

7.3 The Personal Auto Policy: Uninsured Motorists and Physical Damage

OBJECTIVES

- Explain Part C uninsured motorists coverage: what it pays, who triggers it, and how hit-and-run drivers are treated.
- Compute an underinsured motorists recovery when the at-fault driver's limits are too small.
- Sort losses into collision and other-than-collision, including the animal-contact rule.
- Settle a Part D claim at actual cash value minus the deductible and recognize a total loss.
- State the insured's duties under Part E and describe how no-fault (PIP) states differ in mechanics.

> **Warm-up.** In five minutes, list six bad things that could happen to a parked or moving car without any other car touching it — think weather, animals, falling things, thieves. Then circle the one item on your list caused by hitting something while driving. You have just drawn the line between other-than-collision and collision; the lesson will sharpen it.

WATCH

Personal Auto Policies Part C: Uninsured Underinsured Motorist on the Insurance Exam

Insurance Exam Queen · 14:14

https://www.youtube.com/watch?v=v4I99nSd228

> **WHEN TO WATCH**
> Watch after the big idea; every time she names a trigger for Part C — no insurance, denied coverage, hit-and-run, limits too low — add it to a growing list in your notebook.

BACKUP VIDEO

Personal Auto Policy (PAP) Made Easy | Insurance Exam Prep Explained Simply

Insurance BFF · 7:21

https://www.youtube.com/watch?v=-pCmiewuhWw

Watch before the project as a quick tour of all six parts in one sitting, checking each part he names against the rooms of the map you are about to draw.

KEY TERMS

uninsured motorist (UM) coverage

Part C coverage paying what the insured is legally entitled to recover for bodily injury from an at-fault driver who has no liability insurance, whose insurer denies or is insolvent, or who cannot be identified (hit-and-run).

underinsured motorist (UIM) coverage

Coverage that fills the gap when the at-fault driver's liability limits are too small to pay the insured's full damages, up to the UIM limit.

hit-and-run

An accident caused by a driver who cannot be identified; the phantom driver is treated as uninsured, and prompt notice to the police is required.

UM property damage (UMPD)

An optional or state-specific extension paying for damage to the insured's car caused by an uninsured driver; bodily injury is UM's core everywhere, UMPD only in some states.

collision

The upset of the covered auto, or its impact with another vehicle or object — the tree, the guardrail, the other car.

other-than-collision (OTC)

The PAP's name for comprehensive: loss from perils like fire, theft, falling objects, hail, flood, vandalism, glass breakage, and contact with a bird or animal.

actual cash value (ACV)

Replacement cost minus depreciation — the Part D settlement basis for a damaged or stolen auto.

deductible

The amount of each Part D loss the insured keeps; a higher deductible buys a lower premium.

total loss

A loss settled by paying the car's ACV because repair would cost more than the car is worth; the insurer then takes the salvage.

transportation expenses

A small Part D allowance (commonly about $20 a day up to $600, in this example) for substitute transportation after a covered theft or, by endorsement, other losses.

no-fault / personal injury protection (PIP)

A state system in which each driver's own policy pays his medical and wage losses regardless of fault, with lawsuits restricted below a threshold; mechanics vary by state.

duties after an accident (Part E)

The insured's obligations: prompt notice, cooperation, forwarding legal papers, police notice for hit-and-run or theft, protecting the auto from further damage, and submitting to examination.

CORE IDEAS

The story. In 1897 a machinist named Gilbert J. Loomis of Westfield, Massachusetts, built himself a one-cylinder automobile — and then did something no American had done: he bought liability insurance for it. The Travelers Insurance Company of Hartford wrote him $1,000 of protection for a premium of $7.50, as the story is commonly told, and since no automobile form existed, the policy was adapted from the forms used for teams of horses — the underwriters essentially insured his horseless carriage as if it might bolt. The next year, 1898, Travelers issued a policy to Truman Martin of Buffalo that is often called the first true auto policy. From that

$7.50 beginning the auto line grew into the largest property and casualty line in America — and grew new rooms as drivers discovered new ways to lose: physical damage coverage for the car itself, and, in the 1950s, a coverage for the bitterest discovery of all — being badly hurt by a driver who carried no insurance and owned nothing worth suing.

How they figured it out. Liability coverage protects your victim; it does nothing for *you* when the careless driver is the other fellow and he is uninsured. By the 1950s enough judgments were coming back empty that insurers, prodded by legislatures, created **uninsured motorists coverage** — Part C of the modern PAP. Its logic is unusual: your own insurer steps into the shoes of the missing liability insurer and pays what you are *legally entitled to recover* from the at-fault driver for bodily injury. That phrase does double work. You must show the other driver was legally liable — Lesson 7.1's four elements again — and your recovery is measured by your damages, up to your UM limit. Part C triggers when the at-fault driver has no liability insurance, when his insurer denies coverage or goes insolvent, and when he cannot be identified at all — the **hit-and-run**, where the law accepts a phantom but demands prompt police notice to keep the phantom honest. Most states require UM to be offered, and many require it to be carried; the live rule is at your state insurance department.

The big idea. Underinsured motorists coverage finishes the thought: the at-fault driver has insurance, but not enough. In this example, you suffer $70,000 of bodily injury damages; the at-fault driver carries his state's example minimum of 25/50 and his insurer pays its full $25,000 per-person limit; your UIM limit is $100,000. UIM pays the gap: $\min(\$70{,}000, \$100{,}000) - \$25{,}000 = \$45{,}000$. States differ on the trigger and the arithmetic — some compare his limits to your damages, some to your UIM limits, and some reduce the UIM limit by his payment rather than paying on top — so learn the example's logic and flag the variation. Remember what Part C is for: **bodily injury** of insureds — you, family members, and occupants of your covered auto. Damage to your car from an uninsured driver is covered only where **UM property damage** exists by state law or endorsement; otherwise your dented fender simply files under collision.

Part D — coverage for damage to your auto — insures the metal, and it is really two coverages sold with two deductibles. **Collision** is the upset of your covered auto or its impact with another vehicle or object: the other car, the tree, the mailbox, the

rollover on an icy curve. **Other-than-collision** — the older market word is *comprehensive* — is nearly everything else that is not excluded, and the form names its favorites: missiles and falling objects, fire, theft or larceny, explosion or earthquake, windstorm, hail, water or flood, vandalism or malicious mischief, riot, glass breakage, and — memorize this pair — contact with a **bird or animal**. Hitting a deer is other-than-collision; swerving to miss the deer and striking a tree is collision. The classification matters because the two coverages carry separate deductibles and premiums, and because a buyer may carry OTC without collision on an aging car. Loss caused by freezing and by wear and tear is excluded — insurance is for fortuity, not for maintenance.

Part D settles at **actual cash value**: replacement cost minus depreciation, the same arithmetic you learned for buildings in Unit 6, now applied to a machine that depreciates before your eyes. In this example, a car that would cost $24,000 to replace and is 40% depreciated has an ACV of $\$24{,}000 \times 0.60 = \$14{,}400$; a covered loss pays the lesser of repair cost or ACV, minus the **deductible**. When repair would cost more than the car is worth, the insurer declares a **total loss**, pays ACV minus the deductible, and takes the **salvage** — Exodus 21's dead beast again. Small comforts ride along: **transportation expenses** (commonly about $20 a day up to $600 after a theft, in this example), and endorsements add **rental reimbursement** after any covered loss and **towing and labor**. Note what Part D never pays: your liability to others (Part A's job) and your own medical bills (Part B's).

Two housekeeping rooms finish the policy. **Part E** lists the insured's duties, and claims are won and lost here: give prompt notice of the accident; cooperate with the investigation and defense; send the insurer every legal paper; notify the police promptly for hit-and-run (Part C) and for theft (Part D); protect the auto from further damage — the insurer pays reasonable expenses of doing so; permit inspection and appraisal; and submit to examination under oath if asked. Breach a material duty and the insurer may deny an otherwise good claim. Finally, about a dozen states run **no-fault** systems: each driver's own policy pays **personal injury protection** benefits — medical bills, lost wages, essential services — regardless of fault, and in exchange the right to sue for pain and suffering is restricted until damages cross a dollar or injury-severity threshold. This course teaches the mechanics only; whether your state is a no-fault, add-on or tort state is a fact to look up, not a debate to join.

On the exam today. The deer question is practically guaranteed: contact with a bird or animal is other-than-collision, but swerving to avoid the animal and hitting anything else is collision — read which event actually damaged the car. Know Part C's triggers cold — no insurance, denial or insolvency, hit-and-run with police notice — and that UM pays bodily injury the insured is *legally entitled to recover*, so the insured must still show the phantom was at fault. Expect a UIM arithmetic problem shaped like our example: damages, his small limit, your larger limit, pay the gap. Part D questions turn on ACV minus deductible and on the exclusions for wear and tear and freezing. Watch for the duty traps: theft and hit-and-run both demand prompt police notice. And a drafting trap: the PAP says «other-than-collision» where older questions and agents say «comprehensive» — the same coverage wearing two names.

PICTURE STUDY



The Monarch of the Glen, Sir Edwin Landseer, 1851 · Oil on canvas · Scottish National Gallery, Edinburgh

Image: Wikimedia Commons, public domain

Edwin Landseer was Victorian Britain's most beloved painter of animals, knighted by Queen Victoria and mourned by all of London when he died in 1873. His 1851 portrait of a red deer stag in the Scottish Highlands became one of the most reproduced paintings in the world — on whisky labels, biscuit tins and parlor walls from Edinburgh to Ohio. He stands in this lesson with a wink and a warning: on the licensing exam, this noble fellow on a dark highway is the textbook other-than-collision loss — and the swerve to miss him that finds a tree is collision. Learn the stag and you have learned the line.

Look closely

- Count the points on the antlers — twelve, a «royal» stag. Landseer painted him from below to make the viewer look up at an animal, as a driver suddenly does on a night road.
- Study the mist and ground: rough heather, no road, no fence. The painting predates every automobile, yet deer and drivers now meet by the hundreds of thousands each year.
- Notice the light on the muzzle and eye — Landseer's famous skill at giving animals dignity without making them human.

- Find the horizon. The stag owns this landscape; the question of who yields on a shared road is newer than he is.

Talk about it

1. Why do you think the policy's drafters classified animal contact with the comprehensive perils — things that happen TO a driver — rather than with collision?
2. A swerve that misses the deer but finds the guardrail changes the coverage. Why must an adjuster care about what actually damaged the car rather than the whole story's drama?
3. Scripture says the earth is the LORD's and the fulness thereof. What does it mean to drive — and to insure — as a guest among creatures we did not make?

PROJECT

The Whole-Policy Map: Six Parts, One Page

You will draw the complete personal auto policy as a one-page house with six rooms — Parts A through F — and then route twelve pretend losses to the right room, with the arithmetic worked where arithmetic belongs. This map joins the Liability Map and the Claim Desk in your Pathway File, and together the three pages hold most of the auto questions a state exam can ask.

You will need

- One sheet of unlined paper turned sideways, ruler, pencil, two ink colors
- Your exam notebook, this lesson's key terms, and the state auto guide from the kit
- A calculator for the ACV and UIM arithmetic

Steps

1. Draw a house with six labeled rooms: A LIABILITY (others' BI and PD, defense in addition), B MED PAY (insureds, no fault, small), C UM/UIM (bodily injury from the uninsured and underinsured; hit-and-run; police notice), D YOUR AUTO (collision | other-than-collision, ACV minus deductible), E DUTIES, F PROVISIONS.
2. In Room D, draw the dividing line and list five OTC perils on one side — put the deer first — and «impact with vehicle or object, or upset» on the other.
3. Write twelve one-line losses on the page margin: include hitting a deer, swerving into a tree, hail, theft with police notice, a hit-and-run injury, an underinsured at-fault driver, a borrowed-car accident, the insured's own sprained wrist, a three-victim liability crash, a stolen car's rental days, a refused examination under oath, and one of your own invention.
4. Draw an arrow from each loss to its room; where money moves, work it: the UIM gap from the worked example, and one ACV settlement with your own chosen depreciation and deductible.
5. In Room E's corner, star the two losses on your list that die if the police are not promptly told: hit-and-run and theft.

6. Across the roof write the policy's one sentence: A PAYS THEM, B AND C PAY US, D PAYS THE CAR.
7. Date the page and clip it into your Pathway File with the other casualty pages.

EXAM NOTEBOOK

1. Make flashcards for collision, other-than-collision, ACV, UM, UIM, and PIP — with the deer drawn small on the OTC card.
2. Draw the UIM gap as a bar chart: a $70,000 damages bar, the first $25,000 shaded as the at-fault insurer's payment, the next $45,000 shaded as UIM.
3. Write a five-line trap list titled «Deer, swerve, ice», ending with: classify by what HIT the car, not by what caused the story.

KEY FORMULAS

$$\text{ACV} = \text{replacement cost} \times (1 - \text{depreciation rate})$$

$$\text{Part D payment} = \min(\text{repair cost},\ \text{ACV}) - \text{deductible}$$

$$\text{UIM payment} = \min(\text{damages},\ \text{UIM limit}) - \text{at-fault insurer's payment (in this example's state)}$$

From history. Loomis's 1897 policy was literally horse-law stretched over a machine: with no automobile form in existence, Travelers adapted the wording it used for teams and carriages. The industry has recycled forms at every turn since — inland marine floaters grew from ocean cargo clauses, and the PAP's «other-than-collision» list descends from fire and theft forms of the 1910s. When an exam term seems oddly named, there is usually an older policy underneath it, like harness marks on a fender.

WORKED EXAMPLES

Example 1. An insured suffers $70,000 of bodily injury damages in a crash caused entirely by a driver carrying 25/50 limits. The insured carries UIM at $100,000 per person. In this example's state, UIM pays damages minus the at-fault payment. Walk the claim.

Show solution

1. Confirm the trigger: the at-fault driver's $25,000 per-person limit is below the insured's damages (and below the UIM limit), so he is underinsured in this example's state.
2. The at-fault insurer pays its full per-person limit: $25,000.
3. Measure the insured's entitlement: $\min(\$70{,}000, \$100{,}000) = \$70{,}000$.
4. UIM pays the gap: $\$70{,}000 - \$25{,}000 = \$45{,}000$.
5. Check the insured's total recovery: $\$25{,}000 + \$45{,}000 = \$70{,}000$ — made whole, within limits.

Answer: The at-fault carrier pays $25,000 and UIM pays $45,000. States vary on trigger and offset arithmetic, so on the job you read your state's rule — but the exam's usual logic is exactly this gap-filling.

Example 2. A covered auto with a replacement cost of $24,000 is 40% depreciated when a hailstorm ruins its roof and glass; repairs are estimated at $6,500. The OTC deductible is $500. In this example, what is the ACV, and what does Part D pay? What changes if the repair estimate were $16,000?

Show solution

1. Classify the loss: hail is a named other-than-collision peril — the OTC deductible applies.
2. ACV: $\$24{,}000 \times (1 - 0.40) = \$14{,}400$.
3. Payment: $\min(\$6{,}500, \$14{,}400) - \$500 = \$6{,}000$.
4. At a $16,000 estimate, repair exceeds the $14,400 ACV: the insurer totals the car and pays $\$14{,}400 - \$500 = \$13{,}900$, keeping the salvage.

Answer: ACV $14,400; the hail claim pays $6,000. At $16,000 of repairs the car is a total loss and Part D pays $13,900 plus salvage to the insurer.

Example 3. Exam style. Classify each loss as collision or other-than-collision: (1) the insured strikes a deer on a dark road; (2) she swerves to avoid a deer and hits a guardrail; (3) a tree limb falls on the parked car; (4) the car is stolen; (5) the car skids on ice and overturns.

Show solution

1. Apply the definitions: collision is upset, or impact with another vehicle or object; OTC is the named list including animals, falling objects and theft.
2. (1) Contact with an animal is expressly other-than-collision — the exam's favorite line.
3. (2) The damaging impact was with the guardrail, an object: collision. The deer merely explains why.
4. (3) A falling object is OTC; (4) theft is OTC.
5. (5) Upset of the vehicle is collision even though nothing was struck.

Answer: 1 — OTC; 2 — collision; 3 — OTC; 4 — OTC; 5 — collision. Classify by what actually damaged the car: named OTC peril, or impact/upset.

PRACTICE

1. Easy The insured's car hits a deer. Collision or other-than-collision?

   Show answer

   Other-than-collision: contact with a bird or animal is expressly an OTC peril under Part D.

2. Easy What three kinds of at-fault drivers trigger uninsured motorists coverage?

   Show answer

   A driver with no liability insurance; a driver whose insurer denies coverage or is insolvent; and an unidentified hit-and-run driver (with prompt police notice).

3. Easy On what basis does Part D settle a stolen or wrecked car, and what is subtracted?

   Show answer

   Actual cash value — replacement cost minus depreciation (or repair cost if less) — minus the deductible.

4. **Medium** A car with a replacement cost of $18,000 is 35% depreciated; vandals cause $3,200 of damage and the OTC deductible is $250. What does Part D pay?

Show answer

ACV is $\$18{,}000 \times 0.65 = \$11{,}700$, so repair is payable: $\$3{,}200 - \$250 = \$2{,}950$. Vandalism is other-than-collision.

5. **Medium** The insured swerves to avoid a dog and strikes a parked car. Which Part D coverage pays for his own car's damage?

A. Other-than-collision, because an animal caused the swerve

B. Collision, because the car struck another vehicle

C. Neither, because the loss was intentional

D. Part A property damage liability

Show answer

B. The damaging event was impact with a vehicle — collision. A is the classic trap; the animal must actually contact the car for OTC. D pays the parked car's owner, never the insured's own car.

6. **Medium** Why does a hit-and-run claim under Part C require prompt notice to the police?

Show answer

Because the at-fault driver is a phantom, the police report protects the insurer from invented accidents: it fixes the time, place and physical evidence while they can still be checked.

7. **Medium** In a no-fault (PIP) state, who pays the insured's medical bills after a crash, and what right is restricted in exchange?

Show answer

The insured's own policy pays PIP benefits — medical, lost wages, essential services — regardless of fault. In exchange, suits for pain and suffering are barred until damages cross the state's dollar or injury-severity threshold.

8. Hard Damages $120,000; the at-fault driver carries 50/100 and pays $50,000; the insured's UIM limit is $100,000 per person (gap state, as in the lesson). What does UIM pay, and what does the insured absorb?

Show answer

UIM pays $\min(\$120{,}000, \$100{,}000) - \$50{,}000 = \$50{,}000$. Total recovered $100,000; the remaining $20,000 exceeds every available limit and stays with the insured — a reason agents quote higher UIM limits.

9. Hard A collision claim: repair estimate $9,800, ACV $9,200, collision deductible $1,000. Settle the claim and explain each step.

Show answer

Repair exceeds ACV, so the car is a total loss: pay $\$9{,}200 - \$1{,}000 = \$8{,}200$, and the insurer takes the salvage. Part D pays the lesser of repair cost or ACV, minus the deductible.

10. Hard The insured's car is stolen; he waits three weeks to tell anyone, rents a car meanwhile, and refuses the insurer's request for an examination under oath. Name the Part E duties in trouble and the likely result.

Show answer

Prompt notice, prompt police notice of theft, and submission to examination under oath are all breached. Material breach of duties lets the insurer deny an otherwise covered claim — and the transportation-expense allowance he wanted runs from the theft's prompt reporting, not from his silence.

11. Challenge A question says the insured «is legally entitled to recover» from an uninsured driver. Explain why Part C still requires the four elements of negligence from Lesson 7.1, and what happens if the uninsured driver was not at fault.

Show answer

UM substitutes for the missing liability insurer, not for the missing lawsuit: the insured must show the uninsured driver owed a duty, breached it, and proximately caused actual damages. If the uninsured driver was not legally liable — say the insured ran the light — UM owes nothing, because there is nothing the insured was entitled to recover.

12. **Challenge** Proverbs 22:3 praises the prudent man who foresees evil and hides himself. Write three sentences applying the verse to UM/UIM coverage, where the danger is other people's lack of foresight.

Show answer

> The prudent driver cannot make every neighbor carry insurance, but he can foresee that some will not and prepare his own shelter. UM and UIM are that hiding place: protection bought in advance against another's failure. The simple «pass on» assuming every at-fault driver can pay — and the punishment the verse names arrives as an uncollectable judgment.

COMMON MISTAKES

- Calling a deer strike collision — animal contact is other-than-collision, but swerving around the animal into any object is collision.
- Thinking UM coverage pays whenever an uninsured driver is involved; it pays only what the insured is legally entitled to recover, so the uninsured driver must be at fault.
- Forgetting that basic UM is bodily injury coverage — damage to the insured's car needs UMPD (some states) or collision.
- Settling Part D at replacement cost; the PAP pays the lesser of repair cost or actual cash value, minus the deductible.
- Missing the police-notice duties: hit-and-run (Part C) and theft (Part D) both require prompt notice to the police.
- Treating «comprehensive» and «other-than-collision» as different coverages — they are the same coverage under its old and current names.

> **Make it a game · Deer or Guardrail?.** One player is the adjuster; everyone else is a driver with a story. Each driver writes four loss slips — at least one animal strike, one swerve, one weather or theft loss, one upset — mixes them, and reads them aloud with dramatic flair. The adjuster has five seconds to rule COLLISION or OTC and name the deductible that applies; the table checks against the lesson's lists. Correct ruling: one point. A driver whose story fools the adjuster steals the point — but only if the written facts honestly support the trick. Rotate adjusters every four slips. Ten points wins; the champion must then settle one ACV total loss aloud, replacement cost and depreciation chosen by the table.

> **Scripture.** “A prudent man foreseeth the evil, and hideth himself: but the simple pass on, and are punished.” (Proverbs 22:3, KJV)
>
> Uninsured motorists coverage is foresight about other people's lack of it: the prudent driver shelters his family against a danger he did not create and cannot control. The verse does not call the shelter cowardice but wisdom — and the simple who «pass on», assuming every stranger on the road can answer for his own carelessness, bear the loss themselves.

7.4 The Umbrella: Liability for the Catastrophic Day

OBJECTIVES

- Describe the personal umbrella policy: $1 million or more of liability coverage excess over underlying auto and homeowners limits.
- Explain required underlying limits and what happens when the insured fails to maintain them.
- Define the self-insured retention and show when it applies — on drop-down claims the underlying policies do not cover.
- Stack a large judgment across the primary policy and the umbrella, computing each layer's payment.
- Name the broader coverages an umbrella adds, such as personal injury offenses like libel and slander.

> **Warm-up.** With pencil and paper: a jury awards $1,200,000 against a family whose auto policy tops out at $300,000. Write where each dollar of the judgment comes from, in order, if the family owns nothing but a $250,000 house and ordinary savings. Three lines, honest arithmetic. The lesson will show you the policy built for exactly this page.

WATCH

Umbrella Insurance Review for the Insurance Exam

Insurance Exam Queen · 16:28

https://www.youtube.com/watch?v=yRaL0g9WDog

> **WHEN TO WATCH**
> Watch after the big idea; sketch the layer diagram as she talks — underlying limits below, umbrella above — and mark exactly where the self-insured retention appears.

BACKUP VIDEO

Umbrella Insurance Explained: What It Is, What It Covers, and Who Needs It

Logan Allec · 8:43

https://www.youtube.com/watch?v=cHbWuNN27j4

A consumer's-eye second pass; as you watch, list each exposure he names and check it against the flags on your tower diagram.

KEY TERMS

personal umbrella policy

A personal liability policy, commonly written at $1 million to $5 million, that pays excess over the insured's underlying auto and homeowners liability limits and covers some claims they do not.

excess liability

Coverage that begins paying only after an underlying limit is exhausted; the umbrella is excess over the scheduled underlying policies.

underlying limits

The minimum auto and homeowners liability limits the umbrella insurer requires the insured to carry and maintain beneath the umbrella — commonly 250/500 or a $300,000 CSL on the auto, in this example.

attachment point

The level of loss at which the umbrella begins to pay — normally the top of the underlying limit.

self-insured retention (SIR)

The amount the insured pays himself — commonly $250 to $10,000 — when the umbrella covers a claim that no underlying policy covers at all.

drop-down coverage

The umbrella's payment from the first dollar above the SIR when a loss is covered by the umbrella but not by any underlying policy.

failure to maintain underlying

If the insured lets a required underlying limit lapse or drop, the umbrella still pays only as if the required underlying limit were in force — the insured absorbs the gap personally.

personal injury (liability sense)

A group of offenses — libel, slander, defamation, false arrest, invasion of privacy — that umbrellas commonly cover and that bodily-injury-only forms do not.

judgment

The court's final award of damages against a defendant; what remains above all insurance layers is collectible from the defendant's assets and future earnings.

aggregate limit

A ceiling on what a policy pays for all losses in a policy period, as distinct from a per-occurrence limit for one event.

CORE IDEAS

The story. Around 1750 a London merchant and philanthropist named Jonas Hanway began carrying an umbrella through the streets — the first Englishman, it is said, to do so habitually. The city laughed at him for thirty years. Hackney coachmen jeered and splashed him on purpose, for the umbrella threatened their rain-day fares; gentlemen called the thing effeminate and French. Hanway, who had crossed Persia on trade routes and would later found hospitals and reform the care of orphaned children, simply kept dry and kept walking. By the time he died in 1786, umbrellas were ordinary equipment in every London doorway, and within a generation no gentleman was without one. The insurance business borrowed his instrument's name for the same idea in a different storm: a canopy raised *above* everything else you carry, opened against the rare, ruinous day — mocked as unnecessary right up until the sky opens.

How they figured it out. Through the twentieth century, American juries grew generous, and Lesson 7.1 shows why the arithmetic can run away: general damages

for pain and suffering have no price list, and a lifetime of lost wages for a young victim is a large number before sympathy adds a cent. After the Second World War, insurers began writing **umbrella liability** policies for businesses — broad excess layers above all the primary policies — and the device worked so well that a personal version followed for families. The design problem was elegant: how to sell a million dollars of protection for a modest premium. The answer is *position*. The umbrella sits high above the everyday claims, which the primary policies absorb; it pays only in the rare cases that pierce the **underlying limits**. Rare claims, even large ones, cost little per policyholder — the law of large numbers from Unit 1, working at altitude. That is why an umbrella's premium is commonly a few hundred dollars a year, in this example, for $1 million of limit.

The big idea. A **personal umbrella policy** provides $1 million or more of liability coverage **excess** over the insured's underlying policies — Part A of the auto policy and Coverage E of the homeowners, chiefly. The umbrella insurer requires the insured to carry and *maintain* specified **underlying limits** — commonly 250/500 split limits or a $300,000 combined single limit on the auto, and $300,000 of homeowners liability, in this example. The top of the underlying limit is the umbrella's **attachment point**: a $900,000 judgment against an insured with a $300,000 CSL and a $1 million umbrella is paid $300,000 by the auto policy and $600,000 by the umbrella. The umbrella is pure liability protection — it pays what the insured owes others, plus defense when the underlying policies are exhausted; it never pays for the insured's own car or house. Two policies, one tower: primary below, umbrella above, and the family's savings behind both.

The umbrella is also **broader** than what sits beneath it, and two mechanisms handle the mismatch. First, **drop-down coverage**: when a claim is covered by the umbrella but by no underlying policy — a slander suit, in this example, which the homeowners form never covered — the umbrella drops down and pays from the first dollar. Second, because no premium was collected below, the insured keeps a share: the **self-insured retention**, commonly $250 to $10,000 — $1,000 in this example — subtracted only on drop-down claims. When an underlying policy pays its limit, the SIR never applies; the underlying limit itself was the insured's retention. The broadened grant typically includes **personal injury** offenses — libel, slander, defamation, false arrest, invasion of privacy — and worldwide coverage. The exclusions keep the policy personal: business and professional liability, intentional

harm, workers' compensation obligations, and damage to the insured's own property all stay outside the canopy.

One clause deserves fear and respect: **maintenance of underlying limits**. The umbrella's price assumes the primary layers are in place, so if the insured lets the auto policy lapse or cuts its limits to save premium, the umbrella does not quietly become primary. It pays only what it would have paid had the required underlying been in force, and the insured personally owes the difference. In this example, the umbrella requires a $300,000 CSL but the insured dropped to $100,000; a $700,000 judgment arrives. The auto policy pays its real $100,000. The umbrella attaches at $300,000 as the contract promised, paying $400,000 — and the $200,000 between the layers belongs to the insured alone. An agent who writes an umbrella must diary the underlying policies like a watchman, because the gap is born quietly, at renewal time, and discovered loudly, in court.

Who needs the canopy? Think like an underwriter about *exposure*, not wealth. A family with a teenage driver multiplies its liability hours; a dog, a pool, a trampoline, a boat, a rental cottage each add doors a claim can walk through; a long daily commute is exposure by the mile. And the common argument «I own little, so I need no umbrella» misunderstands a judgment: in most states a judgment can follow future earnings for years, so the young professional with no assets but large prospects may need the umbrella most of all. The agent's own stake is real too: umbrella limits are inexpensive, and the agent who never offered one explains that omission to an angry client — or to his own errors-and-omissions insurer — after the catastrophic day. Offer it, document the offer, and let the client decide; that is both good law and good conscience.

On the exam today. The umbrella questions are about *order and position*. First: the umbrella pays after the underlying limit is exhausted — a question that lets the umbrella pay while primary limits remain unspent is wrong. Second: the self-insured retention applies only on drop-down claims that no underlying policy covers; it is never stacked on top of an underlying payment — the classic trap answer. Third: failure to maintain required underlying limits leaves the insured, not the umbrella, holding the gap; the umbrella pays as if the required limits existed. Fourth: the umbrella is liability-only — never the insured's own physical damage — and commonly adds personal injury offenses like libel and slander that the underlying forms lack. Numbers in the stem ($1 million limits, $1,000 SIR, 250/500

underlying) are conventions and examples; the structure — attachment, drop-down, retention, maintenance — is what the examiners are really asking.

PICTURE STUDY



The Umbrellas, Pierre-Auguste Renoir, c. 1881–1886 · Oil on canvas · The National Gallery, London

Image: Wikimedia Commons, public domain

Renoir painted this Parisian shower twice over, beginning around 1881 in his feathery impressionist manner and finishing about 1886 in the crisper, more classical style of his later years — the fashions of the figures even changed with the years between. The result is one long moment under the rain: a whole city block sheltering beneath a single overlapping canopy. It opens this lesson because the picture is the policy: the rain falls on everyone alike, and the wise have raised, in advance, a covering broad enough to share — while the little girl with the hoop, like many a young family, stands happily unaware of what is keeping her dry.

Look closely

- Count the umbrellas you can see, then estimate how many you cannot. The canopy overlaps like insurance layers — no single umbrella shelters the whole crowd.
- Find the young woman with the bandbox at left — she has no umbrella. A gentleman behind her seems ready to offer his. Who in a community goes uncovered, and who notices?
- Compare the crisp drawing of the left-hand figures with the softer, earlier brushwork at right — five years of the painter's life in one canvas.

- Notice that almost no ground or sky is visible; the picture is all people and covering. Liability, too, is entirely about persons.

Talk about it

1. Jonas Hanway was mocked for decades for carrying the first umbrella in London. Why are precautions often ridiculed until the day they are envied?
2. The umbrella in this unit protects a family's future earnings as much as its present savings. Why is protecting what you will earn a duty to the people who depend on you?
3. Psalm 121 calls the LORD «thy shade upon thy right hand.» What can an insurance policy honestly promise, and what shelter can only God provide?

PROJECT

The Tower Diagram: Stacking the Catastrophic Day

You will draw a pretend family's complete liability tower — underlying policies below, umbrella above — and then crash three claims into it, tracing every dollar to its layer. The finished tower goes into your Pathway File beside the Claim Desk worksheet, whose shortfall column it finally answers.

You will need

- One sheet of paper turned tall, ruler, pencil, two ink colors
- A calculator and your exam notebook
- The umbrella explainer from the kit, for a second description of the layers

Steps

1. Invent the Harper family: auto Part A at 250/500/100, homeowners Coverage E at $300,000, and a $1,000,000 umbrella with a $1,000 SIR requiring exactly those underlying limits. Write the schedule at the base of the page.
2. Draw the tower to rough scale: two primary blocks side by side (auto, home) and the umbrella block spanning above both, with the attachment line labeled.
3. Claim 1 — auto judgment $900,000, one victim: shade the layers and write each payment (auto $250,000; umbrella $650,000; SIR none — say why in the margin).
4. Claim 2 — slander verdict $40,000: show the drop-down arrow past the empty homeowners block, and write the split (insured $1,000; umbrella $39,000).
5. Claim 3 — the insured let the auto policy fall to 100/300 before a $600,000 judgment: draw the gap between layers in your second color and label it THE INSURED'S OWN — $150,000 (auto pays $100,000; umbrella attaches above the required $250,000).
6. Beside the tower, list four exposure flags that would make an agent quote the next million: teen driver, pool or trampoline, boat, long commute — and add one of your own.

7. Write the agent's rule across the bottom: OFFER THE UMBRELLA, DOCUMENT THE OFFER, DIARY THE UNDERLYING.
8. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for umbrella, excess liability, underlying limits, attachment point, SIR, drop-down, and personal injury (the liability sense).
2. Draw one umbrella sheltering two small tents labeled AUTO and HOME, with rain falling as dollar signs and a single drip labeled SIR landing on the insured's head only where no tent stands.
3. Write a five-line trap list titled «When the SIR applies», ending with: drop-down ONLY — never on top of an underlying payment.

KEY FORMULAS

$$\text{Umbrella payment} = \min(\text{judgment} - \text{underlying limit},\ \text{umbrella limit})$$

$$\text{Drop-down payment} = \text{covered loss} - \text{SIR}$$

$$\text{Insured's gap} = \text{required underlying} - \text{actual underlying (when limits were not maintained)}$$

From history. The word umbrella is Latin umbra — shade — wearing a diminutive: a «little shadow,» built against Mediterranean sun long before London rain. Commercial insurers of the mid-twentieth century liked the image so well that «umbrella» became the formal market name for broad excess liability, first for corporations and then, by the 1960s and 70s, for households. Jonas Hanway would have appreciated the sequence: the useful thing first endured mockery, then became respectable, then became the name of a whole class of prudence.

WORKED EXAMPLES

Example 1. A jury awards a single victim $1,400,000 of bodily injury damages against an insured carrying auto split limits of 250/500 and a $1,000,000 personal umbrella with the required underlying in force. In this example, trace every dollar.

Show solution

1. Primary layer: the auto Part A pays its per-person limit — $250,000.
2. Remaining judgment: $\$1{,}400{,}000 - \$250{,}000 = \$1{,}150{,}000$.
3. Umbrella layer: $\min(\$1{,}150{,}000,\ \$1{,}000{,}000) = \$1{,}000{,}000$.
4. Insured's share: $\$1{,}400{,}000 - \$250{,}000 - \$1{,}000{,}000 = \$150{,}000$ — even umbrellas have tops.
5. No SIR anywhere: the underlying policy covered and paid, so the retention never enters.

Answer: Auto $250,000; umbrella $1,000,000; insured $150,000. An agent seeing this family's exposure might have quoted a $2 million umbrella — the next layer up is cheap for the same reason the first was.

Example 2. The same insured is successfully sued for $50,000 over a careless, false and damaging statement about a neighbor — slander. His homeowners policy covers no personal injury offenses; his umbrella does, with a $1,000 self-insured retention. In this example, what does each party pay?

Show solution

1. Check the underlying policies: slander is a personal injury offense, outside the homeowners Coverage E grant — no underlying coverage.
2. The umbrella drops down and pays from the first dollar above the retention.
3. Compute: $\$50{,}000 - \$1{,}000 = \$49{,}000$ from the umbrella.
4. The insured pays the $1,000 SIR himself — the price of having had no underlying premium for this exposure.

Answer: Umbrella $49,000, insured $1,000. The SIR applies only here, on the drop-down; it is never added on top of an underlying policy's payment.

Example 3. Exam style. An umbrella requires a $300,000 CSL underlying auto limit, but at renewal the insured quietly reduced his auto policy to a $100,000 CSL. A $700,000 covered auto judgment follows. What happens?

A. The umbrella drops down and pays $600,000 after the auto policy's $100,000

B. The auto pays $100,000, the umbrella pays $400,000 as if $300,000 underlying existed, and the insured owes $200,000

C. The umbrella is void and pays nothing

D. The umbrella pays the whole $700,000 minus the SIR

Show solution

1. Apply the maintenance clause: the umbrella pays only as if the REQUIRED underlying limit were in force.
2. Auto policy pays its actual limit: $100,000.
3. Umbrella attaches at the required $300,000: $\$700{,}000 - \$300{,}000 = \$400{,}000$.
4. The gap between actual and required underlying — $\$300{,}000 - \$100{,}000 = \$200{,}000$ — is the insured's own.
5. A and D reward the insured for breaching the clause; C overpunishes — the umbrella is not voided, it simply holds its position.

Answer: B. Failure to maintain underlying limits never moves the umbrella's attachment point; it moves the gap onto the insured.

PRACTICE

1. Easy At what limits are personal umbrella policies commonly written, and what kind of coverage do they provide?

   Show answer

   Commonly $1 million to $5 million, as examples, of personal liability coverage excess over underlying auto and homeowners limits — liability only, never the insured's own property.

2. Easy What is the umbrella's attachment point?

   Show answer

   The level of loss where the umbrella begins to pay — normally the top of the required underlying limit, such as above a $300,000 auto CSL.

3. Easy Name three personal injury offenses an umbrella commonly covers that a basic homeowners policy does not.

Show answer

Libel, slander (defamation), false arrest, or invasion of privacy — the «personal injury» group of offenses.

4. Medium Judgment $800,000; auto CSL $300,000 (required and in force); umbrella $1,000,000. What does each layer pay?

Show answer

Auto $300,000; umbrella $800,000 − $300,000 = $500,000; insured $0. No SIR, because the underlying policy covered the claim.

5. Medium When does the self-insured retention apply?

A. On every umbrella claim
B. Only when the umbrella pays excess over an underlying policy
C. Only on drop-down claims that no underlying policy covers
D. Never, if the insured pays premiums on time

Show answer

C. The SIR is the insured's share on drop-down claims, where no underlying premium was ever collected. When an underlying policy pays its limit, that limit itself played the retention's role — A and B are the standard traps.

6. Medium Why can $1 million of umbrella coverage cost only a few hundred dollars a year while $300,000 of primary auto liability costs far more?

Show answer

Position. The primary layer absorbs the frequent, ordinary claims; the umbrella pays only in the rare cases that pierce the underlying limits. Low frequency at high attachment means a low pure premium, by the same law of large numbers that prices everything else.

7. Medium An umbrella insured is sued for damage his delivery business caused. Does the personal umbrella respond?

Show answer

No. Business and professional liability are standard personal-umbrella exclusions; commercial exposures need commercial policies (Unit 8).

8. Hard A slander claim settles for $9,000. The insured's umbrella has a $2,500 SIR and the homeowners policy covers no personal injury. Trace the payments, and explain what changes if the homeowners policy had a personal injury endorsement with a $100,000 limit.

Show answer

Drop-down: umbrella pays $\$9{,}000 - \$2{,}500 = \$6{,}500$; insured pays the $2,500 SIR. With the endorsement, the homeowners policy pays the $9,000 in full as primary, the umbrella pays nothing, and no SIR applies — the retention exists only where underlying coverage does not.

9. Hard Required underlying: 250/500. Actual at loss: 100/300. One-victim judgment: $500,000. Compute the auto payment, the umbrella payment, and the insured's personal share.

Show answer

Auto pays its actual per-person limit, $100,000. The umbrella attaches at the required $250,000 and pays $\$500{,}000 - \$250{,}000 = \$250{,}000$. The insured owes the $150,000 gap between actual and required underlying — the maintenance clause at work.

10. Hard A client says: «I rent an apartment and own almost nothing — a judgment can't hurt me.» Give the two-part professional answer.

Show answer

First, judgments in most states can follow future earnings for years, so his coming career is the asset at risk. Second, defense and damages above his renters policy's small liability limit would land on him personally; an umbrella (with the required underlying) shelters both, cheaply, while his exposure — driving, sports, a dog — is as real as anyone's.

11. **Challenge** Design trap: an exam stem says an insured's umbrella «becomes primary» when his auto policy lapses. Write three sentences correcting the stem with the right doctrine and arithmetic shape.

    Show answer

    The umbrella never becomes primary by the insured's neglect: under the maintenance-of-underlying clause it pays only as if the required underlying limits were still in force. The lapsed layer's dollars — the whole required underlying amount — fall on the insured personally before the umbrella's attachment point. So the correct arithmetic is judgment minus required underlying for the umbrella, with the insured owing everything below that line.

12. **Challenge** Psalm 121:5 names the LORD as «thy shade upon thy right hand.» Write three sentences on what an umbrella policy can honestly promise a family and what it cannot, using the verse's distinction.

    Show answer

    An umbrella can promise money: that a catastrophic judgment will not strip a family's savings and future earnings, up to its limit. It cannot promise that the catastrophic day will not come, that bodies will heal, or that a conscience rests — shade for the estate, not for the soul. The verse keeps the order straight: policies are prudent instruments under providence, and the Keeper of the family is not the carrier.

COMMON MISTAKES

- Letting the umbrella pay while underlying limits remain unspent — excess coverage attaches only after the underlying limit is exhausted.
- Applying the self-insured retention on top of an underlying policy's payment; the SIR applies only to drop-down claims no underlying policy covers.
- Treating a lapsed underlying policy as the umbrella's problem — the umbrella pays as if required underlying limits were maintained, and the insured owns the gap.
- Expecting the umbrella to pay for the insured's own wrecked car or damaged house; it is liability coverage only.
- Confusing personal injury (libel, slander, false arrest) with bodily injury (physical harm) — umbrellas commonly add the former.

- Assuming only the wealthy need umbrellas; judgments reach future earnings, so exposure, not net worth, drives the recommendation.

Make it a game · Build the Tower. Deal each player a pretend family card you write beforehand (limits, umbrella, SIR — vary them). A parent rolls two dice and multiplies by $100,000 to create a judgment, then flips a coin: heads it is an auto claim, tails a drop-down claim like slander. Players race to write the three-line stack — primary pays, umbrella pays, family pays — for their own card. First correct stack reads it aloud like an adjuster and scores two points; anyone who wrongly charges the SIR on an auto claim loses one. After six rounds, players trade cards and the parent announces that one family quietly dropped its underlying limits last renewal — recompute. Highest score wins the title of Excess Underwriter.

Scripture. “The LORD is thy keeper: the LORD is thy shade upon thy right hand.” (Psalm 121:5, KJV)

The psalmist's shade is a keeper who neither slumbers nor sleeps — protection no contract can imitate. An umbrella policy is a lesser, honest shade: bought in fair weather, opened in the storm, guarding a family's livelihood against one kind of ruin. Buy the policy as prudence and trust the Keeper for everything above its limits — which is most things.

7.5 Workers' Compensation: The Great Bargain

OBJECTIVES

- Tell the story of the common-law era's three employer defenses and the Wisconsin act of 1911.
- State the great bargain: statutory no-fault benefits in exchange for exclusive remedy.
- Name the four benefit classes — medical, disability income, rehabilitation, death — and compute a weekly disability benefit from the average weekly wage.
- Distinguish employees from independent contractors and explain «arising out of and in the course of employment».
- Describe monopolistic versus competitive state funds, Part Two employers liability, and the experience modification factor, computing a modified premium.

> **Warm-up.** Imagine, with pencil and paper, that you are a factory hand in 1900 injured by a machine at work. Your only remedy is to sue your employer for negligence and win. List three reasons such a suit would be hard to win while you cannot work — think of Lesson 7.1's defenses, your witnesses (fellow workers), and your wages meanwhile. Keep the list; the lesson explains the law built to replace it.

WATCH

Workers Comp Insurance: A simple explanation

Shine Insurance · 9:40

https://www.youtube.com/watch?v=rvjXOU964MU

> **WHEN TO WATCH**
> Watch after the big idea; write the two sides of the bargain as he describes the system — what the worker receives, what the worker gives up — and the same pair for the employer.

BACKUP VIDEO

Property & Casualty Exam Prep 51, Workers Compensation Basics

Open Exam Prep · 3:13

https://www.youtube.com/watch?v=gpFPuCBhoD4

A three-minute drill of the exam's core facts; watch it the day before the unit test and recite each fact a half-second before the narrator.

KEY TERMS

workers' compensation

A state statutory system paying defined no-fault benefits to employees injured by accidents arising out of and in the course of employment, funded by employers.

exclusive remedy

The employer's side of the bargain: statutory benefits are ordinarily the employee's only recourse against the employer, who cannot be sued for negligence for a covered injury.

fellow-servant rule

The old common-law defense that barred a worker's suit when a co-worker's negligence caused the injury.

assumption of risk (employment)

The old defense that a worker who took a known dangerous job had accepted its dangers as part of the wage.

contributory negligence (employment)

The old defense that barred recovery if the injured worker's own carelessness contributed at all — the third leg of the employer's common-law shield.

arising out of and in the course of employment

The compensability test: the injury must spring from the work and occur while doing it; the ordinary commute is excluded under the going-and-coming rule.

average weekly wage (AWW)

The wage base, computed from the worker's earnings before injury, on which disability benefits are figured — commonly two-thirds of AWW within state minimums and maximums.

temporary total disability (TTD)

The most common indemnity benefit: the worker cannot work at all for a time, and receives the weekly formula benefit until he can.

monopolistic state fund

A state in which employers must buy workers' compensation from the state's own fund — as of 2026: North Dakota, Ohio, Washington and Wyoming — so private carriers write only employers liability-type gaps there.

employers liability (Part Two)

The policy's second insuring agreement, covering the employer for the rare employment-related suits that fall outside the workers' compensation statute.

experience modification factor

A multiplier comparing an employer's actual losses with those expected for its class and size; below 1.00 lowers the premium, above 1.00 raises it.

independent contractor

A worker who controls the manner and means of his own work; not an employee, and so generally outside the hiring firm's workers' compensation coverage.

CORE IDEAS

The story. On May 3, 1911, Wisconsin's legislature passed the first workers' compensation act in America to take effect and survive the courts, and within that same year nine more states followed. What died that day was a legal regime workers called hopeless. Under the common law, an injured factory hand could recover only by proving his employer negligent under Lesson 7.1's four elements — and then only by beating three defenses the courts had armed employers with. The **fellow-servant**

rule barred him if a co-worker's slip caused the injury, and in a crowded mill a co-worker nearly always had a hand in it. **Assumption of risk** barred him if the danger was a known part of the job — and what mill danger was not? **Contributory negligence** barred him if his own hands had contributed at all. Lawyers called the three the «unholy trinity»; a famous turn-of-the-century survey found most injured workers recovered little or nothing, after years of litigation their families could not afford. Germany had answered first — Chancellor Bismarck's national accident insurance law of 1884 — and Britain in 1897. Wisconsin translated the idea into American law, and by 1948, when Mississippi acted last, every state had its own.

How they figured it out. The reformers' insight was that the courtroom was the wrong instrument altogether, and both sides had reason to trade it away. So the statutes struck what everyone still calls **the great bargain.** The worker gives up his right to sue the employer for negligence — with it, any hope of a jury's pain-and-suffering verdict — and receives in exchange *certain, swift, no-fault* benefits fixed by statute: no four elements to prove, no unholy trinity to survive, benefits beginning in weeks rather than years. The employer accepts automatic liability for every workplace injury, fault or no fault, and receives in exchange the **exclusive remedy**: the statutory benefits are, with narrow exceptions, the only recovery an employee may seek from him, so the catastrophic verdict disappears from his nightmares. And because the employer's new duty is automatic and bounded, it can be priced — which is where insurance enters: nearly every state requires employers to secure the obligation through a workers' compensation policy or qualified self-insurance.

The big idea. The benefits come in four classes, and the exam expects all four. **Medical benefits** pay the reasonable cost of treating the injury — unlimited in duration and amount, with no deductible and no coinsurance, the only major coverage in this course so unbounded. **Disability income (indemnity) benefits** replace wages by formula: commonly two-thirds of the worker's **average weekly wage**, within state minimums and maximums, after a short waiting period — and the categories are temporary total, temporary partial, permanent partial (often paid by a schedule: so many weeks for the loss of a hand, in this example), and permanent total. **Rehabilitation benefits** pay for physical therapy and retraining toward return to work. **Death benefits** pay burial expenses and income to the surviving spouse and dependent children. In this example, a carpenter earning an AWW of $900 who

cannot work for ten weeks receives $\frac{2}{3} \times \$900 = \$600$ a week — modest beside a jury verdict, but certain, prompt, and paid without proving anybody wrong.

Who is inside the bargain? **Employees** injured by accident — and by listed occupational diseases — **arising out of and in the course of employment**: the injury must spring from the work and happen while doing it. The delivery driver hurt on his route is covered; the same driver hurt driving to work in the morning is not, under the **going-and-coming rule**, because the ordinary commute serves the worker, not the employer. **Independent contractors** are outside: the common tests ask who controls the manner and means of the work, who supplies the tools, and whether the worker serves many customers or one master. States also exempt narrow categories — very small employers, some farm and domestic labor, casual workers — by thresholds that vary state to state; the live rule is at your state's workers' compensation agency. Misclassifying employees as contractors to dodge premiums is both a licensing-exam topic and, in the field, a fraud the agent must never help arrange.

The machinery varies by state. In most states employers buy coverage from **private insurers**, sometimes alongside a **competitive state fund** that sells in the same market; large employers may qualify to **self-insure**. Four states are **monopolistic** — North Dakota, Ohio, Washington and Wyoming, as of 2026 — where the state's own fund is the only seller and private carriers are shut out of the compensation line. The standard policy has two insuring agreements. **Part One** promises to pay whatever the state statute requires — no dollar limit, because the statute itself is the limit. **Part Two, employers liability**, covers the employer for the rare employment suits outside the statute — a spouse's loss-of-consortium claim, or a «third-party-over» action where a sued equipment maker turns and sues the employer — and it carries ordinary dollar limits ($100,000/$500,000/$100,000 is a common example). In monopolistic states, employers buy stop-gap employers liability from private carriers, since the state fund sells Part One alone.

Pricing is payroll arithmetic with a conscience. The base premium is the employer's payroll, per $100, times a rate for each **classification code** — clerical staff rate in pennies, roofers in dollars, in this example. Then the **experience modification factor** compares this employer's actual losses over recent years with the losses expected for its class and size: a mod of 1.00 is average; 0.85 means 15% better than expected and 15% off the modified premium; 1.30 means a loss history 30% worse, surcharged

accordingly. The mod turns safety into money — guards on the saws, dry floors, a return-to-work program for recovering employees — and a casualty agent serving small businesses spends real hours explaining it. In this example, a contractor with $400,000 of payroll in a class rated $4.50 per $100 and a mod of 0.85 pays $\frac{\$400{,}000}{100} \times \$4.50 \times 0.85 = \$15{,}300$ — and knows exactly which safety rail earned the discount.

On the exam today. The phrase to own is **exclusive remedy**: statutory benefits replace the employee's negligence suit against the employer — an answer choice letting a covered employee sue his employer for pain and suffering is almost always wrong. Know the benefit classes and the formula shape: medical unlimited; disability commonly two-thirds of AWW within caps after a waiting period; rehabilitation; death benefits. Expect the four monopolistic states — North Dakota, Ohio, Washington, Wyoming — and the two-part policy: Part One statutory, no limit; Part Two employers liability, with limits. The compensability traps are the commute (going-and-coming: not covered) and the contractor (not an employee: not covered). Remember that benefits are no-fault both ways — the careless employee still collects, and the careful employer still pays — and that workers' compensation obligations are excluded from every other policy in this unit, which is exactly why this one exists.

PICTURE STUDY



The Iron Rolling Mill (Modern Cyclopes), Adolph Menzel, 1872–1875 · Oil on canvas · Alte Nationalgalerie, Berlin

Image: Wikimedia Commons, public domain

Adolph Menzel, the most honored German painter of his century, spent weeks sketching inside a royal iron works in Silesia before composing this enormous canvas — the first great painting of modern heavy industry, finished in 1875. He shows a rolling mill in full cry: one crew works the glowing bar, another eats its dinner by a barrow, a third washes up as its shift ends. Menzel admired these men and painted their skill, not their misfortunes. The picture opens this lesson because it shows exactly the world — strong men, fast machinery, heat and fatigue in close quarters — for which the courtroom's four elements proved too slow and too cruel, and for which Germany, nine years after this canvas was finished, built the first national accident insurance system in 1884.

Look closely

- Find the three groups: the crew at the glowing iron, the men eating at right, the washers at left. Menzel painted a whole working day in one frame.
- Follow the long tongs and the men's braced stances — skill and teamwork, inches from heat and moving steel. Count how many men one bar of iron requires.
- Look up into the dark machinery overhead: belts, wheels and steam. The fellow-servant rule said any of these men barred the others' lawsuits; the

statute said the work itself would carry its costs.

- Notice the half-eaten meal and the tired faces. Wages, meals, families — what a weekly benefit check is actually for.

Talk about it

1. Menzel shows labor with dignity rather than misery. Why is that honest way of seeing workers a better foundation for just law than either sentimentality or contempt?
2. The great bargain gave workers certainty instead of courtroom victory, and employers peace instead of defenses. Which side do you think gave up more, and why did both agree?
3. Galatians 6:2 commands «bear ye one another's burdens.» How does a statute that spreads the cost of workplace injuries across every employer — and every customer — echo that command, and where does the statute's reach end and the church's begin?

PROJECT

The Great Bargain Ledger

You will draw the bargain as a two-sided ledger — what each party gave, what each received — then put it to work: one benefit calculation, one premium calculation, and one set of coverage rulings for a pretend workshop. The finished ledger completes the casualty section of your Pathway File and pairs with Unit 8's commercial pages later.

You will need

- One sheet of paper, ruler, pencil, two ink colors
- A calculator and your exam notebook
- The Wisconsin Worker's Compensation Division site from the kit, open for browsing

Steps

1. Rule the page into a two-column ledger headed THE WORKER and THE EMPLOYER; under each, write GAVE UP and RECEIVED, and fill all four cells — the suit and the verdict surrendered; certain no-fault benefits; automatic liability accepted; exclusive remedy received.
2. Across the top, write the dates that frame the story: Germany 1884 — Britain 1897 — Wisconsin, May 3, 1911 — all states by 1948 (Mississippi last).
3. Below the ledger, list the four benefit classes with one fact each: medical (unlimited), disability (commonly two-thirds of AWW, within caps, after a wait), rehabilitation, death benefits.
4. Work the benefit: your pretend employee, a cabinet-shop sander with an AWW of $780, is out six weeks — compute the weekly check at two-thirds and the six-week total, showing the arithmetic.
5. Work the premium: the shop's $250,000 payroll in a class rated $3.20 per $100 with a mod of 0.90 — compute, then recompute at a mod of 1.25 and label the difference WHAT SAFETY IS WORTH.
6. Add a rulings box: decide and justify, in one line each, the sander hurt at his bench, the bookkeeper hurt on her commute, and the self-employed finisher hired by the job.

7. In the corner, list the four monopolistic states — North Dakota, Ohio, Washington, Wyoming — and note that private carriers sell stop-gap employers liability there.
8. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for exclusive remedy, the three old defenses (one card each), AWW, the four benefit classes, monopolistic states, and the experience mod.
2. Draw the bargain as a handshake across a ledger: the worker's hand labeled NO LAWSUIT, the employer's labeled NO-FAULT BENEFITS, with EXCLUSIVE REMEDY written along the arms.
3. Write a five-line trap list titled «Covered or not», ending with: commute OUT (going-and-coming), careless employee IN (no-fault), contractor OUT (not an employee).

KEY FORMULAS

$$\text{Weekly disability benefit} = \tfrac{2}{3} \times \text{AWW (within state minimum and maximum, commonly)}$$

$$\text{Standard premium} = \tfrac{\text{payroll}}{100} \times \text{class rate} \times \text{experience mod}$$

From history. New York actually moved before Wisconsin — a 1910 compulsory compensation law — but its highest court struck it down in Ives v. South Buffalo Railway (March 1911) as taking property without due process. New Yorkers answered by amending their state constitution in 1913 and re-enacting the law, and in 1917 the United States Supreme Court upheld compulsory compensation statutes for good. Wisconsin's 1911 act kept its place in the books by surviving where New York's first try had not.

Example 1. A warehouse worker earning an average weekly wage of $900 is hurt lifting stock and cannot work for 8 weeks; his state pays two-thirds of AWW with a $1,050 weekly maximum and a 7-day waiting period that is reimbursed if disability lasts past 21 days (all figures in this example). Compute his weekly and total temporary total disability benefit.

Show solution

1. Weekly formula: $\frac{2}{3} \times \$900 = \$600$.
2. Test the cap: $\$600 \leq \$1{,}050$ — the formula amount stands.
3. Duration: 8 weeks of disability exceeds 21 days, so the one-week wait is paid back — he collects for all 8 weeks.
4. Total indemnity: $8 \times \$600 = \$4{,}800$ — and every covered medical bill is paid separately, without limit, deductible or coinsurance.

Answer: $600 a week, $4,800 total, plus unlimited medical — no fault proven, no defenses faced, no lawsuit filed. The certainty, not the size, is the bargain's gift.

Example 2. A roofing contractor has $400,000 of annual payroll in a class rated $4.50 per $100 of payroll. In this example, compute the premium at a 1.00 mod, then at the firm's actual mod of 0.85, and state what a 1.30 mod would have cost instead.

Show solution

1. Base: $\frac{\$400{,}000}{100} = 4{,}000$ payroll units.
2. Manual premium: $4{,}000 \times \$4.50 = \$18{,}000$ at a 1.00 mod.
3. Apply the experience mod: $\$18{,}000 \times 0.85 = \$15{,}300$ — safety bought a $2,700 discount.
4. At 1.30: $\$18{,}000 \times 1.30 = \$23{,}400$ — a poor loss history costs $8,100 more than the safe roofer pays.

Answer: Manual $18,000; modified $15,300 at 0.85; $23,400 at 1.30. The mod is the system's sermon: fewer injuries, smaller premium.

Example 3. Exam style. Which injury is compensable under workers' compensation?

A. A bookkeeper sprains her ankle jogging on Saturday

B. A delivery driver is rear-ended while driving his normal morning commute to the warehouse

C. A machine operator loses time to a hand injury caused by his own careless haste at his machine

D. A freelance graphic designer, hired by the project, develops wrist pain working at home for many clients

Show solution

1. Apply the test: employee + arising out of and in the course of employment, no fault required either way.
2. A fails both prongs — a weekend jog neither arises from nor occurs in the course of employment.
3. B is the going-and-coming rule: the ordinary commute is not in the course of employment.
4. D is an independent contractor — controls her own work, serves many clients — outside the system entirely.
5. C is covered: his own carelessness is no bar, because benefits are no-fault; contributory negligence died with the unholy trinity.

Answer: C. The careless employee at his machine collects; the commuter, the weekend jogger, and the contractor do not. No-fault cuts both ways — that is the bargain.

PRACTICE

1. Easy State the two sides of the great bargain in one sentence each.

Show answer

The worker receives certain, no-fault statutory benefits but gives up the right to sue the employer for negligence; the employer accepts automatic liability for workplace injuries but receives the exclusive remedy — immunity from such suits.

2. **Easy** Name the three common-law defenses that made worker suits nearly hopeless before 1911.

Show answer

The fellow-servant rule, assumption of risk, and contributory negligence — the «unholy trinity» the compensation statutes swept away.

3. **Easy** Which benefit class in workers' compensation has no dollar or time limit?

Show answer

Medical benefits — reasonable treatment of the injury is paid without limit, deductible or coinsurance.

4. **Medium** A worker's average weekly wage is $1,200; her state pays two-thirds of AWW with a weekly maximum of $700 (in this example). What is her temporary total disability check?

Show answer

The formula gives $\frac{2}{3} \times \$1{,}200 = \$800$, but the cap applies: she receives the $700 state maximum. Benefits live inside statutory minimums and maximums.

5. **Medium** Which state's 1911 act was the first workers' compensation law in America to take effect and last?

A. New York

B. Wisconsin

C. Ohio

D. Massachusetts

Show answer

B. Wisconsin's act of May 3, 1911 led, and nine more states followed that year; by 1948 every state had one. New York's early 1910 law was struck down by its courts — see the history note.

6. Medium Name the four monopolistic state funds as of 2026, and say what private insurers sell to employers in those states.

Show answer

North Dakota, Ohio, Washington and Wyoming. Private carriers cannot write the statutory compensation line there, so they sell stop-gap employers liability to cover the suits the state fund's Part One-only coverage leaves open.

7. Medium What does Part Two (employers liability) of the policy cover that Part One does not, and which part carries dollar limits?

Show answer

Part Two covers the rare employment-related suits outside the statute — a spouse's consortium claim or a third-party-over action — and it carries ordinary dollar limits. Part One pays whatever the statute requires, with no policy dollar limit.

8. Hard Compute: payroll $600,000, class rate $2.80 per $100, experience mod 1.15. What is the premium, and what would a 0.80 mod have saved?

Show answer

$\frac{\$600{,}000}{100} \times \$2.80 = \$16{,}800$ manual; at 1.15 the premium is $19,320. At 0.80 it would be $13,440 — a $5,880 difference, which is the experience mod translating safety into money.

9. Hard A covered machinist is badly hurt because he removed a machine guard to work faster. His employer had warned him twice. Does he collect benefits, and may the employer be sued instead? Explain.

Show answer

He collects: benefits are no-fault, and an employee's own negligence is no bar (willful intentional self-injury is the narrow exception in most statutes). And the exclusive remedy means he cannot sue the employer for negligence either — the bargain replaces the courtroom in both directions.

10. Hard A firm calls its delivery drivers «independent contractors»: the firm sets their routes and hours, owns the vans, and they serve no one else. An agent is asked to quote without their payroll. What should the agent see, and why does it matter?

Show answer

Control of manner and means, the firm's tools, and single-master service all mark these drivers as employees, whatever the label. Excluding their payroll understates premium and leaves injuries uncovered until an audit or a claim exposes it — misclassification is premium fraud the agent must not assist.

11. Challenge Write three sentences explaining why making employer liability automatic and limited — rather than fault-based and unlimited — is precisely what made it insurable, using Unit 1's law of large numbers.

Show answer

Fault-based verdicts were rare but unbounded, so no employer could predict his cost and no pool could price it calmly. The statute made losses frequent but defined — a formula benefit per injury — turning wild verdicts into a measurable expected loss per $100 of payroll. Predictable frequency with bounded severity is exactly what the law of large numbers prices best, which is why a compensation premium can be quoted to the penny while a jury cannot.

12. Challenge Galatians 6:2 commands bearing one another's burdens. Write three sentences on how the workers' compensation system obeys the letter of that command, and one way a Christian employer should go beyond it.

Show answer

The statute makes the injury's cost a burden of the whole enterprise — employer, insurer, and ultimately every customer — rather than of the injured family alone. Its no-fault promise means the burden is borne without first assigning shame. But the statute pays wages and bills, not visits; a Christian employer also keeps the injured worker's place warm, his family fed in the waiting week, and his dignity intact — the burdens the formula cannot reach.

COMMON MISTAKES

- Letting a covered employee «sue the employer for pain and suffering» in an answer choice — the exclusive remedy bars it; statutory benefits are the recourse.

- Capping medical benefits; workers' compensation medical is unlimited, with no deductible — the disability (indemnity) benefit is what the formula and caps govern.
- Covering the morning commute; under the going-and-coming rule the ordinary trip to work is not in the course of employment.
- Denying benefits because the worker was careless; compensation is no-fault, and contributory negligence died with the old defenses.
- Forgetting the monopolistic four — North Dakota, Ohio, Washington, Wyoming — or placing private statutory coverage inside them.
- Giving Part Two the statute's unlimited promise; employers liability carries dollar limits, while Part One is the unlimited statutory side.

Make it a game · Bargain or Courtroom?. Shuffle ten scenario slips you write together: injured at the bench, hurt on the commute, careless with a guard, contractor by the job, spouse's consortium suit, injured Ohio machinist, and so on. Players take turns drawing; on each slip the drawer must shout either BENEFITS (and name which class pays first), NOT COVERED (and name the rule — going-and-coming, contractor), or PART TWO (for the rare outside suits). One point per correct call, a bonus point for the rule's name, minus one for letting anyone «sue the boss» on a covered injury. For the last round, the parent calls out an AWW and everyone races to compute two-thirds of it; closest fastest answer steals two points. Highest total wins the title of Compensation Commissioner.

Scripture. “Bear ye one another’s burdens, and so fulfil the law of Christ.” (Galatians 6:2, KJV)

The great bargain is a civic echo of this command: the cost of the mill's injuries is carried by the whole enterprise instead of crushing one household at a time. Law can compel the sharing of money; Christ's law asks the sharing of the weight itself — the visit, the meal, the kept job. An agent who sells this coverage well is helping a community obey at least the first half.

UNIT 7

Casualty Insurance: Autos and Liability

Property insurance pays you when your own things burn or blow away. **Casualty insurance** faces the other direction: it pays the people you hurt. The key that unlocks this whole unit is **legal liability** — the law's judgment that one person must pay for another's loss — and the law's chief tool for assigning that blame is **negligence**, proved by four elements: a duty owed, a breach of that duty, proximate cause, and actual damages. You will learn the four elements from a fireworks package that fell on a Brooklyn train platform in 1924, and then you will carry them into the policy nearly every American family owns: the **personal auto policy**, part by part — liability and medical payments, uninsured and underinsured motorists, collision and other-than-collision. You will finally learn to read **split limits** like 100/300/50 aloud and to work the claim arithmetic the licensing exam loves best.

Above the auto and homeowners policies you will raise the **personal umbrella**, a million dollars or more of liability protection for the catastrophic day, and you will finish with the most remarkable bargain in American insurance law: **workers' compensation**, born in Wisconsin in 1911, by which workers gave up the right to sue their employers and received in exchange certain, no-fault benefits — and employers accepted automatic duty in exchange for peace. Casualty questions crowd every property and casualty licensing exam, and most of them are won with the four elements, the three numbers of a split limit, and the phrase *exclusive remedy*. By the end of this unit all three will be yours.

PREREQUISITES

- Has completed Unit 6, or can compute actual cash value (replacement cost minus depreciation) and apply a deductible to a loss
- Can work comfortably with percents and large numbers (find two-thirds of $900, find 30% of $80,000, keep thousands straight)
- Can read a short legal scenario twice and list its facts in order before answering anything
- Can keep a tidy, dated exam notebook and a growing flashcard box from the earlier units

MASTERY CHECKLIST

- ☐ I can name the four elements of negligence, define each in one sentence, and show which element fails in a given scenario.
- ☐ I can contrast contributory and comparative negligence, compute a comparative-negligence recovery, and define strict and vicarious liability.
- ☐ I can read a split limit like 100/300/50 aloud, apply it to a multi-victim claim, and contrast it with a combined single limit.
- ☐ I can name Parts A through F of the personal auto policy and say who counts as an insured under Part A.
- ☐ I can explain uninsured and underinsured motorists coverage and compute what Part C pays in an example.
- ☐ I can sort any loss into collision or other-than-collision — including the deer — and settle it at actual cash value minus the deductible.
- ☐ I can explain how a personal umbrella sits above underlying limits, when the self-insured retention applies, and stack a large judgment across the layers.

- ☐ I can tell the story of the workers' compensation bargain — statutory no-fault benefits in exchange for exclusive remedy — and compute a weekly disability benefit and an experience-modified premium.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **Insurance Information Institute: Auto Insurance Basics**: Free consumer page from the insurance industry's own information institute, walking the same coverages as Lessons 7.2 and 7.3 in plain language. Read it after 7.2 and check that you can name the part of the policy behind each paragraph. Ages 14 and up.
- **Texas Department of Insurance: Automobile Insurance Guide**: Free, official. A real state insurance department's consumer guide to auto coverage, with that state's required minimums. Use it with Lessons 7.2 and 7.3 as your model, then find the matching guide from your own state's department — every state publishes one. Ages 14 and up.
- **Insurance Information Institute: What Is an Umbrella Liability Policy?**: Free consumer explainer on the personal umbrella — what sits beneath it and what it adds. Read it with Lesson 7.4 and compare its example limits with the ones in this unit, remembering that real figures vary by insurer and state. Ages 14 and up.
- **Wisconsin Department of Workforce Development: Worker's Compensation Division**: Free, official — and historic: Wisconsin's 1911 act was the first workers' compensation law in America to last. Browse the division's pages with Lesson 7.5 to see the great bargain still running, then look up your own state's workers' compensation agency. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

7.1 Negligence and the Four Elements: How the Law Assigns Blame

3 sessions of 50 minutes

7.2 The Personal Auto Policy: Liability and Medical Payments

3 sessions of 50 minutes

7.3	**The Personal Auto Policy: Uninsured Motorists and Physical Damage**	3 sessions of 50 minutes
7.4	**The Umbrella: Liability for the Catastrophic Day**	3 sessions of 50 minutes
7.5	**Workers' Compensation: The Great Bargain**	3 sessions of 50 minutes

Unit 7 test

Closed book. Twenty four-choice questions, 5 points each — the same style your state licensing exam uses, at about one minute per question, so set a timer for 25 minutes. Answer every question; an unanswered question is simply a wrong one. On a licensing exam 70% (14 of 20 here) is a pass, but aim higher — the real exam will be longer and you will be nervous. Remember that every dollar figure and state minimum marked «in this example» is exactly that: the live numbers for your state are at your state insurance department's website.

1. **5 pts**

   A claimant proves the defendant owed a duty, breached it, and that the breach proximately caused the harm — but can show no actual loss of any kind. The negligence claim:

   A. Succeeds, because three of four elements are proven

   B. Fails, because all four elements, including actual damages, are required

   C. Succeeds, but only nominal punitive damages are awarded

   D. Becomes a strict liability claim automatically

2. **5 pts**

   A jury finds $60,000 of damages and puts 40% of the fault on the claimant in a pure comparative negligence state. The claimant recovers:

   A. $0

   B. $24,000

   C. $36,000

   D. $60,000

3. 5 pts

A homeowner keeps a pet wolf that escapes — despite an expensive, well-built enclosure — and bites a neighbor. The homeowner's liability is best described as:

A. Strict (absolute) liability, regardless of his precautions

B. No liability, because he was not negligent

C. Vicarious liability

D. Negligence per se

4. 5 pts

Which damages punish the defendant rather than compensate the victim, and are therefore uninsurable in many states?

A. Special damages

B. General damages

C. Compensatory damages

D. Punitive damages

5. 5 pts

An insured carries split limits of 50/100/25. One at-fault accident injures two people, with claims of $70,000 and $30,000, and causes $30,000 of damage to the other car. The policy pays:

A. $100,000 BI and $30,000 PD

B. $80,000 BI and $25,000 PD

C. $100,000 BI and $25,000 PD

D. $130,000 total from a single pool

6. 5 pts

Under PAP Part A, defense costs the insurer incurs defending the insured are:

A. Paid in addition to the limits of liability

B. Paid from within the limits, reducing them

C. Paid only after a judgment

D. The insured's own responsibility once suit is filed

7. 5 pts

Which person is NOT an insured under Part A of a family's personal auto policy?

A. The named insured's resident 17-year-old son driving a borrowed car

B. A neighbor driving the covered auto with permission

C. A thief who takes the covered auto from the driveway

D. The named insured's spouse, who lives in the household

8. 5 pts

The named insured bumps her own garage wall, bruising her chin; no one else is involved. Which PAP coverage pays her medical bill?

A. Part A liability

B. Part C uninsured motorists

C. No coverage — she was at fault

D. Part B medical payments

9. 5 pts

The insured's car strikes a deer at night, then three weeks later is dented by hail. Under Part D these losses are, respectively:

A. Other-than-collision and other-than-collision

B. Collision and other-than-collision

C. Collision and collision

D. Other-than-collision and collision

10. 5 pts

An insured suffers $90,000 of bodily injury damages caused by a driver carrying 25/50 limits whose insurer pays its $25,000. The insured's UIM limit is $100,000, in a state where UIM pays damages minus the at-fault payment (in this example). UIM pays:

A. $100,000

B. $65,000

C. $90,000

D. $25,000

11. 5 pts

A hit-and-run driver injures the insured, who files under Part C. Which duty is specific to this claim?

A. Obtaining the insurer's consent before any medical treatment

B. Posting a bond for the phantom driver

C. Promptly notifying the police

D. Repairing the car before inspection

12. 5 pts

A covered auto with an actual cash value of $11,000 needs $12,500 of collision repairs; the collision deductible is $500. The insurer will pay:

A. $12,000

B. $11,000

C. $12,500

D. $10,500, and take the salvage

13. 5 pts

A personal umbrella policy is best described as:

A. Liability coverage of $1 million or more, excess over required underlying auto and homeowners limits

B. Property coverage for catastrophic damage to the insured's home and autos

C. A substitute for auto and homeowners policies

D. Health coverage for catastrophic injuries to the insured

14. 5 pts

A $1,000,000 umbrella has a $1,000 SIR. The insured's underlying auto policy pays its full $250,000 limit toward a $600,000 judgment. The umbrella pays:

A. $349,000 — the balance minus the SIR

B. $600,000

C. $350,000 — the SIR does not apply when an underlying policy has paid

D. Nothing until the insured pays $1,000

15. 5 pts

An umbrella requires 250/500 underlying auto limits, but the insured reduced his auto policy to 100/300. After a $400,000 one-victim judgment, the insured personally owes:

A. Nothing — the umbrella drops down

B. $150,000 — the gap between his actual and required underlying limits

C. $400,000 — the umbrella is void

D. $1,000 — the SIR only

16. 5 pts

Which claim could the umbrella cover from the first dollar above the retention, because the underlying policies do not cover it at all?

A. A three-car pileup the insured caused

B. Hail damage to the insured's roof

C. A guest's fall on the insured's stairs

D. A slander judgment against the insured

17. 5 pts

Under the workers' compensation «great bargain,» the employee receives no-fault statutory benefits and gives up:

A. The right to sue the employer for negligence

B. The right to statutory death benefits

C. The right to choose any doctor

D. The right to quit the job

18. 5 pts

A covered worker earning an average weekly wage of $750 is disabled for 6 weeks; the state pays two-thirds of AWW, below its maximum (in this example). Her weekly benefit is:

A. $750

B. $375

C. $250

D. $500

19. 5 pts

In which group of states must employers buy workers' compensation from the state's own monopolistic fund, as of 2026?

A. Texas, Florida, Georgia, Alabama

B. California, New York, Illinois, Pennsylvania

C. North Dakota, Ohio, Washington, Wyoming

D. Maine, Vermont, New Hampshire, Massachusetts

20. 5 pts

Which injured person is entitled to workers' compensation benefits?

A. An independent contractor hurt using his own tools on his own schedule

B. A stock clerk who carelessly cuts himself opening boxes at work

C. A cashier rear-ended during her ordinary drive to the store before her shift

D. An employee hurt in a weekend softball game unrelated to work

ANSWER KEY

1. B. Negligence requires duty, breach, proximate cause AND actual damages; a majority of elements is not enough, and strict liability (D) applies only to abnormally dangerous activities, not to failed negligence claims.
2. C. Recovery equals damages times the defendant's share: $60,000 × 0.60 = $36,000. A would be right only under contributory negligence, and B reverses the percentages — the classic arithmetic trap.
3. A. Keeping a wild animal is a classic strict liability activity: the keeper pays for the harm his extraordinary hazard causes, and the quality of his precautions is irrelevant — which is why B is the tempting wrong answer.
4. D. Punitive damages punish outrageous conduct; insuring them would shift the punishment to the pool, so many states forbid it. Special and general damages (A, B) together make up compensatory damages (C), which insurance exists to pay.
5. B. Cap each person first: min(70, 50) = $50,000 and min(30, 50) = $30,000; the $80,000 sum passes the $100,000 per-accident test. PD pays min(30, 25) = $25,000 from its separate pool. A and C forget the per-person cap or the PD limit; D describes a combined single limit.
6. A. The PAP pays defense costs and supplementary payments in addition to the stated limits; the duty to defend ends only when the limits are exhausted by payment of judgments or settlements.
7. C. A thief has no reasonable belief of permission and is no insured. Resident family members (A) and the resident spouse (D) are insureds for any auto, and the permissive user (B) is an insured for the covered auto.
8. D. Medical payments is no-fault coverage for insureds injured while occupying an auto, so her own clumsiness is irrelevant. Part A pays others, not the insured; C wrongly imports fault into a no-fault coverage.
9. A. Contact with a bird or animal and hail are both named other-than-collision perils. The deer becomes a collision question only when the driver swerves and strikes some other object instead.
10. B. The insured is entitled to min($90,000, $100,000) = $90,000, less the $25,000 received: UIM pays $65,000. A pays the limit regardless of damages, and C ignores the at-fault insurer's payment — both classic traps.
11. C. A hit-and-run claim requires prompt police notice, which protects the insurer against invented phantom-driver accidents. D is backwards — the insured must

permit inspection and protect the car from further damage, not repair it first.

12. D. Repair cost exceeds ACV, so the car is a total loss: the insurer pays ACV minus the deductible ($11,000 − $500 = $10,500) and takes the salvage. A and C pay repair figures the policy never promises once repairs exceed the car's value.
13. A. The umbrella is pure liability protection sitting above the underlying policies it requires. It never pays the insured's own property or medical losses (B, D), and it supplements rather than replaces the primary policies (C).
14. C. The umbrella pays the $350,000 excess over the exhausted underlying limit. The self-insured retention applies only on drop-down claims no underlying policy covers — A charges it in the wrong place, which is the exam's favorite umbrella trap.
15. B. The auto pays its actual $100,000; the umbrella attaches at the required $250,000 and pays $150,000; the $150,000 between $100,000 and $250,000 is the insured's own. Failure to maintain underlying limits moves the gap onto the insured, not onto the umbrella (A) and not into a void policy (C).
16. D. Slander is a personal injury offense the basic underlying forms lack, so the umbrella drops down, minus the SIR. A and C are covered by the underlying auto and homeowners liability first, and B is property damage to the insured's own home — no liability policy pays it.
17. A. Exclusive remedy is the bargain's other half: statutory benefits replace the negligence suit against the employer. B is a benefit received, not surrendered, and C and D are state-by-state details, not the bargain itself.
18. D. Two-thirds of $750 is $500 a week. A replaces the full wage, which no state formula does; B is one-half and C is one-third — misread fractions, the question's whole point.
19. C. North Dakota, Ohio, Washington and Wyoming run monopolistic state funds; private carriers there sell only stop-gap employers liability. The other lists are large or regional states with private and competitive markets.
20. B. Compensation is no-fault, so the careless employee at his task collects. The contractor (A) is not an employee; the commute (C) fails the going-and-coming rule; the weekend game (D) neither arises out of nor occurs in the course of employment.

PORTFOLIO PIECE: THE CASUALTY FILE

Assemble the five artifacts this unit built: the Liability Map of the four elements with its defenses and doctrines (7.1), the Split-Limits Claim Desk worksheet with its shortfall column (7.2), the Whole-Policy Map of PAP Parts A through F with twelve routed losses (7.3), the Tower Diagram stacking three claims through the umbrella (7.4), and the Great Bargain Ledger with its benefit and premium calculations (7.5). Clip them into the casualty section of your Pathway File in that order — blame, the policy, the policy's second half, the layer above, and the workplace bargain.

Then write the one-page cover sheet that proves the unit is yours: in your own words, trace a single $1,000,000 judgment from the four elements that created it, through the split limits that paid first, to the umbrella layer that finished it — with every number shown — and close with two sentences on why the workers' compensation bargain removed exactly this kind of lawsuit from the workplace.

LOOK FOR	WHAT IT MEANS
Complete file	All five artifacts are present, dated, and labeled with their lesson numbers, clipped in order behind the casualty divider.
Split-limits arithmetic	The Claim Desk worksheet applies the fences in the correct order — per person, per accident, then property damage — in every claim, with the insured's personal shortfall computed each time.
Umbrella mechanics	The Tower Diagram shows a correct attachment point, one correct drop-down claim with the self-insured retention, and one correct failure-to-maintain gap charged to the insured.
The great bargain	The Great Bargain Ledger states both sides of the bargain accurately and computes one disability benefit and one experience-modified premium without error.
Cover-sheet walk-through	The one-page judgment walk-through is arithmetically correct at every layer and uses duty, breach, proximate cause, damages, per-person limit, attachment point, and exclusive remedy correctly.
Honest figures	Every changeable figure on every page is flagged «in this example» or «commonly», with at least one note pointing to the state insurance department for live numbers.

UNIT 8

Commercial Lines

Every shop on Main Street is a family's livelihood wearing a storefront. In this unit you cross from personal lines to **commercial lines** — the policies that protect businesses — and you will find the same ideas you already know, grown to commercial scale. You will meet the **building and personal property coverage form** and discover that when a mill burns, the flames are only half the loss: the income stops too, which is why **business income insurance** exists. You will study the **commercial general liability policy**, the CGL, and learn why a plumber's customers demand a certificate of insurance before he touches a pipe, and what the strange pair **occurrence** and **claims-made** means. You will package it all into the **businessowners policy** — the HO-3 of Main Street — and learn when a business is too big or too odd for the package and needs a **commercial package policy** built part by part.

Then the unit goes traveling: business autos and their coverage symbols, cargo crossing oceans under **ocean marine** policies whose rules reach back past Edward Lloyd's coffee house to the sailors of ancient Rhodes, and **inland marine** floaters that follow tools and goods over the road. The unit closes with the policies that guard a business from dishonesty and from its own mistakes: crime insurance and **fidelity bonds**, the three-party **surety bond** that is not insurance at all, and **professional liability** — including the errors and omissions coverage that will one day protect you, the agent. Roughly a quarter of a property and casualty licensing exam lives in this territory. Master it, and the hard part of the P&C outline is behind you.

PREREQUISITES

- Has completed Units 6 and 7 (personal property and liability lines) and can state the difference between named-peril and open-peril coverage
- Can compute a coinsurance recovery with the did-over-should formula and subtract a deductible in the right order
- Can define negligence, bodily injury, property damage and legal liability in one sentence each
- Can keep a tidy exam notebook and look up a figure at a state insurance department website

MASTERY CHECKLIST

- ☐ I can name the three property coverages of the building and personal property coverage form and sort any item of a business's property into the right one.
- ☐ I can tell the basic, broad and special causes of loss forms apart and explain business income and extra expense coverage, including the period of restoration.
- ☐ I can name the CGL's three coverages, tell premises/operations from products/completed operations, and keep per-occurrence and aggregate limits straight.
- ☐ I can explain an occurrence form and a claims-made form, including the retroactive date and the extended reporting period.
- ☐ I can state what a businessowners policy packages together, who is eligible for one, what it never covers, and when a commercial package policy is the right tool instead.
- ☐ I can read the main business auto coverage symbols and explain hired and non-owned auto liability.
- ☐ I can name the four coverages of ocean marine insurance, work a general average problem, and give three examples of inland marine floaters.

- ☐ I can diagram the three parties of a surety bond, contrast a bond with insurance, and tell malpractice, E&O and D&O coverage apart.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **SBA: Get Business Insurance**: Free, official. The U.S. Small Business Administration's plain-language page on the policies a new business needs, with a six-step buying guide. Read it with Lesson 8.3 and notice how closely its list tracks this unit's table of contents. Ages 14 and up.
- **Insurance Information Institute: Business Insurance Basics**: Free. The industry's own consumer-education institute explains commercial property, liability, BOPs, commercial auto and more in short articles. Use it as a second voice throughout the unit whenever a coverage feels fuzzy. Ages 14 and up.
- **California Department of Insurance: Commercial Insurance Guide**: Free, official. A state regulator's complete walk through commercial coverages, from the BOP to surety bonds — the same material this unit teaches, in a department's own words. Skim the matching section after each lesson; your own state's department publishes figures that may differ. Ages 15 and up.
- **Texas Department of Insurance: Business Insurance Publication**: Free, official. A second state's consumer bulletin on business coverage — useful for the habit this course keeps preaching: every state says it a little differently, so always check the department where you will be licensed. Compare it with the California guide during Lesson 8.5. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

8.1	**Commercial Property and the Income That Stops**	3 sessions of 50 minutes
8.2	**The CGL: Commercial General Liability**	3 sessions of 50 minutes
8.3	**The Businessowners Policy: Main Street's Package**	3 sessions of 50 minutes
8.4	**Commercial Auto, Inland and Ocean Marine**	3 sessions of 50 minutes

Unit 8 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about one minute per question — set a timer for 25 minutes and finish inside it, as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example” or “commonly,” use the figures given, and remember that real eligibility rules, limits and bond amounts vary — the live figures are at your state insurance department's website. On a state licensing exam 70% — 14 of 20 here — is a pass, but aim higher. Choose the one BEST answer.

1. **5 pts**

   A watch-repair shop's covered fire destroys the shop's workbenches, a customer's watch awaiting repair, and shelving the shop installed in its rented space. Under the building and personal property coverage form, the customer's watch is:

   A. Building property

   B. The shop's business personal property

   C. Personal property of others in the insured's care, custody or control

   D. Uninsurable under commercial property forms

2. **5 pts**

   In this example, a building worth $600,000 carries an 80% coinsurance clause and $360,000 of insurance with a $1,000 deductible. A covered loss of $40,000 occurs. The policy pays:

   A. $40,000

   B. $29,000

   C. $30,000

   D. $24,000

3. 5 pts

Under the special causes of loss form, which statement is TRUE?

A. Only the perils listed in the form are covered

B. The insured must prove a named peril caused the loss

C. Flood and earth movement are automatically covered

D. All direct physical loss is covered unless excluded, and the insurer must show an exclusion applies

4. 5 pts

Business income coverage commonly begins paying:

A. After a waiting period, commonly 72 hours, following direct physical loss by a covered cause

B. Immediately upon any drop in revenue

C. After a dollar deductible is exhausted

D. Only if the business closes permanently

5. 5 pts

A flower shop's radio advertisement copies a competitor's slogan, and the competitor sues. Which CGL coverage responds?

A. Coverage A — property damage

B. Coverage B — personal and advertising injury

C. Coverage C — medical payments

D. None; the CGL excludes all advertising disputes

6. 5 pts

A CGL carries a $1,000,000 per-occurrence limit and a $2,000,000 general aggregate. After two premises judgments of $950,000 and $850,000 this year, a third occurrence produces a $500,000 judgment. The policy pays:

A. $500,000

B. Nothing — the aggregate is exhausted

C. $200,000

D. $1,000,000

7. 5 pts

A claims-made CGL for calendar 2025 has a retroactive date of January 1, 2021. Which claim is covered?

A. A claim made in 2026, after expiration with no tail, for a 2024 injury

B. A claim made in 2025 for a 2019 injury

C. A claim made in 2024 for a 2025 injury

D. A claim first made in 2025 for a 2023 injury

8. 5 pts

A homeowner hiring a contractor receives a certificate of insurance naming her as certificate holder. The certificate:

A. Is evidence that the coverage shown existed on the date issued, and confers no policy rights on her

B. Makes her an insured under the contractor's CGL

C. Guarantees the policy cannot be canceled during her project

D. Amends the contractor's policy to cover her home

9. 5 pts

Under common eligibility rules, which business is MOST likely to qualify for a businessowners policy?

A. A tavern earning most of its revenue from alcohol

B. A 3,500-square-foot stationery store with modest annual sales

C. An automobile dealership

D. A regional bank

10. 5 pts

Business income coverage in a BOP is commonly written:

A. With an 80% coinsurance requirement

B. With a scheduled dollar limit and monthly limitation

C. On an actual loss sustained basis for up to twelve months, with no coinsurance

D. Only by endorsement for extra premium

11. 5 pts

Which exposure is NEVER covered by an unendorsed businessowners policy?

A. A customer's slip-and-fall in the shop

B. Fire damage to the insured building

C. Lost income during covered repairs

D. An employee's on-the-job injury

12. 5 pts

A commercial package policy consists of:

A. Common declarations and common policy conditions plus two or more coverage parts selected for the risk

B. A fixed bundle of property, liability and auto coverage identical for every insured

C. A homeowners form adapted for business use

D. A single line of insurance written at a package discount

13. 5 pts

A business auto policy shows liability coverage with symbol 7 (specifically described autos). An employee causes a crash while driving her own car to deliver company documents. The business is sued. The policy:

A. Covers the suit — any business driving is included

B. Does not cover it; the employee's car is a non-owned auto, outside a symbol 7 grant

C. Covers it only if the employee is uninsured

D. Covers it under physical damage coverage

14. 5 pts

In ocean marine insurance, the shipowner's legal liability for injury to crew members and damage to piers and cargo is covered by:

A. Hull coverage

B. Freight coverage

C. Protection and indemnity

D. General average

15. 5 pts

A master jettisons $50,000 of cargo, saving a venture whose remaining values are hull $600,000, cargo $300,000 and freight $100,000. The hull interest's general average contribution is:

A. $30,000

B. $50,000

C. $15,000

D. $20,000

16. 5 pts

Which of the following is one of the implied warranties of ocean marine insurance?

A. The cargo is new merchandise

B. The premium is paid in advance

C. The vessel carries a full crew roster filed with the insurer

D. The vessel is seaworthy

17. 5 pts

A city requires a contractor to furnish a performance bond on a bridge project. In this bond, the city is the:

A. Principal

B. Surety

C. Obligee

D. Underwriter

18. 5 pts

Which statement correctly contrasts suretyship with insurance?

A. The surety expects no losses and may recover its payment from the defaulting principal; an insurer expects losses and cannot recover a covered payment from its insured

B. Both expect losses, but only insurers charge premiums

C. A bond has two parties; insurance has three

D. Insurance protects the obligee; a bond protects the insured

19. 5 pts

An insurance agent fails to submit a client's application, leaving the client uninsured when a loss strikes. The client's suit against the agent is covered by the agent's:

A. Commercial general liability policy

B. Errors and omissions policy

C. Fidelity bond

D. Directors and officers policy

20. 5 pts

A retailer's annual inventory count shows $25,000 of unexplained shrinkage, and the owner files an employee theft claim offering the count as the only evidence. The claim is commonly:

A. Paid in full — shrinkage proves theft

B. Paid at half under the coinsurance clause

C. Denied unless the employee confesses in writing

D. Denied or limited, because inventory shortage alone is excluded as sole proof of employee theft

ANSWER KEY

1. C. Ownership controls the classification: the watch belongs to a customer and is in the insured's care, custody or control. B is the trap — possession is not ownership — and the shelving, not the watch, is the insured's business personal property as improvements and betterments.
2. B. Required: $0.80 \times \$600{,}000 = \$480{,}000$; ratio $360/480 = 0.75$; $0.75 \times \$40{,}000 = \$30{,}000$, minus the $1,000 deductible = $29,000. C forgets the deductible, which comes off last.
3. D. The special form is open peril: coverage for all direct physical loss except exclusions, with the burden of proof shifted to the insurer. A and B describe named-peril forms, and C names two losses the special form still excludes.
4. A. Business income carries a time deductible — commonly a 72-hour waiting period — and requires suspension of operations caused by direct physical loss from a covered cause. B pays on mere revenue dips (no trigger), and C invents a dollar deductible the coverage does not use.
5. B. Using another's advertising idea is a personal and advertising injury offense under Coverage B — no bodily injury or property damage is required. A needs physical harm, and C pays only small no-fault medical bills.
6. C. The aggregate began at $2,000,000 and the first two losses consumed $1,800,000, leaving $200,000 — the most the third claim can collect regardless of the per-occurrence limit. A ignores the aggregate; B empties it too soon.
7. D. The claims-made trigger needs both: claim first made during the policy period and injury after the retroactive date. A fails the made-during test (no tail), B fails the retroactive date, and C was made before this policy existed.
8. A. A certificate is information only — proof that coverage existed when issued. It adds no insureds, blocks no cancellation and amends nothing, which is exactly why B, C and D are the classic wrong answers.
9. B. The BOP fence admits small, predictable Main Street risks — small retail is the textbook case. Bars, auto businesses and financial institutions are commonly ineligible classes, whatever their size.
10. C. The package includes business income automatically on an actual loss sustained basis, commonly twelve months, with no coinsurance to compute — one of the BOP's chief conveniences. A and B describe options on the standard commercial form instead.

11. D. Workers' compensation is always a separate policy — no BOP includes it. A, B and C are the package's three core protections: liability, property and business income.
12. A. The CPP is custom-built: shared declarations and conditions up front, chosen coverage parts behind — property, general liability, crime, inland marine, commercial auto and others. B describes the BOP's pre-built approach, and D describes a monoline policy, which is the package's opposite.
13. B. Symbol 7 reaches only scheduled autos; an employee's personal car on company business is the classic non-owned auto, which needs symbol 9 (or the sweep of symbol 1) for the business's liability to be covered.
14. C. P&I is the liability member of the marine quartet. Hull covers the vessel, freight covers the carrier's lost revenue, and general average is a loss-sharing rule, not a coverage.
15. A. Total saved values are $1,000,000; the hull's share is $\frac{600{,}000}{1{,}000{,}000} \times \$50{,}000 = \$30{,}000$. B charges the hull the whole sacrifice; C is the freight-plus trap from misreading the proportions.
16. D. The three implied warranties — binding without being written — are seaworthiness, no deviation from the voyage, and legality of the venture. The others are invented conditions no marine form implies.
17. C. The obligee is the protected party owed the performance — here the city. The contractor is the principal whose performance is guaranteed, and the surety is the company lending its guarantee.
18. A. Suretyship is lent credit — underwritten to zero expected loss, with indemnity against the principal — while insurance pools expected losses it keeps. B, C and D each reverse one of the classic distinctions.
19. B. A professional's negligent service causing financial harm is E&O territory — the agent's own malpractice coverage. The CGL excludes professional services, a fidelity bond covers employee dishonesty, and D&O answers management decisions.
20. D. Crime forms commonly refuse inventory computations as the only proof, since shrinkage has many non-theft causes. A confession is not required (C overshoots) — the insured simply needs evidence beyond the count that employees stole.

PORTFOLIO PIECE: MY PATHWAY FILE: THE COMMERCIAL DESK

Assemble the commercial-lines section of your Pathway File: the Mill Inspection pages from Lesson 8.1 (the three-drawer property schedule and shutdown worksheet for Hollis & Daughters), the Certificate Desk kit from Lesson 8.2 (coverage map, limits ladder, two clocks and the pretend certificate stamped INFORMATION ONLY), the BOP-or-CPP pages from Lesson 8.3 with their eligibility fences and gaps boxes, the Moving-Property Map from Lesson 8.4 with its symbols, floaters and general average finale, and the Trust Map from Lesson 8.5 ending with THE AGENT'S OWN SHIELD. Staple them behind a one-page cover memo written to the Hollis family, summarizing in plain words the complete program you built them — what each policy protects, what remains uncovered and must be bought separately, and what their agent will review with them each year. The memo is the real test: a program you can explain to a baker is a program you understand.

LOOK FOR	WHAT IT MEANS
Property pages	Property pages classify every item correctly into the BPP's three coverages, and the coinsurance and business income computations are accurate with the deductible and waiting period handled properly.
CGL pages	The CGL pages sort claims correctly among Coverages A, B and C, run the aggregate ledger without error, and show both the occurrence and claims-made timelines with the retroactive date and tail labeled.
Package pages	The package pages walk both businesses through the eligibility fence with correct results, and the gaps box names workers' compensation, owned autos, professional liability and flood with the policy that fills each.
Moving-property map	The moving-property map assigns correct symbols to every vehicle, distinguishes the shipper's and carrier's coverages, and the general average contributions are computed in proportion to saved values and sum to the sacrifice.
Trust map	The trust map labels every bond triangle correctly and contrasts suretyship with insurance accurately, and the E&O page states the claims-made rules an agent must keep for her own coverage.
Cover memo	The cover memo explains the whole program honestly in language a non-insurance reader can follow, names what is not covered as plainly

LOOK FOR	WHAT IT MEANS
	as what is, and reflects the unit's Scriptures on diligence and trust without decoration.

8.1 Commercial Property and the Income That Stops

OBJECTIVES

- Name the three coverages of the building and personal property coverage form and classify a business's property under the correct one.
- Distinguish the basic, broad and special causes of loss forms and state who bears the burden of proof under each.
- Compute a coinsurance recovery on a commercial building, including the deductible.
- Explain business income and extra expense coverage, the period of restoration and the waiting period.
- Tell the story of Zachariah Allen and the first factory mutual, and explain what loss control is.

> **Warm-up.** In five minutes, list everything a small bakery could lose if fire gutted it at 2 a.m. with no one inside. Write fast — ovens, inventory, the building itself. Then circle the one loss on your list that keeps growing every day the doors stay shut. That circled item is what this lesson is really about.

WATCH

Building & Personal Property(BPP) Insurance

P & C Insurance Helpline · 11:55

https://www.youtube.com/watch?v=S_40vaFO-Q0

> **WHEN TO WATCH**
> Watch after the big idea; every time a kind of property is named, call out loud which coverage it falls under — building, business personal property, or personal property of others — before the teacher does.

BACKUP VIDEO

Property & Casualty Exam Prep 38, Business Income and Extra Expense

Open Exam Prep · 3:51

https://www.youtube.com/watch?v=9QiLwoRD5Lg

Watch before the project if the difference between business income and extra expense still feels blurry — four minutes squarely on the income that stops and the money spent to restart it.

building and personal property coverage form (BPP)

The standard commercial property form that insures buildings, the insured's business personal property, and personal property of others in the insured's care, custody or control.

business personal property

The insured's furniture, machinery, equipment and stock located in or on the described building, or in the open (or in a vehicle) commonly within 100 feet of the premises.

personal property of others

Property belonging to customers or others that is in the insured's care, custody or control at the described premises — a repair shop's customer goods, for example.

causes of loss — basic form

The named-peril form covering roughly eleven listed perils, including fire, lightning, windstorm or hail, smoke, vandalism, sprinkler leakage, sinkhole collapse and volcanic action.

causes of loss — broad form

The named-peril form that adds perils such as falling objects, weight of ice, sleet or snow, and accidental water damage to the basic list.

causes of loss — special form

The open-peril form covering all direct physical loss except what the policy excludes, which shifts the burden to the insurer to prove an exclusion applies.

coinsurance

A policy condition requiring the insured to carry a stated percentage of the property's value — commonly 80% — or share proportionally in any partial loss.

business income coverage

Time-element coverage paying the actual loss of net income plus continuing normal operating expenses while operations are suspended by direct physical loss from a covered cause.

extra expense coverage

Coverage for costs beyond normal operating expenses — renting temporary quarters, overtime, expediting equipment — paid to keep the business running or shorten the shutdown.

loss control

The engineering side of insurance: inspections, sprinklers, fire walls and safe practices that reduce the frequency and severity of losses before they happen.

period of restoration

The span business income coverage pays for: from shortly after the loss until the property should be repaired or replaced with reasonable speed and the business restored.

vacancy condition

A commercial property condition that reduces or removes coverage — vandalism and sprinkler leakage among the casualties — when a building has been vacant beyond a stated period, commonly 60 days.

CORE IDEAS

The story. Zachariah Allen was a mill owner in Providence, Rhode Island, and in 1835 he did something insurers found baffling: he spent his own money making his textile mill harder to burn. He built thick masonry walls, installed a rotary fire pump and copper-riveted hose, replaced open stoves with safer central heating, and organized his workers into a fire brigade. Then he walked into his insurance company's office and asked the obvious question: since my mill is now far less likely to burn, may I have a lower premium? The answer was no — every mill paid the same. So Allen gathered other owners of carefully run mills and founded the Manufacturers Mutual Fire Insurance Company, a **mutual** that would insure only well-built, well-kept factories, inspect them regularly, and return unspent premium to the members. The idea worked spectacularly: losses were low, dividends were real, and the "factory mutual" system Allen started made **loss control** — preventing fires, not merely paying for them — a permanent part of commercial insurance. Thirty-six years later, the Great Chicago Fire of October 1871 burned more than 17,000 buildings and bankrupted dozens of insurers that had collected premiums without ever asking how their risks were built. The market learned Allen's lesson the hard way.

How they figured it out. Out of a century of mill fires and city fires, the industry worked out the machinery this lesson teaches. Underwriters learned to standardize:

by the twentieth century nearly every state built its fire insurance on a standard policy form, and today's commercial property forms descend from it through the industry's advisory organizations. They learned to inspect, as Allen's engineers did, trading premium credits for sprinklers and fire walls. They learned the hard arithmetic of partial losses: most fires destroy part of a building, not all of it, so owners were tempted to insure for half the value and pay half the premium — and collect in full on nearly every fire. The **coinsurance** condition was the answer: carry at least a stated percentage of the value, commonly 80%, or become a co-insurer of your own partial losses. And they learned, slowly, that the building is only half the risk. A burned mill pays no wages and fills no orders, so insurers developed "use and occupancy" coverage — today's **business income coverage** — to replace the income that stops while the walls go back up.

The big idea. The **building and personal property coverage form** — the exam says BPP — organizes everything a business can lose into three drawers. First, **Building**: the structure itself, plus completed additions, permanently installed fixtures and machinery, and even the lawn mower and snow blower kept to service the premises. Second, **Your Business Personal Property**: the furniture, machines, equipment and stock the business owns, in or on the building or in the open (or in a vehicle) commonly within 100 feet of the premises — and, a classic exam detail, a tenant's "improvements and betterments," the built-in upgrades a tenant installs in someone else's building. Third, **Personal Property of Others** in the insured's care, custody or control — the customers' watches in a repair shop's drawer. Each coverage carries its own limit, and the first question of every commercial property claim is which drawer the damaged thing belongs in. A sign over the door, a walk-in freezer, a customer's wedding dress at the dry cleaner: before you can pay, you must classify.

What perils do those three drawers face? The **causes of loss forms** answer, in three steps. The **basic form** names roughly eleven perils — fire, lightning, explosion, windstorm or hail, smoke, aircraft or vehicles, riot or civil commotion, vandalism, sprinkler leakage, sinkhole collapse and volcanic action. The **broad form** keeps those and adds falling objects, weight of ice, sleet or snow, and accidental discharge of water from plumbing systems. The **special form** flips the logic: instead of naming covered perils it covers all direct physical loss and names only the *exclusions* — flood, earth movement, wear and tear, dishonesty of the insured and the rest. That flip moves the burden of proof. Under a named-peril form the insured must show a

listed peril caused the loss; under the special form the insurer must show an exclusion applies. You met this same ladder in homeowners forms; commercial lines simply sells it à la carte.

Coinsurance at commercial scale works exactly as it did for homes, with bigger numbers and a sterner penalty. Suppose, in this example, a warehouse worth $1,000,000 carries an 80% coinsurance clause, so the owner should insure for $800,000. He buys only $600,000. Fire does $200,000 of damage. The recovery is did-over-should times the loss: $\frac{600{,}000}{800{,}000} \times \$200{,}000 = \$150{,}000$, minus the deductible. The owner saved a quarter of the premium and silently agreed to pay a quarter of every partial loss. Insure to value and the formula never bites; underinsure and it bites on exactly the losses — partial ones — that actually happen. Agents who let clients guess at values instead of using current replacement costs are writing future coinsurance penalties, and future errors-and-omissions claims against themselves.

Now the income that stops. **Business income coverage** pays the *actual loss sustained* of net income — the profit the business would have earned — plus the normal operating expenses that continue anyway: payroll the owner chooses to keep paying, the loan on the building, the lease on the espresso machine. It pays only when operations are suspended by direct physical loss from a covered cause at the described premises, and only during the **period of restoration**, which begins commonly 72 hours after the damage and ends when the property should, with reasonable speed, be repaired and the business resumed. That 72-hour wait is a time deductible — this coverage has no dollar deductible. Its partner, **extra expense coverage**, pays costs beyond normal expenses that keep the business serving customers or shorten the shutdown: renting temporary space, flying in a replacement oven, paying overtime. A bakery that reopens across the street in a week may spend thousands extra and lose little income — exactly the trade extra expense coverage is designed to fund.

On the exam today. State exams drill this lesson's classifications. Expect an item-sorting question — the tenant's installed shelving (business personal property, as improvements and betterments), the customer's goods (personal property of others), the detached sign or the fence (usually covered only by endorsement or as outdoor property with small sublimits). Know the three causes of loss forms and the burden-of-proof flip under the special form. Be ready to compute coinsurance with the deductible subtracted *after* the formula. On business income, the traps are the 72-

hour waiting period (time, not dollars), the requirement of direct physical loss from a covered cause (a power outage across town does not trigger it, though endorsements exist), and the difference between business income (replaces what you lose) and extra expense (pays what you spend to lose less). And remember the vacancy condition: a building vacant beyond the stated period, commonly 60 days, loses vandalism and sprinkler-leakage coverage and takes reduced payments on other losses.

PICTURE STUDY



Chicago in Flames, Currier & Ives, 1871 · Hand-colored lithograph · Published in New York; impressions in the Library of Congress and the Chicago History Museum

Image: Wikimedia Commons, public domain

Nathaniel Currier and James Merritt Ives ran the most famous print shop in America, selling inexpensive hand-colored lithographs of the news to parlors across the country — and in October 1871 the news was Chicago. Their print shows the fire as the whole city experienced it: not one burning building but a horizon on fire, with the crowds on the Randolph Street bridge carrying what they could save. It opens this lesson because commercial property insurance was rebuilt in this glow: dozens of insurers failed when the claims came due, the ones that paid in full earned reputations that lasted a century, and the industry finally learned Zachariah Allen's lesson that preventing fires is cheaper than funding them.

Look closely

- Trace the fire line across the whole width of the print. This is not a building burning; it is a conflagration — the peril that breaks insurers whose risks are too concentrated in one city.
- Find the crowd on the bridge in the foreground. Notice what the fleeing figures carry — bundles, not furniture. What a family can save in an hour is the measure of what insurance must replace.

- Look at the ships' masts and the river. Water everywhere, and still the city burned — pumps and hoses of 1871 were no match for wind-driven flame among wooden buildings.
- Notice the printmakers' vantage point, safely across the water. The whole country saw the fire through prints like this — and so did the shareholders of every insurance company with Chicago policies on its books.

Talk about it

1. An insurer that wrote one block of Chicago could survive a fire; an insurer that wrote a thousand buildings in the same square mile could not. What does this print teach about concentration of risk?
2. After 1871, surviving insurers charged more in cities that refused fire codes and less where mills installed sprinklers and brick walls. How is that pricing a kind of honesty?
3. Thousands lost everything that night, yet Chicago was rebuilt within a decade, partly by insurance money honestly paid. What does keeping promises at ruinous cost — as the solvent insurers did — have to do with loving your neighbor?

PROJECT

The Mill Inspection: Three Drawers and a Shutdown

You will play Zachariah Allen's inspector for a pretend business — the Hollis family's bakery, Hollis & Daughters — and produce the two pages a commercial agent builds before quoting: a property schedule sorted into the BPP's three coverages, and a business income worksheet showing what a three-month shutdown would really cost. Both pages go in your Pathway File; they are the skeleton of every commercial property application you will ever complete.

You will need

- Two sheets of paper or a two-tab spreadsheet
- Your exam notebook and pen
- This lesson's key terms list
- A calculator for the coinsurance check

Steps

1. Invent the bakery honestly: a $400,000 building the family owns, ovens and mixers worth $80,000, flour and inventory worth $15,000, display cases, and three wedding cakes awaiting pickup that belong to customers.
2. Page one: three columns headed BUILDING, BUSINESS PERSONAL PROPERTY, PERSONAL PROPERTY OF OTHERS. Sort every item, including two tricky ones you add yourself (a permanently installed walk-in freezer; a leased delivery van — which belongs in NO column, and say why).
3. Run the coinsurance check: with an 80% clause, write the amount the building must be insured for, then compute the recovery on a $100,000 partial loss if the family carries only $240,000.
4. Page two: the shutdown. Estimate monthly net income (pick a figure and defend it), list which expenses continue during a closure (rent or loan, insurance, the head baker's wages) and which stop (flour purchases, hourly wages).
5. Compute the business income loss for a three-month period of restoration, then invent one extra expense that would shorten it and show the arithmetic of why the insurer should want to pay it.

6. Mark the 72-hour waiting period and the covered-cause requirement in a NOTES box so the pages teach the conditions, not just the numbers.
7. Date both pages, title them THE MILL INSPECTION, and clip them into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the three BPP coverages, the three causes of loss forms, business income, extra expense and period of restoration, and add them to your course box.
2. Draw the three-drawer dresser: one drawer each for building, business personal property and personal property of others, with two example items sketched inside each drawer.
3. Write a five-line trap list titled “Coinsurance at commercial scale,” ending with: DEDUCTIBLE COMES OFF LAST.

KEY FORMULAS

$$\text{recovery} = \frac{\text{amount carried}}{\text{amount required}} \times \text{loss} - \text{deductible}$$

$$\text{amount required} = \text{property value} \times \text{coinsurance}\ \%$$

From history. The policy Zachariah Allen's heirs inspected against was eventually standardized by law: New York's Standard Fire Policy, in its famous 165-line 1943 edition, became the required foundation of fire insurance in nearly every state, and its ancient phrases — “direct loss by fire,” the concealment and vacancy conditions — still echo inside today's commercial forms. Few documents so short have governed so much American property for so long.

Example 1. In this example, a commercial building is worth $500,000 and carries an 80% coinsurance clause. The owner insures it for $300,000 with a $1,000 deductible. A kitchen fire causes $80,000 of damage. How much does the policy pay?

Show solution

1. Amount required: $\$500{,}000 \times 0.80 = \$400{,}000$.
2. Did over should: $\frac{300{,}000}{400{,}000} = 0.75$.
3. Apply to the loss: $0.75 \times \$80{,}000 = \$60{,}000$.
4. Subtract the deductible last: $\$60{,}000 - \$1{,}000 = \$59{,}000$.
5. The owner absorbs $21,000 of an $80,000 loss — the price of carrying three-quarters of what the clause required.

Answer: $59,000. Underinsurance converted a fully covered kitchen fire into a shared one.

Example 2. Exam style. A tailor's shop holds a customer's suit for alteration, the tailor's own sewing machines, and shelving the tailor installed in the building he rents. Under the BPP form, how is each classified?

A. All three are business personal property

B. Suit — personal property of others; machines — business personal property; shelving — business personal property as improvements and betterments

C. Suit — business personal property; machines — building; shelving — personal property of others

D. The suit cannot be covered under any BPP coverage

Show solution

1. Classify by ownership and situation, not by location alone — everything here sits in the same shop.
2. The customer's suit belongs to someone else and is in the tailor's care, custody or control: personal property of others.
3. The sewing machines are the insured's own equipment: business personal property.
4. The shelving is a tenant's permanent upgrade to a building he does not own: improvements and betterments, which the form treats as the tenant's business personal property.
5. D is false — covering customers' goods is exactly why the third coverage exists.

Answer: B. Ownership sorts the drawers: others' property, own property, and a tenant's built-in improvements treated as his business personal property.

Example 3. In this example, a florist's shop is closed for repairs for three months after a covered fire. Lost net income would have been $8,000 per month; continuing expenses (rent, loan payments, a key employee's wages) run $5,000 per month; and the florist spends $4,000 once to rent a refrigerated kiosk that saves one whole month of shutdown. What do business income and extra expense coverage together pay, ignoring the waiting period?

Show solution

1. Without the kiosk, the period of restoration would be three months; the kiosk shortens the income loss to two months.
2. Business income pays lost net income plus continuing expenses for the actual suspension: $2 \times (\$8{,}000 + \$5{,}000) = \$26{,}000$.
3. Extra expense pays the $4,000 kiosk cost, because it reduced the loss — it bought a $13,000 month for $4,000.
4. Total: $\$26{,}000 + \$4{,}000 = \$30{,}000$, versus $39,000 had the florist simply stayed closed three months.

Answer: $30,000 — and the insurer is glad to pay the extra expense, because spending it made everyone's loss smaller.

PRACTICE

1. Easy Name the three property coverages of the building and personal property coverage form.

   Show answer

   Building; the insured's business personal property; and personal property of others in the insured's care, custody or control.

2. Easy Which causes of loss form covers all direct physical loss except what is excluded?

   Show answer

   The special form — open peril. The basic and broad forms are named peril, so under them the insured must show a listed peril caused the loss.

3. **Easy** What two things does business income coverage pay while operations are suspended?

Show answer

The actual loss of net income the business would have earned, plus normal operating expenses that continue during the suspension, such as rent, loan payments and retained payroll.

4. **Medium** A building worth $800,000 has an 80% coinsurance clause and is insured for $640,000. A storm causes $50,000 of damage; the deductible is $2,500. What is paid?

Show answer

The requirement is $640,000, which is exactly what is carried, so no penalty: $\$50{,}000 - \$2{,}500 = \$47{,}500$.

5. **Medium** A dry cleaner's customer garments are destroyed by a covered fire. Under which BPP coverage are they paid, and whose property are they?
A. Building — they were inside it
B. Business personal property — the cleaner possessed them
C. Personal property of others — they are in the cleaner's care, custody or control
D. They are never covered under commercial property forms

Show answer

C. Ownership controls: the garments belong to customers and are in the insured's care, custody or control. B is the trap — possession is not ownership.

6. **Medium** Which perils does the broad causes of loss form add to the basic form? Name two of the three taught in this lesson.

Show answer

Falling objects; weight of ice, sleet or snow; and accidental water damage from plumbing systems. Any two of those earn the point.

7. Medium When does the period of restoration begin and end, commonly?

Show answer

It begins commonly 72 hours after the direct physical loss (a time deductible) and ends when the property should, with reasonable speed, be repaired or replaced and operations resumed — not whenever the insured actually finishes.

8. Hard A tenant spends $30,000 installing counters and lighting in a rented storefront. What does the BPP call this property, and under whose coverage does it fall?

Show answer

Improvements and betterments — permanent upgrades a tenant makes to a building it does not own. The form treats them as part of the tenant's business personal property.

9. Hard A building worth $1,200,000 carries 90% coinsurance and $810,000 of insurance. Compute the recovery on a $160,000 loss with a $5,000 deductible.

Show answer

Required: $0.90 \times \$1{,}200{,}000 = \$1{,}080{,}000$. Ratio: $810{,}000 / 1{,}080{,}000 = 0.75$. Recovery: $0.75 \times \$160{,}000 = \$120{,}000$; minus $5,000 = $115,000.

10. Hard A pipe bursts in a building that has stood vacant for five months, and vandals strike the week after. What does the vacancy condition do to these claims?

Show answer

Vacancy beyond the stated period — commonly 60 days — removes coverage entirely for certain perils including vandalism and sprinkler leakage, and commonly reduces payment on other covered losses. The vandalism claim is denied and the water claim is paid at a reduced amount.

11. **Challenge** Your pretend client wants to drop business income coverage to save premium, reasoning that his property limits would rebuild the store. In three sentences, correct him using the bakery arithmetic of this lesson.

    Show answer

    Property coverage rebuilds walls and ovens but replaces none of the income that stops the day of the fire. During a three-month restoration a shop losing $8,000 of monthly net income while $5,000 of expenses continue is $39,000 poorer — often more than the fire damage itself. Businesses fail after fires not for lack of bricks but for lack of the income the bricks used to earn.

12. **Challenge** Zachariah Allen's insurer refused him a discount, so he started a company that inspected before it insured. Explain in three sentences how loss control changes the bargain for everyone — insurer, insured and neighbor.

    Show answer

    Inspection and prevention lower the real probability of loss, so the insurer can charge less and still stay solvent, and the mutual's members get the savings back as dividends. The insured gets something no claim check provides: a mill that never burns, with no interrupted orders and no workers idled. And the neighbor benefits too, because fire — as Chicago proved in 1871 — rarely stays on the lot where it starts.

COMMON MISTAKES

- Classifying a tenant's improvements and betterments as part of the building — the BPP treats them as the tenant's business personal property, since the tenant cannot insure a building he does not own.
- Subtracting the deductible before applying the coinsurance formula; the did-over-should ratio applies to the loss first, and the deductible comes off last.
- Thinking business income coverage has a dollar deductible — it has a waiting period instead, commonly 72 hours, a deductible measured in time.
- Forgetting that business income needs direct physical loss from a covered cause at the premises; lost sales from bad weather, a canceled festival or a competitor's grand opening trigger nothing.
- Confusing business income (replaces what you lose while closed) with extra expense (pays what you spend to stay open or reopen sooner).

- Assuming the special form covers literally everything; flood, earth movement, wear and tear, and the insured's own dishonesty stay excluded — open peril is not all peril.

Make it a game · Basic, Broad or Special?. Write fifteen perils and losses on slips: fire, falling object, weight of snow, flood, windstorm, a burst pipe's water damage, wear and tear, vandalism, sprinkler leakage, earthquake, smoke, a mysterious disappearance, riot, volcanic action, a dropped crate from a crane. A family member draws and reads each slip; you have ten seconds to call the cheapest causes of loss form that would cover it — BASIC, BROAD, SPECIAL — or EXCLUDED EVERYWHERE. One point per correct call; a bonus point on SPECIAL calls if you also name who must prove what. Miss one and the reader explains it back to you in their own words. Best of fifteen wins the oven mitt of underwriting authority.

Scripture. “Be thou diligent to know the state of thy flocks, and look well to thy herds. For riches are not for ever: and doth the crown endure to every generation?” (Proverbs 27:23-24, KJV)

The proverb commands owners to actually know the condition of what feeds their household — Allen walking his mill with a lantern, a baker listing her ovens and their values honestly. Riches are not forever; buildings burn and income stops. Diligent knowledge of what you have, and prudent provision for its loss, is the proverb's stewardship translated into schedules and coinsurance.

8.2 The CGL: Commercial General Liability

OBJECTIVES

- Name the CGL's three coverages and state what each pays.
- Distinguish the premises/operations hazard from the products/completed operations hazard with examples.
- Explain how per-occurrence and aggregate limits work together across a policy year.
- Contrast occurrence and claims-made forms, defining the retroactive date and the extended reporting period.
- Explain what a certificate of insurance is and is not.

> **Warm-up.** In five minutes, list four ways a small pizza shop could be forced to pay money to a stranger — not fire damage to its own kitchen, but harm to other people. Push past the obvious slip-and-fall. Keep the list; by the end of the lesson you will be able to file each item under Coverage A, B or C.

WATCH

CGL: Occurrence vs Claims Made on the Insurance Exam

Insurance Exam Queen · 10:16

https://www.youtube.com/watch?v=F4dl9VipkA0

> **WHEN TO WATCH**
> Watch after core idea six; draw the two timelines — occurrence and claims-made — as she talks, marking the retroactive date and the tail on the second one.

BACKUP VIDEO

General Liability Insurance Explained in 10 Minutes

The Coyle Group - Business Insurance · 10:14

https://www.youtube.com/watch?v=wXEwQsyhALo

A working agent's tour of the same policy; watch before the project and note every real-world example he files under Coverage A, B or C.

KEY TERMS

commercial general liability policy (CGL)

The standard policy covering a business's legal liability to others for bodily injury, property damage, and personal and advertising injury arising from its premises, operations and products.

occurrence

An accident, including continuous or repeated exposure to substantially the same harmful conditions — the trigger of Coverage A under the occurrence definition.

premises/operations hazard

Liability exposure from the insured's location and ongoing work — the customer who slips in the showroom or the trench a contractor leaves open.

products/completed operations hazard

Liability exposure arising away from the premises from the insured's finished products or completed work — the sold pastry, the finished wiring job.

personal and advertising injury

Coverage B's package of offenses: libel, slander, false arrest, malicious prosecution, wrongful eviction, and use of another's advertising idea, among others — harms without physical contact.

medical payments (CGL Coverage C)

A small no-fault coverage paying medical expenses of non-employees injured on the premises or by operations, regardless of the insured's legal liability.

per-occurrence limit

The most the policy pays for all damages arising from any one occurrence.

general aggregate limit

The most the policy pays in a policy period for all covered losses other than products/completed operations, which carry their own aggregate.

occurrence form

A CGL form covering injury that happens during the policy period, no matter when the claim is finally made — even years after the policy expires.

claims-made form

A CGL form covering claims first made during the policy period, provided the injury happened after the retroactive date.

retroactive date

The date on a claims-made policy before which injuries are not covered, however late the claim arrives.

extended reporting period (tail)

A window after a claims-made policy ends during which claims for prior covered injuries may still be reported — a basic tail is automatic, and a broader supplemental tail can be bought by endorsement.

certificate of insurance

A one-page information form proving that coverage existed on the date shown; it confers no rights and changes no policy terms.

CORE IDEAS

The story. In 1910 Donald MacPherson, a stonecutter from upstate New York, bought a Buick Model 10 runabout from a dealer in Schenectady. One day in 1911, while he drove a sick neighbor to the doctor, a rear wheel collapsed — its wooden spokes crumbled — and MacPherson was thrown from the car and injured. He sued not the dealer who sold him the car but the Buick Motor Company that built it, and Buick raised the old shield of **privity**: we have no contract with this man; we sold to the dealer, the dealer sold to him; let him sue the dealer. In 1916 the New York Court of Appeals, in an opinion by Judge Benjamin Cardozo, broke the shield. *MacPherson v. Buick Motor Co.* held that a manufacturer who puts a product into the stream of commerce owes a duty of care to the people who will foreseeably use it — contract or no contract. Buick had bought the wheel from a supplier and failed to inspect it; the injured driver could recover. From that case grew the modern law of products liability, and from that law grew the insurance this lesson teaches: if a business can be sued by anyone its products or operations foreseeably harm, a business needs liability coverage as surely as it needs a roof.

How they figured it out. Liability insurance grew up a policy at a time — one for the factory's liability to the public, one for products, one for elevators, each with its own gaps and overlaps. In 1940 the industry's rating bureaus consolidated the pieces into a single *comprehensive* general liability policy, and in 1986 its successor organization rewrote it as the **commercial general liability** policy that exams test today. The 1986

revision answered two hard-learned lessons. Courts had read the old policies to cover injuries that developed silently over decades, leaving insurers paying claims on policies priced in another era — so the new program offered a **claims-made** form that ties coverage to when the claim arrives, not when the harm occurred. And single bad years had produced unlimited strings of losses — so the new forms capped the policy year with **aggregate limits**. The CGL you will sell is a treaty written after long wars, and every odd clause in it marks an old battlefield.

The big idea. The CGL promises to pay the sums the insured becomes *legally obligated to pay as damages* because of covered injury — and, just as valuable, to defend the insured, with defense costs commonly paid in addition to the limits. It divides the work among three coverages. **Coverage A** pays for **bodily injury and property damage** to others caused by an occurrence — the slip on the wet floor, the fire the welder starts in the client's warehouse. **Coverage B** pays for **personal and advertising injury** — offenses like libel, slander, false arrest, wrongful eviction and stealing an advertising idea, where the wound is to reputation or rights rather than flesh. **Coverage C**, **medical payments**, is the goodwill coverage: small medical bills of a customer hurt on the premises, paid promptly without any admission or proof of fault, because a paid ambulance bill settles quietly what a lawsuit would settle expensively. Who is an insured? The named insured, of course, plus its partners or executive officers in their business capacity, and employees acting within the scope of their work.

The CGL splits the world of Coverage A into two hazards, and the exam loves the border between them. The **premises/operations hazard** is harm from the insured's place and ongoing work: the customer who trips over a rolled carpet in the showroom, the passerby struck by a contractor's falling scaffold plank while the job is still under way. The **products/completed operations hazard** is harm away from the premises after the product is sold or the work finished: the customer sickened at home by the bakery's cream pie, the deck that collapses a year after the carpenter drove the last nail. The distinction is not trivia — it is priced separately, and it carries its own aggregate limit. One memory hook: while the ladder is up, it is operations; when the ladder comes down and the bill is paid, what remains is completed operations.

Limits come in layers, and the arithmetic is testable. In this example a CGL carries a $1,000,000 per-occurrence limit, a $2,000,000 general aggregate and a $2,000,000

products/completed operations aggregate. No single accident can draw more than $1,000,000, however terrible. Across the policy year, premises and operations losses can draw at most $2,000,000 in total from the general aggregate, while products losses spend down their own separate $2,000,000 pool. Inside the general aggregate sit sublimits: a per-person medical expense limit (commonly $5,000 or $10,000), a damage-to-premises-rented-to-you limit for fire damage to space the insured leases, and a personal and advertising injury limit per person or organization. When an aggregate is exhausted, the policy is done paying that kind of loss for the year — a fact that keeps real underwriters, and exam writers, awake.

Now the two clocks. An **occurrence form** covers injury that *happens* during the policy period — if the harm occurred on its watch, the policy answers, even if the claim arrives ten years later, long after the policy expired. A **claims-made form** covers claims *first made* during the policy period, provided the injury happened after the **retroactive date.** Claims-made coverage is cheaper at first and easier for insurers to price, but it creates two famous cliffs. Move the retroactive date forward when renewing, and you silently uninsure past years of work. Let a claims-made policy lapse with nothing after it, and claims from already-completed work have nowhere to land — which is why the form includes a basic **extended reporting period** automatically (commonly a short window, with five years for occurrences reported promptly) and offers a **supplemental tail** by endorsement, commonly unlimited in length, for a hefty one-time premium. The rule an agent lives by: never let a claims-made client change forms, carriers or retroactive dates without mapping where every past year's claims will go.

On the exam today. Expect a sorting question across the three coverages: slander is Coverage B, not A — no bodily injury need exist; the customer's sprained ankle paid without a lawsuit is Coverage C. Expect the hazards question: the pie eaten at home is products; the wet floor is premises. Expect limits arithmetic — two $600,000 occurrences against a $1,000,000 per-occurrence limit and a $2,000,000 aggregate pay in full, but a third exhausts the year. On the two forms, the trap is always the trigger: for occurrence forms, when the injury happened; for claims-made, when the claim was first made, gated by the retroactive date. Know that employees injured at work are never CGL claims — that is workers' compensation — and that liquor liability, pollution, expected or intended injury, and auto are excluded. And know the certificate of insurance cold: it is evidence that coverage existed on a date, it is

not a policy, it amends nothing, and it gives the holder no rights — the tradesman's customer who demands one is checking, not contracting.

PICTURE STUDY



An Iron Forge, Joseph Wright of Derby, 1772 · Oil on canvas · Tate Britain, London

Image: Wikimedia Commons, public domain

Joseph Wright of Derby was the first great painter of the Industrial Revolution, famous for scenes lit by a single brilliant source — a candle, an experiment, molten iron. In this forge a water-driven hammer has replaced the smith's arm, and the founder stands at ease, proud of machinery that multiplies his strength. But Wright paints the glare, the children flinching from it, the family standing inside the workplace — and an underwriter sees what the painter saw: power that can maim as easily as it can make. The modern CGL exists because every forge, shop and job site puts strangers and neighbors within reach of the work, and the law, since MacPherson's broken wheel, holds the maker answerable for the harm his work does.

Look closely

- Find the light source: a white-hot bar of iron, the most dangerous object in the room, placed exactly in the center of the family circle.
- Look at the founder's posture — arms crossed, relaxed, almost showing off. Confidence around hazard is the oldest cause of liability claims.
- Notice the mother turning the children from the glare at the right edge. The public is inside the premises; this is the premises/operations hazard, painted in 1772.

- Find the great wooden beam and drive shaft of the trip hammer overhead. When the bar leaves this forge as a finished tool, any harm it later does belongs to a different hazard: products and completed operations.

Talk about it

1. The founder's trip hammer let one man do the work of five. How does machinery that multiplies productivity also multiply the harm one mistake can cause to others?
2. Wright shows the family inside the forge. Who, in a modern shop, counts as the public the CGL protects — and why are the shop's own employees pointedly not on that list?
3. Cardozo wrote that a maker owes care to everyone who will foreseeably use what he makes. How is that legal duty an old commandment — to love thy neighbour as thyself — written into the law of commerce?

PROJECT

The Certificate Desk: One Policy, Three Coverages, Two Clocks

You will build the two-page CGL kit for the Hollis bakery from Lesson 8.1 — now adding a wedding-catering operation that works in other people's venues. Page one is a coverage map with limits; page two is a pretend certificate of insurance and a claims ledger that runs the aggregate down through a bad year. Real agents issue certificates weekly; building one teaches you exactly what the one-page form does and does not promise.

You will need

- Two sheets of paper or a spreadsheet
- Your exam notebook and pen
- This lesson's key terms and the limits figures from core idea five
- A ruler for the certificate's boxes

Steps

1. Page one, top half: draw three boxes labeled COVERAGE A, B, C. In each, write what it pays and one bakery-specific example (the slip near the ovens; the ad that copied a rival's slogan; the customer's clinic bill paid quietly).
2. Page one, bottom half: a limits ladder — $1,000,000 per occurrence, $2,000,000 general aggregate, $2,000,000 products/completed operations aggregate, $10,000 medical expense per person, in this example — with one sentence on which pool each example claim drains.
3. Draw the two clocks side by side: an occurrence timeline and a claims-made timeline with its retroactive date and tail. Mark one claim that only the occurrence form catches and one that only claims-made with a tail catches.
4. Page two, top: rule a pretend CERTIFICATE OF INSURANCE for “Hollis & Daughters Bakery” naming the venue “Maple Hall” as certificate holder — insurer (invented), policy number (invented), limits, dates. Stamp it in block letters: INFORMATION ONLY — CONFERS NO RIGHTS.
5. Page two, bottom: a claims ledger. Post three losses of your own invention against the aggregates, computing the remaining pools after each, until one pool runs dry.

6. Write the agent's rule from core idea six at the foot of the page: never move a retroactive date or lapse a claims-made policy without mapping where past work's claims will land.
7. Date both pages and clip them into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the three coverages, the two hazards, occurrence form, claims-made form, retroactive date, extended reporting period and certificate of insurance.
2. Draw the two clocks: an occurrence timeline (injury inside the period = covered forever) and a claims-made timeline (claim inside the period, injury after the retroactive date), with the tail sketched as a net past the policy's end.
3. Write a five-line trap list titled “The CGL's borders,” ending with: EMPLOYEES BELONG TO WORKERS' COMP.

> **From history.** Liability insurance reached America in 1886, when the Employers' Liability Assurance Corporation of London opened a United States branch to insure factory owners against suits by injured workers — coverage many thought scandalous, as if insuring a man against the consequences of his own negligence would make him careless. The debate ended as workers' compensation laws spread after 1911 and liability insurance proved the opposite: insurers, holding the bill, became the loudest voices for guards on machines and railings on stairs.

Example 1. Exam style. A hardware store's CGL has a $1,000,000 per-occurrence limit and a $2,000,000 general aggregate. During one policy year it suffers three premises losses: judgments of $900,000, $800,000 and $700,000. In this example, how much does the policy pay on each?

Show solution

1. First loss: $900,000 is under the per-occurrence limit — paid in full. Aggregate remaining: $2,000,000 − $900,000 = $1,100,000.
2. Second loss: $800,000 is under both the per-occurrence limit and the remaining aggregate — paid in full. Aggregate remaining: $1,100,000 − $800,000 = $300,000.
3. Third loss: $700,000 is under the per-occurrence limit, but only $300,000 of aggregate remains.
4. The policy pays $300,000 and the yearly pool is empty; the store bears the remaining $400,000 itself.

Answer: $900,000, $800,000, then $300,000 — the aggregate, not the per-occurrence limit, ends the year.

Example 2. Exam style. Which coverage of the CGL responds to each claim? (1) A customer slips on a wet aisle and sues for a broken wrist. (2) A competitor sues because the insured's radio ad used its slogan. (3) A visitor bumps her head on a low shelf and the store offers to pay the $800 clinic bill with no lawsuit filed.

A. 1-A, 2-B, 3-C

B. 1-A, 2-A, 3-B

C. 1-C, 2-B, 3-A

D. 1-B, 2-C, 3-A

Show solution

1. Claim 1 is bodily injury to a third party from an occurrence on the premises — Coverage A.
2. Claim 2 is advertising injury, the use of another's advertising idea — Coverage B, no bodily injury required.
3. Claim 3 is a small no-fault medical payment to keep goodwill and avoid suit — Coverage C.
4. The pattern to memorize: A hurts bodies and property, B hurts reputations and rights, C pays small medical bills without asking whose fault.

Answer: A. Bodily injury to Coverage A, advertising offense to Coverage B, no-fault medical bill to Coverage C.

Example 3. A contractor held a claims-made CGL with a retroactive date of January 1, 2020, for policy year 2025. In this example, decide coverage for: (1) a claim made in March 2025 for a stair rail that failed in 2023; (2) a claim made in 2026, after the policy expired with no tail purchased, for a 2024 injury; (3) a claim made in June 2025 for a floor installed in 2018.

Show solution

1. Apply the claims-made trigger: the claim must be first made during the policy period AND the injury must fall after the retroactive date.
2. Claim 1: made during 2025, injury in 2023, after the 2020 retroactive date — covered.
3. Claim 2: injury qualifies, but the claim was made after expiration with no extended reporting period in place beyond the basic one — outside the basic tail's window, it fails the made-during-the-period test. This is the lapse cliff the supplemental tail exists to cure.
4. Claim 3: made during 2025, but the injury occurred in 2018, before the retroactive date — never covered, no matter when reported.

Answer: 1 covered; 2 not covered (no tail to catch it); 3 not covered (before the retroactive date). The two cliffs of claims-made are the lapse and the retroactive date.

PRACTICE

1. Easy Name the CGL's three coverages.

   Show answer

   Coverage A, bodily injury and property damage liability; Coverage B, personal and advertising injury; Coverage C, medical payments.

2. Easy A customer eats a bakery's éclair at home and becomes ill. Premises/operations or products/completed operations?

   Show answer

   Products/completed operations — the harm happened away from the premises, after the product left the insured's hands.

3. Easy What is a retroactive date?

Show answer

The date on a claims-made policy before which injuries are never covered, no matter when the claim is made.

4. Medium A visitor trips in the shop and the insurer pays her $900 urgent-care bill without any finding of fault. Which coverage paid, and why does the insurer offer it at all?

Show answer

Coverage C, medical payments — a small no-fault coverage. It exists because promptly paid medical bills preserve goodwill and often prevent the far larger cost of a liability lawsuit.

5. Medium Which claim belongs to Coverage B?

A. A falling sign breaks a parked car's windshield
B. A store manager wrongly detains a shopper as a suspected thief
C. A customer slips on ice at the entrance
D. A delivery driver injures a pedestrian with the company van

Show answer

B. False arrest or detention is a personal and advertising injury offense. A and C are Coverage A bodily injury or property damage, and D is excluded entirely — auto liability belongs to a commercial auto policy.

6. Medium A CGL has a $1,000,000 per-occurrence limit and $2,000,000 general aggregate. A single catastrophe produces $1,600,000 in judgments. How much is paid?

Show answer

$1,000,000. One occurrence can never draw more than the per-occurrence limit, whatever the aggregate still holds.

7. Medium Why does a homeowner hiring a roofer ask for a certificate of insurance before work begins?

Show answer

To verify the roofer carries liability coverage, so that if the roofer injures someone or damages property there is an insurer to answer. The certificate is information only — it proves coverage existed on the date shown but gives the homeowner no policy rights.

8. Hard An employee of the insured is badly burned while working the fryer and files suit against the business. Does the CGL respond?

Show answer

No. Injuries to the insured's own employees arising from employment are excluded from the CGL — they belong to workers' compensation and employers liability coverage.

9. Hard A claims-made policy runs January–December 2025 with a retroactive date of January 1, 2022. Decide coverage: (a) claim made October 2025 for a 2023 injury; (b) claim made October 2025 for a 2021 injury; (c) claim made February 2026, no tail purchased, for a 2024 injury.

Show answer

(a) Covered — claim made in the period, injury after the retroactive date. (b) Not covered — injury predates the retroactive date. (c) Not covered once the basic reporting window closes — the claim was not made during the period and no supplemental tail exists to extend reporting.

10. Hard Why does the CGL give products/completed operations its own aggregate limit instead of letting all losses share one pool? Answer in two or three sentences.

Show answer

Products claims can surface in waves long after work is done, with a different rhythm and pricing than premises accidents. A separate aggregate lets underwriters price and cap each exposure on its own, so a bad product year cannot silently consume the protection a business counts on for its everyday premises risks — and vice versa.

11. **Challenge** A contractor on claims-made coverage since 2019 is offered a cheaper occurrence policy for next year and plans to simply switch and save. In three sentences, name the danger and the cure.

    Show answer

    The new occurrence policy covers only injuries that happen while it is in force, and the old claims-made policy stops answering once claims can no longer be made in its period — so injuries from 2019–2025 work that get claimed later fall into a gap. The cure is a supplemental extended reporting period (tail) on the expiring claims-made policy, which keeps the door open for late claims from those years. An agent who lets the client switch without pricing the tail has set up the client's uninsured lawsuit — and his own E&O claim.

12. **Challenge** MacPherson never signed a contract with Buick, yet Buick paid. Using the case, explain in three sentences why liability follows foreseeable harm rather than paperwork, and what that means for a business owner's conscience.

    Show answer

    Cardozo held that a maker who sends a product into the world owes care to everyone it will foreseeably reach, because the danger, not the contract, creates the duty. Privity had let makers harm strangers and answer only to middlemen; the law caught up with the moral fact that the stonecutter's broken wheel was Buick's doing. For an owner, the lesson is older than the case: responsibility runs to everyone your work touches, which is why liability insurance is not a license to be careless but a provision for the day care fails.

COMMON MISTAKES

- Filing slander, false arrest or a stolen advertising slogan under Coverage A — these are personal and advertising injury, Coverage B, and need no bodily injury at all.
- Treating medical payments as an admission of fault — Coverage C is no-fault by design; it pays small medical bills precisely so no one has to prove negligence.
- Confusing the triggers: an occurrence form asks when the injury happened; a claims-made form asks when the claim was first made, gated by the retroactive date.

- Forgetting that one occurrence can never collect more than the per-occurrence limit even when the aggregate has room — and that an exhausted aggregate stops payment even on small claims.
- Reading a certificate of insurance as if it were a policy; it is evidence of coverage on a date, confers no rights, and amends nothing.
- Expecting the CGL to cover employee injuries, autos or liquor liability — workers' compensation, commercial auto and liquor liability policies exist because the CGL excludes them.

Make it a game · A, B, C or No. Write sixteen claim scenarios on slips — a shopper's broken ankle in the aisle, a libelous flyer, a paid clinic bill with no suit, an employee's burn, a van crash, a collapsed deck a year after completion, a copied ad jingle, a welding fire in a client's warehouse, and eight of your own. The reader draws and reads; you have eight seconds to call COVERAGE A, B, C, or NO — and on every NO you must name where the claim actually goes (workers' comp, commercial auto, nowhere). One point per correct call, one bonus for the correct destination. Fourteen of sixteen earns the title Underwriter of the Dinner Table; swap roles and play again, because writing scenarios teaches more than sorting them.

Scripture. “And if a man shall open a pit, or if a man shall dig a pit, and not cover it, and an ox or an ass fall therein; The owner of the pit shall make it good, and give money unto the owner of them; and the dead beast shall be his.” (Exodus 21:33-34, KJV)

Three thousand years before Cardozo, the law of Moses stated the premises hazard perfectly: dig the pit, cover the pit, or pay for the ox. Liability law is not a modern invention but an old moral debt — he whose work endangers his neighbor must make the harm good. The CGL simply funds the obligation Scripture assumes an honest man will meet.

8.3 The Businessowners Policy: Main Street's Package

OBJECTIVES

- State what a businessowners policy packages together and name its standard coverages.
- Apply common BOP eligibility rules to decide whether a given business qualifies.
- Name the exposures a BOP never covers and the policies that fill each gap.
- Describe the commercial package policy and contrast it with the BOP.
- Explain why packaging coverages reduces both premium and coverage gaps.

> **Warm-up.** In five minutes, write the shopping list of separate policies the Hollis bakery would need if it had to buy protection one piece at a time: property, lost income, liability — keep going. Then write one sentence on what could go wrong when a busy owner buys five separate policies from three different companies. You have just discovered why packages exist.

WATCH

Business Owners Policy Preview - Insurance Exam Prep

Insurance Lady · 6:21

https://www.youtube.com/watch?v=dGMFqu8hrkM

> **WHEN TO WATCH**
> Watch after the big idea; list every coverage she names as included automatically, then box the ones she says must be bought separately — that box is half the exam's BOP questions.

BACKUP VIDEO

Business Owners Policies on the Property and Casualty Exam!

P&CP · 4:02

https://www.youtube.com/watch?v=hCdyE1FtbFM

A quick second pass aimed straight at exam questions; watch it before the project and jot the eligibility rules it emphasizes.

KEY TERMS

businessowners policy (BOP)

A package policy for eligible small and medium businesses combining commercial property, business income and extra expense, and CGL-type liability coverage under one premium.

monoline policy

A policy covering a single line of insurance — the opposite of a package.

actual loss sustained

The BOP's common business income basis: the policy pays the real income lost for up to twelve months, commonly with no dollar limit and no coinsurance.

commercial package policy (CPP)

A custom-built policy for risks outside BOP eligibility: common declarations and conditions plus two or more chosen coverage parts, such as commercial property, general liability, crime, inland marine and commercial auto.

package policy

A single policy combining two or more lines of coverage, priced with a discount because the insurer saves expense and the insured avoids gaps.

eligibility rules

The underwriting gate for a BOP — commonly limits on building size, annual sales and class of business; large or hazardous risks must use a commercial package policy instead.

seasonal increase provision

A BOP feature that automatically raises the business personal property limit — commonly 25% — during peak seasons, such as a toy store's December.

coverage part

A self-contained module of a CPP — its own declarations and forms — snapped onto the policy's common declarations and conditions.

multiple-line underwriting

Writing property and casualty coverages together in one policy, permitted broadly in the United States only after state law changes in the late 1940s.

hired and non-owned auto endorsement

An optional BOP endorsement giving liability coverage for autos the business rents or employees use on its behalf — but never for autos the business owns.

CORE IDEAS

The story. In September 1950, the Insurance Company of North America — the Philadelphia insurer founded in 1792, whose fire marks you met earlier in this course — introduced something American families had never been offered: a single **homeowners** policy. Before that date, a careful householder bought fire insurance from one company, theft coverage from another, and personal liability from a third, each with its own agent, bill, renewal date and fine print — and most families, finding the errand endless, simply left gaps. The package changed everything: one policy, one premium, no seams for a loss to fall through. It was possible only because the law had just changed. For a century most states had required insurers to stick to a single line — fire companies wrote fire, casualty companies wrote casualty — and only after the Supreme Court's *South-Eastern Underwriters* decision in 1944 and the McCarran-Ferguson Act of 1945 reorganized insurance regulation did states pass **multiple-line underwriting** laws allowing one policy to do it all. The homeowners package swept the country within a decade, and the industry asked the obvious next question: why not do the same for the barber, the grocer and the bakery? In the 1970s the industry's forms organizations answered with the **businessowners policy** — the BOP — and Main Street got its own HO-3.

How they figured it out. The designers of the BOP faced a problem the homeowners pioneers had already solved: packages only work for predictable risks. Houses resemble one another, so one broad form fits millions of them. A dry cleaner resembles a gift shop more than either resembles a refinery — so the BOP's architects drew a fence called **eligibility**. Inside the fence go the small, well-understood risks of Main Street: offices, stores, apartment buildings, small restaurants and services, commonly capped by building size, stories and annual sales, with the exact figures varying by insurer and state. Outside the fence stay the big, the odd and the hazardous — manufacturers of scale, bars, auto dealers, banks, amusement operations — risks that need individual underwriting. For them the same era

produced the **commercial package policy**, a build-your-own frame: common declarations and common policy conditions up front, then whichever **coverage parts** the business needs snapped in behind — commercial property, general liability, crime, inland marine, commercial auto, equipment breakdown, farm. Package the predictable; custom-build the rest. That one sentence is the whole architecture of commercial lines.

The big idea. A **businessowners policy** bundles, under one premium, the three protections nearly every small business needs. First, commercial property coverage on the building and business personal property, written commonly on a special (open-peril) basis. Second — and this is the quiet gem of the package — **business income and extra expense** coverage on an **actual loss sustained** basis: commonly up to twelve months of real lost income, with no dollar limit stated, no coinsurance to compute, and the waiting period you met in Lesson 8.1. Third, business liability on the CGL pattern — the same Coverages A, B and C you learned in Lesson 8.2, occurrence form. Around the core cluster the conveniences: the **seasonal increase provision** that automatically lifts the personal property limit, commonly 25%, when the toy store's December inventory swells; automatic coverage for newly acquired locations for a short period; and a menu of optional endorsements — hired and non-owned auto liability, equipment breakdown, spoilage for the restaurant's walk-in cooler. One application, one policy, one renewal date: the agent's work gets easier, and the gaps get rarer.

Eligibility is where the exam lives, so learn the fence. Commonly eligible, in this example pattern: office buildings and apartment buildings within size limits; retail stores and service businesses under caps on floor area and annual sales (figures like 35,000 square feet or $6,000,000 in annual sales appear in common programs — treat them as examples, since insurers and states vary); small restaurants under seating and cooking restrictions; convenience stores; contractors only in limited classes. Commonly ineligible: automobile dealers, repair shops and parking operations; bars and places where the main business is serving alcohol; banks and financial institutions; large manufacturers; amusement parks. The logic beats the list: a BOP is priced on averages, so any business whose hazards are bigger, stranger or more volatile than the average Main Street shop must leave the package and be underwritten on its own.

Just as important is what no BOP covers, because every omission is a sale the agent must remember to make and a gap the exam loves to probe. A BOP never includes **workers' compensation** — every state regulates it separately, and it is its own policy. It never covers **owned autos** — the bakery's delivery van needs a commercial auto policy, though the hired and non-owned endorsement can cover the rented truck and the employee running errands in her own car. It never includes **professional liability** — the pharmacist's misfilled prescription and the accountant's bad return are E&O exposures, Lesson 8.5's subject. And like nearly all property forms, it excludes **flood** and **earthquake**, which require separate policies or endorsements. An agent who sells a BOP and stops talking has protected the shop against fire and the slip-and-fall, and left the owner naked to the van crash, the employee's back injury and the rising river.

When the fence says no, the **commercial package policy** says build it. The CPP begins with common declarations (who, where, when, how much) and common policy conditions (cancellation, changes, inspections, transfer of rights) that apply to everything behind them. Then the underwriter attaches **coverage parts**: a machine shop might carry commercial property, general liability, crime and inland marine parts; a trucking firm adds commercial auto; a food processor adds equipment breakdown. Two or more parts make it a package, and insurers commonly grant a package discount for the same reasons the BOP is cheap: one policy costs less to issue than five, and a customer with five coverages is likelier to stay. The CPP delivers package convenience without the BOP's one-size pricing — the premium for each part is calculated on that business's own numbers. BOP for the predictable shop, CPP for everyone bigger or odder, monoline policies for the exposures that always stand alone: workers' compensation and, usually, the auto fleet.

On the exam today. The BOP questions are eligibility, inclusions and exclusions, in that order. Expect a lineup — florist, bar, auto dealer, three-story office building — and the question of who qualifies: the bar and the auto dealer are out in nearly every program. Expect “which coverage is automatically included in a BOP?” — business income, actual loss sustained, commonly twelve months, no coinsurance — and its mirror, “which is never included?” — workers' compensation, owned-auto liability, professional liability. Watch the endorsement trap: hired and non-owned auto liability can be added to a BOP, owned autos cannot. On the CPP side, know the anatomy — common declarations, common conditions, two or more coverage parts

— and that commercial auto and workers' compensation, even when a business buys them, are commonly issued as separate policies rather than BOP add-ons. And keep the vocabulary straight under pressure: BOP is a pre-built package for eligible small business; CPP is a custom package assembled from parts; monoline is one line alone.

PICTURE STUDY



The Country Store, Edward Lamson Henry, 1885 · Oil on canvas · Smithsonian American Art Museum, Washington, D.C.

Image: Wikimedia Commons, public domain

Edward Lamson Henry spent his career painting the America that railroads and cities were leaving behind — village squares, stagecoaches, and stores like this one, where a community bought its flour, mailed its letters and traded its news. Everything a businessowners policy protects is in this one canvas: the building, the stock on the porch and behind the counter, the customers on the steps who could fall, and the livelihood that stops the day the store closes. It opens this lesson because the BOP was invented for precisely this scale of enterprise — a family's whole living under one modest roof — and because the storekeeper of 1885, buying fire coverage alone if he bought anything, had none of the seamless protection the package would one day make ordinary.

Look closely

- Count the kinds of property in view: the building, the barrels and crates on the porch, the goods implied behind the windows. Sort them into the BPP's three drawers from Lesson 8.1.
- Find the customers by the steps and the doorway — the premises/operations hazard taking its ease in the shade.
- Notice the horse and buggy at the rail: the 1885 version of the delivery van, and then as now, not covered by the store's package.

- Look at the crossroads location and the fields beyond. This store is the only one for miles; if it burns, the income stops for the family and the convenience stops for a township.

Talk about it

1. The storekeeper's building, stock, customers and income are one bundle of risk in real life. Why did it take insurance until the 1950s–70s to sell them as one bundle of protection?
2. A package policy leaves fewer gaps than five separate policies. Whose job is it to find the gaps that remain — and what does this lesson's list of BOP exclusions tell you about where to look?
3. The country store ran on credit and trust — the painter shows no cash register, just neighbors. When a storekeeper insures his livelihood prudently, who besides his own family is he serving?

PROJECT

Insuring the Family Business: BOP or CPP?

You will insure a pretend family business end to end. Half the class of exam questions on packages comes down to one skill — walking a business through the eligibility fence, loading the package, and then naming what the package still leaves bare. You will do all three on one page, twice: once for a business that fits the BOP and once for one that does not.

You will need

- Two sheets of paper or a two-tab spreadsheet
- Your exam notebook and pen
- This lesson's eligibility and exclusion lists
- The property schedule you built for Hollis & Daughters in Lesson 8.1

Steps

1. Business one: the Hollis bakery. Walk the fence in writing — size, sales (invent modest figures), class — and declare it BOP-eligible with a sentence of reasoning for each test.
2. Draw the package as a loaded shelf: property (special form), business income (actual loss sustained, twelve months, no coinsurance), liability (A, B, C), seasonal increase, and one optional endorsement you choose and justify.
3. Below the shelf, draw the GAPS box: the owned delivery van, the two employees (workers' compensation), the custom-cake design consulting the family wants to add (professional liability), and the creek two blocks away (flood). Name the separate policy that fills each.
4. Business two: invent a disqualified business — a tavern, an auto repair shop, or a 70,000-square-foot parts manufacturer. Walk the same fence and show exactly which test it fails.
5. Build its commercial package policy: common declarations and conditions at the top, then the coverage parts you select, each with a one-line reason.
6. Write the closing rule of the lesson at the foot of the page: PACKAGE THE PREDICTABLE, CUSTOM-BUILD THE REST, AND NAME THE GAPS OUT

LOUD.

7. Date both pages and clip them into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for BOP, CPP, package policy, monoline, eligibility, actual loss sustained, seasonal increase and coverage part.
2. Draw the fence: inside it, five eligible businesses; outside it, five ineligible ones; and label the gate ELIGIBILITY — SIZE, SALES, CLASS.
3. Write a five-line trap list titled “Never in a BOP,” ending with: THE OWNED VAN NEEDS ITS OWN POLICY.

> **From history.** The Insurance Company of North America, whose 1950 homeowners policy began the package era, was itself a museum of firsts: organized in 1792 in Independence Hall's shadow, it was America's first marine insurance company organized as a stock corporation, an early writer of fire coverage beyond city limits, and the insurer whose leather fire mark — an eagle rising — hung on Philadelphia house fronts for a century. The company that packaged Main Street had been practicing on American risk since Washington's second term.

Example 1. Exam style. Which of the following businesses is MOST likely eligible for a businessowners policy, under common eligibility rules?

A. A neighborhood gift shop with 4,000 square feet and $700,000 in annual sales

B. A tavern whose revenue is chiefly alcohol sales

C. An automobile dealership with a repair bay

D. A six-story manufacturing plant

Show solution

1. Apply the fence: BOPs take small, predictable Main Street risks and refuse the big, the odd and the hazardous.
2. B fails — businesses primarily serving alcohol are commonly ineligible.
3. C fails — auto dealers, repair shops and parking risks are classic exclusions from eligibility.
4. D fails on size and class — large manufacturing needs a commercial package policy with individually rated parts.
5. A is the textbook BOP risk: small retail, modest floor area, modest sales.

Answer: A. The gift shop is exactly the risk the package was built for; the tavern, the dealership and the plant all need coverage built outside the BOP fence.

Example 2. The Hollis bakery buys a BOP with business personal property coverage of $100,000 and a 25% seasonal increase provision. In this example, a fire strikes during the December wedding-and-holiday rush, when inventory and supplies on hand have swelled to $118,000. How much of the personal property loss is within the limit?

Show solution

1. The seasonal increase raises the limit automatically during the peak: $\$100{,}000 \times 1.25 = \$125{,}000$.
2. The swollen inventory of $118,000 sits inside the increased limit — covered in full, less the deductible.
3. Without the provision, $18,000 would have fallen outside the limit at exactly the season a bakery can least afford it.
4. Note the design lesson: the provision exists because small-business inventories breathe with the calendar, and owners rarely remember to endorse limits up in November and down in January.

Answer: All $118,000 is within the seasonally increased limit of $125,000 — the package anticipated the owner's busiest month for her.

Example 3. Exam style. A machine-parts manufacturer too large for a BOP wants property, general liability, crime and contractors' equipment coverage in one policy, plus coverage for its delivery trucks. How is this commonly arranged?

A. A BOP with endorsements for each exposure

B. Five monoline policies from five insurers

C. A commercial package policy containing property, general liability, crime and inland marine coverage parts, with commercial auto written as its own policy or part

D. A personal auto policy listing the trucks and a homeowners policy listing the plant

Show solution

1. The manufacturer is outside BOP eligibility, so A is wrong at the gate.
2. B is possible but wasteful — five issuances, five renewal dates, seams between policies; packaging exists to cure exactly this.
3. D misuses personal lines forms for business exposures — never correct.
4. C matches the CPP's anatomy: common declarations and conditions, chosen coverage parts behind them; the trucks go on a commercial auto form, commonly as a separate policy or its own part.

Answer: C. The CPP is the custom frame: pick the parts the business needs, and keep auto on its own commercial form.

PRACTICE

1. Easy What three core protections does a businessowners policy package together?

   Show answer

   Commercial property coverage, business income and extra expense coverage, and CGL-type business liability coverage — one policy, one premium.

2. Easy Name three businesses commonly ineligible for a BOP.

   Show answer

   Any three of: bars and taverns, automobile dealers or repair shops, banks and financial institutions, large manufacturers, amusement operations.

3. **Easy** What does a commercial package policy consist of?

Show answer

Common declarations and common policy conditions, plus two or more coverage parts chosen for the risk — such as commercial property, general liability, crime, inland marine or commercial auto.

4. **Medium** How is business income commonly written in a BOP, and how does that differ from the Lesson 8.1 form?

Show answer

On an actual loss sustained basis for commonly up to twelve months, with no stated dollar limit and no coinsurance — simpler than the standard business income form, which carries chosen limits and coinsurance options.

5. **Medium** A toy store's BOP carries a $200,000 business personal property limit with a 25% seasonal increase. December inventory peaks at $240,000. Is the peak within the limit?

Show answer

Yes. The seasonal provision lifts the limit to $\$200{,}000 \times 1.25 = \$250{,}000$, which covers the $240,000 peak.

6. **Medium** Which exposure can be added to a BOP by endorsement?

A. The business's owned delivery van
B. Hired and non-owned auto liability
C. Workers' compensation
D. The owner's personal residence

Show answer

B. Hired and non-owned auto liability is a common BOP endorsement. Owned autos always need a commercial auto policy, workers' compensation is always separate, and personal exposures never ride on commercial forms.

7. Medium Why do insurers commonly discount a package compared with the same coverages bought separately? Give two reasons.

Show answer

Issuing and servicing one policy costs less than several, and package customers are better risks to retain — they renew more reliably and leave fewer gaps that turn into disputes. Part of the savings is returned as the package discount.

8. Hard A pharmacist with a BOP misfills a prescription and the customer is harmed. Does the BOP's liability coverage respond?

Show answer

No. That is professional liability, excluded from BOP and CGL-type coverage alike; the pharmacist needs a professional liability (druggists' liability or E&O-type) policy.

9. Hard Why did packaged policies like homeowners and the BOP become possible only after the late 1940s? Answer in two or three sentences.

Show answer

Most states long required monoline underwriting — fire insurers could not write casualty lines in the same policy. After the South-Eastern Underwriters decision of 1944 and the McCarran-Ferguson Act of 1945 reset insurance regulation, states passed multiple-line underwriting laws, and insurers could legally combine property and liability coverage. The first homeowners package followed in 1950, and the BOP applied the same idea to small business in the 1970s.

10. Hard A diner qualifies for a BOP. Its owner asks why the policy cannot simply be endorsed to add the cook's on-the-job injuries. Give the answer and the reason behind it.

Show answer

Workers' compensation is never part of a BOP; every state regulates it as its own line with state-set benefits and its own policy form. The BOP fence exists so the package stays simple and uniformly priced — statutory coverage with state-mandated benefits cannot be one shelf item among many.

11. **Challenge** Your pretend client runs a 2,000-square-foot florist shop and also owns a bar next door. She wants one BOP covering both. In three sentences, give the likely answer and the arrangement you would propose.

    Show answer

    The florist shop is a textbook BOP risk, but the bar is commonly ineligible, and one package cannot stretch over a disqualified class. Write the BOP on the florist, and insure the bar separately — commonly through a commercial package policy or specialty program, with liquor liability coverage the bar needs anyway and no BOP provides. Two businesses, two risk profiles, two policies — and an agent's file note explaining why.

12. **Challenge** The 1950 homeowners package and the 1970s BOP both replaced stacks of separate policies. In three sentences, explain how packaging serves the buyer morally as well as financially.

    Show answer

    Gaps between separate policies fall on exactly the families least equipped to find them, so a package is a form of honesty — the seller, who knows where the seams are, sews them shut in advance. It also lowers cost, putting real protection within reach of modest businesses. The agent's remaining duty is to name aloud what the package still omits, because a customer who hears one premium naturally, and wrongly, assumes one complete protection.

COMMON MISTAKES

- Assuming every small business qualifies for a BOP — eligibility rules on size, sales and class are the first question, and bars, auto businesses, banks and large manufacturers commonly fail them.
- Adding the business's owned vehicles to a BOP — only hired and non-owned auto liability can be endorsed on; owned autos need a commercial auto policy.
- Expecting workers' compensation or professional liability inside a BOP or CPP coverage part list by default — workers' compensation is always a separate policy, and professional liability is always a separate purchase.
- Forgetting the BOP's business income is actual loss sustained, commonly twelve months, with no coinsurance — exam writers contrast it with the standard form's limits and coinsurance.

- Confusing the CPP's anatomy: common declarations and common conditions apply to the whole policy, while each coverage part carries its own declarations and forms.
- Treating the eligibility figures in any study guide as law — square footage and sales caps are program examples that vary by insurer and state; the classes and the logic are what the exam tests.

Make it a game · Through the Fence. Write fourteen businesses on slips: gift shop, tavern, auto dealer, dentist's office, four-unit apartment building, bank, 60,000-square-foot factory, diner, barber shop, amusement park, bookstore, auto repair shop, small accounting office, convenience store. The reader draws and reads; you have eight seconds to call BOP or CPP, then one sentence of why — size, sales or class. One point per correct call, a bonus when your reason names the failed test. Then flip the game: the reader calls a coverage (workers' comp, owned van, flood, professional liability) and you shout NOT IN THE PACKAGE and name the policy that fills the gap. Twelve of fourteen opens the store on Monday.

Scripture. “Seest thou a man diligent in his business? he shall stand before kings; he shall not stand before mean men.” (Proverbs 22:29, KJV)

The proverb honors the shopkeeper's diligence — the daily faithfulness of stocking shelves, keeping books and serving neighbors that a package policy exists to protect. Prudent insurance is part of that diligence, not a substitute for it: the diligent owner guards the livelihood God has given, so that one bad night of fire does not undo twenty years of honest work.

8.4 Commercial Auto, Inland and Ocean Marine

OBJECTIVES

- Explain how the business auto coverage form defines covered autos with numbered symbols, and read the common symbols.
- Define hired auto and non-owned auto liability and say when a business needs each.
- Name the four coverages of ocean marine insurance and the implied warranties beneath them.
- Work a general average problem and state the conditions that make a sacrifice general average.
- Give examples of inland marine floaters and explain why the line is called marine at all.

> **Warm-up.** With pencil and paper: a ship in a storm must throw ten crates overboard or sink with a hundred. The ninety saved crates belong to nine different merchants; the ten lost belonged to one. In five minutes, write the fairest rule you can invent for who bears the loss. Sailors solved this before Rome ruled the sea — by the end of the lesson you can check your rule against twenty-five centuries of theirs.

WATCH

EVERYTHING You Need to Know about Commercial Auto Insurance!

The Massachusetts Insurance Channel · 8:52

https://www.youtube.com/watch?v=ejox58hKrSk

> **WHEN TO WATCH**
> Watch after core idea three; each time a kind of vehicle use is mentioned, decide aloud whether an owned-auto, hired-auto or non-owned-auto exposure is on the screen.

BACKUP VIDEO

Understanding Inland Marine Insurance | P&C Joe

P&C Joe · 6:07

https://www.youtube.com/watch?v=uM8YhzAOuyg

Watch before the project for the land half of the lesson; list every floater he names and match each to a business in your town.

KEY TERMS

business auto coverage form (BACF)

The standard commercial policy for a business's autos, with liability and physical damage coverage defined by numbered covered-auto symbols on the declarations.

covered auto symbols

Numbered designations that define which vehicles a coverage applies to — commonly symbol 1 for any auto, 2 for owned autos, 7 for specifically described autos, 8 for hired autos and 9 for non-owned autos.

hired auto

An auto the business leases, hires, rents or borrows — a rented box truck, for example — excluding vehicles borrowed from employees or their households.

non-owned auto

An auto the business does not own, lease or borrow but which is used in its business — commonly an employee's personal car on a company errand.

ocean marine insurance

The oldest line of insurance, covering ships and sea cargo through four classic coverages: hull, cargo, freight and protection and indemnity.

cargo coverage

Ocean marine coverage on the goods being shipped, commonly written on an open-peril basis against perils of the sea.

freight coverage

Coverage for the shipping revenue the carrier loses if cargo is not delivered — the shipowner's income that stops.

protection and indemnity (P&I)

The liability coverage of ocean marine insurance — the shipowner's legal liability for injury to crew and others and damage to cargo, piers and other property.

general average

The ancient marine rule that a voluntary, successful sacrifice made to save the whole venture — jettisoned cargo, for example — is shared proportionally by all interests saved.

particular average

A partial marine loss that falls on one interest alone — storm damage to one merchant's cargo — with no contribution from the others.

implied warranties (ocean marine)

Promises read into every ocean marine policy without being written: the vessel is seaworthy, the voyage will not deviate from its course, and the venture is legal.

inland marine insurance

Coverage that followed cargo ashore: policies on property in transit over land, movable equipment, bailee exposures and instrumentalities of transportation such as bridges and tunnels.

bailee

A person or business lawfully holding property that belongs to others — a dry cleaner, a repair shop — whose customers' goods are insured by bailee's customers coverage.

CORE IDEAS

The story. The oldest rule in insurance was written for a sinking ship. The merchants of Rhodes, the Greek island whose sailors ruled Mediterranean trade centuries before Rome, kept a custom so fair it never died: when a master jettisons cargo in a storm to save the vessel, the loss belongs to everyone the sacrifice saved. The Romans adopted it whole as the *Lex Rhodia de iactu*, the Rhodian law of jettison, and when the emperor Justinian's lawyers compiled the *Digest* in 533 A.D. they preserved it in one sentence: what is thrown overboard for the sake of all shall be made good by the contribution of all. Sailors knew the rule in Jonah's day — the mariners "cast forth the wares that were in the ship into the sea, to lighten it" — and a version still governs ocean shipping under the York-Antwerp Rules first agreed in 1877. The rule is called **general average** — average here meaning loss — and it is the seed of all insurance: a loss that would crush one man, shared deliberately among all who were spared by it. The underwriters at Edward Lloyd's London coffee house in the 1680s were trading in Rhodian fairness; they simply priced it in advance and called it a premium.

How they figured it out. Because ocean marine insurance is older than any legislature that might have standardized it, it remains the free spirit of the business: largely unregulated in rate and form, written policy by policy in language descended from Lloyd's old forms, and bound by three **implied warranties** no one needs to

write down — the vessel is *seaworthy*, it will not *deviate* from its course without cause, and the venture is *legal*. Break one and coverage fails. When steam and rail carried cargo ashore, marine underwriters followed it inland — goods on trains, trucks and barges — and then kept going, covering anything movable: a contractor's crane, a jeweler's stock, a traveling exhibition. Land insurers protested the poaching, and the states answered in 1933 with the **nationwide marine definition**, redrawn in 1953, listing what may be written as **inland marine**: property in transit, bailee exposures, movable equipment, and instrumentalities of transportation and communication — bridges, tunnels, pipelines, towers. The sea rule had come ashore for good.

The big idea. A business's vehicles need their own policy — Lesson 8.3 taught you no package covers an owned auto — and the **business auto coverage form** defines its scope with a stroke of genius: numbered **symbols** instead of vehicle lists. On the declarations, next to each coverage, sits a number that answers "which autos?" Commonly: symbol 1 means *any auto* — owned, hired, borrowed, an employee's car on an errand — the broadest grant, available for liability coverage only. Symbol 2 means owned autos; symbol 7 means only the autos specifically described on the schedule; symbol 8 means **hired autos** — leased, rented or borrowed; symbol 9 means **non-owned autos** — vehicles the business neither owns nor hires, chiefly employees' own cars used on company business. The craft of writing commercial auto is matching symbols to the client's real life: a liability symbol of 1 so no vehicle surprise ever lands outside coverage, physical damage on 7 for the trucks worth insuring, and 8 and 9 wherever rentals and employees' errands are part of the work. A business whose employee causes a crash while driving her own car to the bank on company business will be sued alongside her — symbol 9 is why the suit finds coverage.

Ocean marine divides its ancient work among four coverages, and the quartet is pure exam material. **Hull** insures the vessel itself. **Cargo** insures the goods in the hold, commonly on an open-peril basis against the perils of the sea. **Freight** insures the shipowner's revenue — if the cargo never arrives, the carrier is never paid, so freight coverage is the mariner's business income insurance, the income that stops at sea. **Protection and indemnity** — P&I — is the liability coverage: the shipowner's legal obligations for injured crew and passengers, damaged piers, and cargo harmed by the owner's negligence. Notice the familiar skeleton inside the exotic names: property on the vessel, property on the goods, time element on the revenue, liability

to others. Every line of insurance you have learned this year is a child or cousin of these four, which is why examiners still ask about them three thousand years after Rhodes.

General average has rules, because sailors knew every captain would otherwise call his losses communal. The sacrifice must be *voluntary* — cargo deliberately jettisoned, not washed overboard; it must be *necessary* and reasonably made for the safety of the whole venture; and it must *succeed* — if the ship sinks anyway, there is nothing saved to contribute. When the rules are met, every saved interest — hull, cargo, freight — contributes in proportion to its saved value. In this example: a storm forces the master to jettison $100,000 of one merchant's cargo, saving a venture whose surviving values total $2,000,000 — ship worth $1,200,000, remaining cargo $600,000, freight $200,000. Each interest contributes its share of the loss in proportion to value saved: the shipowner $\frac{1{,}200{,}000}{2{,}000{,}000} \times \$100{,}000 = \$60{,}000$, the other cargo owners $30,000, the freight interest $10,000. A loss that falls on one interest alone — seawater spoiling one hold's coffee — is **particular average**, and lies where it falls.

Inland marine is the sea rule's life ashore, and its instrument is the **floater** — a policy that follows property wherever it goes, commonly open peril, picking up what fixed-location forms leave behind. The working examples: *transit coverage* on goods riding trucks and trains, bought by shippers; *motor truck cargo* coverage, bought by the trucker who is legally liable as a carrier for the goods in his trailer; *contractors' equipment floaters* on the backhoe that lives on a different job site every month; *bailee's customers* coverage for the dry cleaner and repair shop, paying for customers' goods regardless of fault, because explaining legal defenses to a customer whose suit burned is no way to keep a town's business; *jewelers block* policies for stock that is valuable, portable and always moving; and the *instrumentalities of transportation and communication* — bridges, tunnels, pipelines, broadcast towers — property that never moves at all, yet belongs to marine underwriting by the logic of 1933. The memory hook is honest history: if it moves, if it is movable, or if commerce moves over it, think marine.

On the exam today. Commercial auto questions turn on the symbols: symbol 1, any auto, is the broadest grant and is used for liability only; hired (8) and non-owned (9) autos are different exposures; and an employee's personal car on a business errand is the classic non-owned auto. Marine questions are a vocabulary harvest: match

hull, cargo, freight and P&I to property, goods, lost revenue and liability; name the three implied warranties — seaworthiness, no deviation, legality; and keep general average (a voluntary, necessary, successful sacrifice shared by all) apart from particular average (one interest's loss, borne alone). Expect one general average computation — contribution in proportion to saved values. On inland marine, know that floaters follow movable property, commonly open peril; that a bailee holds others' goods; that motor truck cargo insures the carrier's liability for the freight; and that the nationwide marine definition is why bridges and tunnels are marine business. Deepest distinction of all: ocean marine remains largely unregulated as to rate and form — the oldest and freest line.

PICTURE STUDY



Ships in Distress off a Rocky Coast, Ludolf Backhuysen, 1667 · Oil on canvas · National Gallery of Art, Washington, D.C.

Image: Wikimedia Commons, public domain

Ludolf Backhuysen was the storm painter of the Dutch Golden Age, sketching skies from an open boat in weather that kept other artists ashore, and selling his marines to the merchants of Amsterdam whose fortunes rode in exactly such ships. This canvas shows the moment every ocean marine policy was written for: hull, cargo, freight and crew all one wave from loss, and the master weighing what to sacrifice to save the rest. The merchants who bought Backhuysen's paintings were the same men inventing the machinery of this lesson — shared ventures, cargo policies, and the Rhodian arithmetic of general average — because no one who saw the sea like this believed he could stand against it alone.

Look closely

- Find the nearest ship plunging bow-down. Name the four ocean marine coverages and point to where each one's loss is happening or about to happen.
- Look at the rocks at the right and the shaft of light beyond. Seaworthiness, course and weather were the underwriter's whole file in 1667 — two of the three implied warranties are visible in this picture.

- Count the ships. Several ventures share this one storm; tomorrow the survivors' merchants may owe general average contributions for whatever tonight's masters cast overboard.
- Notice how small the sailors are against the sea. The painter is honest about scale — and so is the insurance that prices it.

Talk about it

1. Why did marine insurance arise centuries before fire or life insurance? What about the sea forces merchants to share risk?
2. The general average rule only rewards a sacrifice that succeeds. Why is that condition wise — what would masters do if failed sacrifices were shared too?
3. The sailors in Psalm 107 “cry unto the LORD in their trouble” and are brought to their desired haven. What does it mean that the same merchants who prayed for calm seas also kept honest books of contribution for their neighbors' jettisoned cargo?

PROJECT

The Delivery Van and the Cargo: A Moving-Property Map

You will chart everything that moves for the Hollis bakery's new wholesale operation — vans, rented trucks, an employee's errand car, pallets of pastry riding a contract carrier to three towns — and assign each moving thing its policy, symbol or floater. Commercial lines stops being abstract the moment you follow one business's property out the door and down the road.

You will need

- One large sheet of paper turned sideways, or a spreadsheet
- Two ink colors — one for vehicles, one for goods
- Your exam notebook and this lesson's symbol and floater lists
- A calculator for the general average finale

Steps

1. Draw the bakery at the left margin and three customer towns at the right. Between them, draw every mover: the owned van, the December rental truck, the office manager's personal car (bank errands), and the contract trucker who hauls the wholesale pallets.
2. Under each vehicle, write the business auto question: which symbol would cover its liability exposure? Mark the owned van (2 or 7), the rental (8), the manager's car (9), and write the one symbol that sweeps all of them (1, liability only).
3. Follow the goods: label the pallets in the trucker's trailer and answer who insures them — the bakery's transit floater, the trucker's motor truck cargo coverage, or both — with one sentence on the difference (owner's property coverage versus carrier's liability coverage).
4. Add a bailee corner: the bakery's espresso machine goes to a repair shop for a month. Name the coverage the repair shop should carry for it and why fault should not matter.
5. Now the sea finale: the bakery exports a $20,000 pallet of fruitcakes (pretend bravely). The ship jettisons it in a storm, saving hull worth $700,000, other

cargo $250,000 and freight $50,000. Compute each interest's general average contribution and show the Hollises made whole.

6. Write the lesson's memory hook across the bottom: IF IT MOVES, IF IT IS MOVABLE, OR IF COMMERCE MOVES OVER IT — THINK MARINE.
7. Date the page and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the five common auto symbols (1, 2, 7, 8, 9), the four ocean marine coverages, general and particular average, the three implied warranties, floater and bailee.
2. Draw the storm diagram: a ship with four labeled arrows — hull, cargo, freight, P&I — and below it the general average formula with a worked three-interest example.
3. Write a five-line trap list titled “Symbols and sacrifices,” ending with: A SACRIFICE SHARED ONLY IF IT SAVES.

KEY FORMULAS

$$\text{interest's contribution} = \frac{\text{value of interest saved}}{\text{total values saved}} \times \text{general average loss}$$

From history. For two centuries nearly every marine policy in the English-speaking world was written on Lloyd's ancient S.G. form, whose salt-stained phrases — covering “the adventures and perils of the seas, men-of-war, fire, enemies, pirates, rovers, thieves” — were already old when Parliament standardized the form in 1779. Courts came to treasure the archaic wording precisely because two hundred years of decisions had settled what every syllable meant; it served until a plain-language replacement finally arrived in 1982.

WORKED EXAMPLES

Example 1. In this example, a master jettisons $60,000 of cargo in a storm, saving the venture. Saved values: hull $500,000, remaining cargo $400,000, freight $100,000. Compute each interest's general average contribution.

Show solution

1. Total saved values: $\$500{,}000 + \$400{,}000 + \$100{,}000 = \$1{,}000{,}000$.
2. Hull's share: $\frac{500{,}000}{1{,}000{,}000} \times \$60{,}000 = \$30{,}000$.
3. Cargo's share: $\frac{400{,}000}{1{,}000{,}000} \times \$60{,}000 = \$24{,}000$.
4. Freight's share: $\frac{100{,}000}{1{,}000{,}000} \times \$60{,}000 = \$6{,}000$.
5. Check: $\$30{,}000 + \$24{,}000 + \$6{,}000 = \$60{,}000$ — the sacrificed merchant is made whole by the venture he saved.

Answer: Hull $30,000, cargo $24,000, freight $6,000 — shared in proportion to values saved, exactly as Rhodes ruled.

Example 2. Exam style. A courier business rents two vans every December and its office manager regularly drives her own car to the bank for deposits. The business owns three vans listed on its business auto policy with liability symbol 7. Which exposures are NOT covered as written?

A. None — symbol 7 covers all business driving

B. The rented vans only

C. The office manager's car only

D. Both the rented vans (hired autos) and the manager's car (non-owned auto)

Show solution

1. Symbol 7 grants coverage only for autos specifically described on the schedule — the three owned vans.
2. The December rentals are hired autos — symbol 8 territory — and are outside a symbol 7 grant.
3. The manager's personal car on company errands is the classic non-owned auto — symbol 9 territory — also outside symbol 7.
4. The cure is to write liability with symbol 1 (any auto), or add symbols 8 and 9; the business is sued for its employee's errand crash whether or not it bought the right symbols.

Answer: D. Symbol 7 reaches only scheduled autos; the rentals and the employee's car need symbols 8 and 9 — or the sweep of symbol 1.

Example 3. Exam style. Match the ocean marine coverage to the loss: (1) the vessel's propeller shaft snaps in heavy seas; (2) a wave floods a hold and ruins a shipper's textiles; (3) the shipowner is sued after a crewman is injured rigging cargo; (4) the voyage is abandoned and the carrier collects nothing for the haul.

A. 1-hull, 2-cargo, 3-P&I, 4-freight

B. 1-cargo, 2-hull, 3-freight, 4-P&I

C. 1-hull, 2-freight, 3-P&I, 4-cargo

D. 1-P&I, 2-cargo, 3-hull, 4-freight

Show solution

1. The vessel itself is hull — loss 1.
2. The goods in the hold are cargo — loss 2. (One hold, one owner's goods, no sacrifice: this is particular average, borne by that interest.)
3. Liability for injury to crew and others is protection and indemnity — loss 3.
4. The carrier's lost shipping revenue is freight — loss 4, the mariner's income that stops.

Answer: A. Hull for the ship, cargo for the goods, P&I for liability, freight for the lost revenue.

PRACTICE

1. Easy What do covered auto symbols do on a business auto policy?

   Show answer

   Each coverage on the declarations carries a numbered symbol defining which autos it applies to — commonly 1 for any auto, 2 for owned, 7 for specifically described, 8 for hired and 9 for non-owned autos.

2. Easy Name the four coverages of ocean marine insurance.

   Show answer

   Hull (the vessel), cargo (the goods), freight (the carrier's shipping revenue) and protection and indemnity (the shipowner's liability).

3. **Easy** An employee drives her own car to pick up supplies for her employer and causes an accident. What kind of auto is her car to the business?

Show answer

A non-owned auto — commonly symbol 9 territory — because the business neither owns nor hires it, yet is exposed to suit for its business use.

4. **Medium** State the three conditions that make a jettison a general average sacrifice.

Show answer

It must be voluntary (deliberately made, not accidental), necessary and reasonable for the safety of the whole venture, and successful — something must actually be saved to contribute.

5. **Medium** A storm floods one hold and ruins one merchant's cocoa while every other interest arrives unharmed. General or particular average, and who bears it?

Show answer

Particular average — a partial loss that was no deliberate sacrifice for the venture. It lies where it falls: the cocoa merchant (and his cargo insurer) bear it alone.

6. **Medium** Name the three implied warranties of ocean marine insurance and what happens when one is breached.

Show answer

Seaworthiness, no deviation from the voyage, and legality of the venture. They bind without being written, and breaching one voids the coverage.

7. **Medium** Why does a trucking company buy motor truck cargo coverage when the shippers already insure their own goods?

Show answer

Because a carrier is legally liable for the freight in its care; motor truck cargo coverage pays the trucker's liability for the goods, while the shipper's transit floater protects the owner's interest. The two coverages answer different questions — whose property, versus whose fault.

8. Hard Which liability grant is broadest on a business auto policy, and what is its common limitation?

Show answer

Symbol 1, any auto — owned, hired or non-owned. It is commonly available only for liability coverage; physical damage must use narrower symbols.

9. Hard A jettison of $40,000 saves hull worth $450,000, cargo worth $300,000 and freight worth $50,000. Compute each contribution.

Show answer

Total saved $800,000. Hull: $\frac{450}{800} \times \$40{,}000 = \$22{,}500$; cargo: $\frac{300}{800} \times \$40{,}000 = \$15{,}000$; freight: $\frac{50}{800} \times \$40{,}000 = \$2{,}500$. The shares sum to the $40,000 sacrificed.

10. Hard A dry cleaner's shop burns and forty customers' garments are destroyed. The fire was not the cleaner's fault. Why does a well-run cleaner carry coverage that pays those customers anyway, and what is it called?

Show answer

Bailee's customers coverage — inland marine coverage on others' property in the insured's care that pays regardless of the bailee's legal liability. Strictly, a faultless bailee might owe nothing, but a cleaner who tells forty neighbors to sue the fire's cause instead of paying them has saved a legal argument and lost a business.

11. Challenge Your pretend client writes liability on symbol 7 to save premium, reasoning that his three scheduled trucks are all he owns. In three sentences, name the two exposures he has silently left bare and the fix.

Show answer

His rentals are hired autos and his employees' errand driving creates non-owned auto liability, and neither reaches a symbol 7 grant — yet both produce suits against the business, not just the driver. The fix is liability written on symbol 1, or symbols 8 and 9 added alongside 7. Premium saved on symbols is the most expensive savings in commercial auto.

12. **Challenge** The Rhodian rule made the saved pay for the sacrificed. In three sentences, explain how general average contains the whole moral idea of insurance, and where a premium improves on it.

Show answer

General average refuses to let a loss suffered for everyone's benefit crush the one it happened to fall on — the community of the venture bears it in proportion to what each was spared. That is insurance in miniature: many contributing so that no single member is ruined. A premium improves the timing: instead of levying neighbors after the storm, it collects the contribution in advance, in peace, from everyone who might someday be the one whose cargo goes over the side.

COMMON MISTAKES

- Confusing hired autos (rented, leased or borrowed by the business — symbol 8) with non-owned autos (employees' own cars used on business — symbol 9); the exam tests the border, not the definitions alone.
- Assuming symbol 1, any auto, applies to physical damage — it is commonly a liability-only grant, and scheduled or owned-auto symbols carry the physical damage.
- Calling accidental washing-overboard of cargo general average — the sacrifice must be voluntary, necessary and successful, or the loss is particular average and lies where it falls.
- Forgetting freight coverage exists — the carrier's lost revenue is a real ocean marine coverage, the income that stops at sea, and it belongs in the quartet with hull, cargo and P&I.
- Thinking inland marine covers only property that moves; the nationwide marine definition also assigns instrumentalities of transportation and communication — bridges, tunnels, pipelines — to the marine line.
- Expecting ocean marine forms and rates to be state-filed and standardized like fire forms; ocean marine remains largely unregulated in rate and form, the oldest and freest line.

Make it a game · Jettison!. Each player is a merchant with pretend cargo worth $100,000 aboard a shared ship (hull $500,000, freight $100,000). A parent rolls a die each round for the storm: 1–3 safe passage; 4–5 the master must jettison one player's full cargo (draw lots); 6 the ship founders and all is lost. After every jettison that saves the ship, everyone computes the general average contributions — fastest correct arithmetic collects a $5,000 bonus from the slowest. Play five voyages. The winner is the merchant with the most wealth left, and the lesson writes itself: nobody minds contributing once he has been the one whose crates went over the side.

Scripture. “They that go down to the sea in ships, that do business in great waters; These see the works of the LORD, and his wonders in the deep.” (Psalm 107:23-24, KJV)

The psalm's sailors meet God's power where no man controls anything — the storm that stills to a calm only when He commands it. Marine insurance was honest commerce's answer to that helplessness: merchants could not command the sea, so they learned to share its losses. Doing business in great waters still teaches the double lesson of this trade — work boldly, and know how little is in your hands.

8.5 Crime, Bonds and Professional Liability

OBJECTIVES

- Explain what commercial crime insurance and fidelity coverage protect against, with examples of employee dishonesty.
- Diagram the three parties of a surety bond and contrast suretyship with insurance.
- Name the main families of surety bonds — contract, license and permit, and judicial — with an example of each.
- Distinguish malpractice, errors and omissions, and directors and officers coverage by the harm each answers.
- Describe cyber liability coverage factually, naming its first-party and third-party halves.

> **Warm-up.** In five minutes, write two short definitions in your own words: what it means for an employee to be dishonest with the till, and what it means for an honest professional to simply make a mistake. Keep both sentences — this lesson is built on the difference between them, and on the strange third thing (a bond) that is neither.

WATCH

Bonds on the Insurance Exam -Casualty

Insurance Exam Queen · 7:25

https://www.youtube.com/watch?v=reglDS8uCf8

> **WHEN TO WATCH**
> Watch after core idea three; draw the three-party triangle as she teaches it and label principal, obligee and surety in your own words before she defines them.

BACKUP VIDEO

What Is Professional Liability Insurance? | Errors & Omissions Explained for Business Owners

The Insurance Dork · 8:56

https://www.youtube.com/watch?v=o4JzKZRLXjE

Watch before page two of the project — the E&O half of the lesson — and note every example of a professional's financial harm that could never be a CGL claim.

KEY TERMS

fidelity bond

Coverage protecting an employer against dishonest acts of its own employees — theft of money, securities or other property; today commonly written as employee theft coverage in a commercial crime policy.

commercial crime policy

A policy packaging crime coverages such as employee theft, forgery or alteration, theft of money and securities inside and outside the premises, robbery, safe burglary and computer fraud.

surety bond

A three-party agreement in which the surety guarantees to the obligee that the principal will perform an obligation — and pays if the principal fails.

principal

The party whose performance a bond guarantees — the contractor who must build, the licensee who must obey the rules.

obligee

The party a bond protects — the project owner, the state, the court — who receives payment if the principal defaults.

surety

The company that guarantees the principal's performance, expects no losses, and holds a right of indemnity to recover from the principal anything it pays.

contract bonds

Surety bonds guaranteeing construction obligations: bid bonds (the bidder will sign if awarded), performance bonds (the work will be completed), and payment bonds (laborers and suppliers will be paid).

license and permit bond

A bond a state or city requires of licensees — contractors, auto dealers, notaries — guaranteeing compliance with the laws governing the license.

judicial bonds

Court-required bonds, such as fiduciary bonds guaranteeing the honest administration of estates and guardianships, or appeal bonds securing judgments.

malpractice insurance

Professional liability coverage for professionals whose errors can cause bodily injury — physicians, surgeons, dentists.

errors and omissions insurance (E&O)

Professional liability coverage for professionals whose errors cause financial harm — insurance agents, accountants, architects, attorneys, real estate brokers.

directors and officers liability (D&O)

Coverage for a company's leaders against claims that their management decisions wrongfully harmed the company, its shareholders or others.

cyber liability insurance

Coverage for computer-related losses — first-party costs such as data restoration and customer notification after a breach, and third-party liability to people whose data was exposed.

CORE IDEAS

The story. In the London of 1840, a young man who wanted a clerk's position at a bank faced a hurdle that had nothing to do with his ability: he needed *security*. Employers, burned by absconding cashiers, demanded that friends or relatives pledge their own fortunes as private sureties for a new clerk's honesty — so a capable young man without a rich uncle was simply unemployable in any position of trust, and the uncle who did pledge might be ruined by another man's sin years later. That year a group of Londoners founded the **Guarantee Society**, the first company to sell fidelity guarantees for a premium: the Society investigated the clerk, charged a modest annual sum, and stood behind his honesty with corporate capital instead of an uncle's estate. Skeptics called it insuring virtue. It worked — employers got stronger protection than any private surety could give, young men's careers stopped depending on family wealth, and the Society's inspectors became a quiet force for better bookkeeping, since a well-audited till protects an honest clerk as surely as it exposes a thief. The idea crossed the Atlantic within a generation, and

corporate suretyship and fidelity coverage — the subjects of this lesson — are its direct descendants.

How they figured it out. The Victorians had rediscovered a distinction as old as Proverbs: guaranteeing another man's conduct is not the same business as insuring against accidents. An insurer of fires expects fires — it prices them, pools them, and pays them as the ordinary cost of the line. A **surety** expects *no* losses: it underwrites the principal the way a bank underwrites a borrower, examining the three C's — **character, capacity and capital** — and lends its good name only where default should not happen. When default happens anyway, the surety pays the obligee and then turns to the principal for **indemnity**: unlike your fire insurer, the surety collects back from its own customer. The premium, accordingly, is less like an insurance premium and more like a fee for the investigation and the lending of a trusted name. Congress leaned on exactly this machinery when it faced unpaid builders on federal projects: because no one can place a mechanic's lien on a courthouse, the Heard Act of 1894 and its successor, the Miller Act of 1935, required contractors on federal public works to post performance and payment bonds — a surety's guarantee standing where a lien cannot.

The big idea. Hold the triangle in your mind, because every bond question on the exam is a question about it. The **principal** owes a duty: build the bridge, obey the licensing law, administer the estate honestly. The **obligee** is owed the duty and holds the bond's protection: the project owner, the state, the court. The **surety** guarantees the principal's performance to the obligee, pays when the principal defaults, and then recovers from the principal under its right of indemnity. Count the differences from insurance and you have a harvest of exam answers: a bond has three parties, insurance two; the surety expects no losses, the insurer expects many; the bond's loss payment is recoverable from the principal, an insurance payment is not; and the bond protects the *obligee*, though the *principal* buys it. A performance bond is not kindness to the contractor — it is the owner's guarantee, purchased at the owner's insistence, with the contractor's own assets standing behind the surety's signature.

The families of bonds follow the kinds of promises people must be helped to keep. **Contract bonds** guard construction: the *bid bond* guarantees a bidder will sign the contract and provide required bonds if awarded the job; the *performance bond* guarantees the work will be completed per the contract; the *payment bond* guarantees the laborers and suppliers are paid, so no lien lands on the owner.

License and permit bonds are the state's handshake with its licensees — auto dealers, contractors, notaries — guaranteeing compliance with the governing law, with the state or an injured citizen as obligee. **Judicial bonds** serve the courts: *fiduciary bonds* guarantee that executors and guardians will administer what they hold faithfully, and appeal and attachment bonds secure the other side against a litigant's maneuvers. Alongside the true bonds stands their two-party cousin from the story: **fidelity** coverage, today commonly the **employee theft** insuring agreement of a **commercial crime policy** — which also offers forgery or alteration coverage, theft of money and securities inside and outside the premises, robbery and safe burglary, and computer fraud. Crime coverage is real insurance — the employer is protected against its people's dishonesty, losses are expected and priced — but notice the fidelity echo: the dishonest employee, like a defaulting principal, can be pursued for what he took.

Professional liability picks up where the CGL deliberately stops: the harm done not by a wet floor but by skilled judgment gone wrong. Sort it by the wound. **Malpractice** coverage answers professionals whose mistakes break bodies — physicians, surgeons, dentists; the suit says the standard of care was violated and the patient was injured. **Errors and omissions** coverage answers professionals whose mistakes break finances — the accountant's bad return, the architect's flawed drawing, the real estate broker's missed disclosure, and, mark it well, the **insurance agent** who lets a client's coverage lapse, writes the wrong limit or forgets the flood policy. E&O is *your* malpractice coverage in this career, and nearly every agency requires it. **Directors and officers** coverage answers the boardroom: shareholders or others claiming that officers' management decisions — not the company's products — wrongfully cost them money. Professional forms are commonly written claims-made, so everything you learned in Lesson 8.2 about retroactive dates and tails returns here with real money attached.

One modern exposure belongs in this lesson's toolbox, stated factually. Businesses keep customer records — names, card numbers, medical details — on computers, and a break-in to those systems creates two bundles of cost. **Cyber liability insurance** answers both. The first-party bundle is the insured's own response: hiring forensic help, restoring data, notifying affected customers as state laws commonly require, and the business income lost while systems are down. The third-party bundle is liability: claims by the people whose data was exposed and by banks and

partners harmed downstream. Standard property forms were written for tangible property and standard liability forms for bodily injury and property damage, so cyber coverage is sold as its own policy or endorsement. For the exam and for Main Street practice, the point is placement: data breach belongs on the same checklist as fire, theft and the slip-and-fall — a named gap the agent raises, not a novelty.

On the exam today. The bond triangle is tested relentlessly: name the party protected (the obligee), the party whose conduct is guaranteed (the principal), and the party that pays and then recovers (the surety, by indemnity). The sharpest distinction on the page — *surety expects no losses; insurance expects losses* — is a stock question, as is matching bond to scenario: bid, performance and payment bonds on a construction job; a license bond behind the auto dealer; a fiduciary bond over the orphan's estate. On crime, know that employee theft coverage pays even when the thief cannot be identified, but inventory shortage alone — shrinkage with no evidence of theft — is commonly excluded or limited as proof. On professional liability, sort by harm: bodily injury to malpractice, financial loss to E&O, management decisions to D&O — and remember professional liability is excluded from the CGL and the BOP, which is why it must be sold separately. Expect one agent-E&O scenario, because regulators like licensees who know their own exposure; and expect cyber to appear as a definitions question about first-party versus third-party costs.

PICTURE STUDY



Regents of the St Elizabeth Hospital of Haarlem, Frans Hals, 1641 · Oil on canvas · Frans Hals Museum, Haarlem

Image: Wikimedia Commons, public domain

Frans Hals was Haarlem's great portraitist, and in 1641 the regents of the St Elizabeth Hospital — five citizens elected to govern the city's charitable hospital — sat for him around their boardroom table. These men hold other people's trust: donors' money, patients' care, the city's good name, all administered through the ledger and the coins Hals places on the table. The painting closes this unit because everything in this lesson — the fidelity bond behind the clerk, the surety behind the contractor, the fiduciary bond over the orphan's estate, the E&O policy behind the agent — is machinery for the same thing these regents embodied: making one person's stewardship trustworthy to strangers who will never sit in the room.

Look closely

- Find the ledger and the inkstand on the table. Records are the honest steward's best friend — employee theft is found in books kept well, and hidden in books kept badly.
- Find the coins by the regent at the right. The hospital's money passes through his hands and is not his — the exact situation a fidelity bond and a fiduciary bond exist for.

- Look at each face in turn. Hals gives every regent a distinct, watchful intelligence; this is a committee, so no single man's weakness can empty the till unnoticed.
- Notice the sober black clothing and the great map on the wall. Wealth under discipline, and a world of obligations beyond the room — capacity and capital, two of the surety's three C's, with character in the faces.

Talk about it

1. The regents' names and faces guaranteed the hospital's funds in 1641; today a surety company's signature does the same work for strangers. What was gained, and what must never be lost, in that exchange?
2. A surety examines character, capacity and capital before lending its name. Which of the three can a company verify on paper, and which must be judged the way Hals judged a face?
3. These men answered to the city for money that was not theirs — but Scripture says every steward answers to God for what he holds in trust. How does working as if the Auditor sees everything change how a man keeps books no one else reads?

PROJECT

The Agent's Own Shield: A Trust Map for the Family Business

You will finish the Hollis bakery's commercial program with the trust coverages — crime, bonds and professional liability — and then turn the lens on yourself: a one-page explainer of the E&O policy you will someday carry as a licensed agent. This page completes the commercial-lines portfolio your Pathway File has been building all unit.

You will need

- Two sheets of paper or a two-tab spreadsheet
- Your exam notebook and pen
- This lesson's key terms and the bond triangle from core idea three
- Your Lesson 8.3 gaps box for reference

Steps

1. Page one, top: the bakery hires a bookkeeper and a delivery clerk. Draw the crime shelf — employee theft, forgery or alteration, money and securities inside and outside, computer fraud — and write one bakery-shaped loss example under each insuring agreement.
2. Page one, middle: the bakery bids to supply a school district's cafeterias, and the district demands bonds. Draw the triangle for a performance bond — label principal (the bakery), obligee (the district) and surety — and add one sentence on the indemnity arrow that makes it different from every insurance policy on the page.
3. Page one, bottom: the family's eldest becomes a notary to help customers, and the state requires a license bond. Identify the obligee and what the bond guarantees.
4. Page two, top: THE AGENT'S OWN SHIELD. In your own words, four sentences: what E&O covers, one example of an agent's error, why it is written claims-made, and the retroactive-date rule you would follow when changing carriers.
5. Page two, bottom: a six-row master table of the lesson — fidelity/crime, bid bond, performance bond, payment bond, license bond, E&O — with columns

WHO IS PROTECTED and WHAT IS GUARANTEED OR COVERED.

6. Add the cyber line: one factual sentence on first-party versus third-party breach costs, placed in the gaps list where it now belongs.
7. Date both pages, clip them into your Pathway File, and staple this unit's five project pages together as the commercial-lines section.

EXAM NOTEBOOK

1. Make flashcards for principal, obligee, surety, indemnity, the three bond families, fidelity bond, employee theft, malpractice, E&O, D&O and cyber liability.
2. Draw the bond triangle large: three corners labeled and arrowed — the duty owed, the protection held, the guarantee given — with the indemnity arrow doubling back from surety to principal.
3. Write a five-line trap list titled “Bond or insurance?”, ending with: THE SURETY EXPECTS NO LOSSES — AND COLLECTS FROM ITS OWN PRINCIPAL.

> **From history.** America's corporate surety era began in earnest with the Miller Act's predecessor generation: when the Heard Act passed in 1894, bonding federal contractors created a national market almost overnight, and the young surety companies formed a joint bureau to share the loss records no single firm possessed. Surety remains the line where underwriting looks most like banking — the American surety trade still calls its product credit, not insurance, and its claim departments measure success not in claims paid but in defaults prevented.

Example 1. Exam style. A city requires a road contractor to post a performance bond. The contractor abandons the half-finished road, and the surety pays the city $400,000 to complete it. Identify the principal, the obligee, and what happens to the $400,000.

A. City is principal; contractor is obligee; the surety absorbs the loss

B. Contractor is principal; city is obligee; the surety seeks indemnity from the contractor

C. Surety is principal; city is obligee; the loss is pooled with other bonds

D. Contractor is principal; surety is obligee; the city repays the surety

Show solution

1. The party whose performance is guaranteed is the principal — the contractor.
2. The party protected, who receives payment on default, is the obligee — the city.
3. The surety pays the obligee, then exercises its right of indemnity against the principal — it recovers the $400,000 from the contractor's assets if it can.
4. That recovery right is the signature difference from insurance: an insurer cannot bill its own insured for a covered fire; a surety can and does pursue its principal.

Answer: B. Contractor-principal, city-obligee, and the surety pays then recovers from the contractor — suretyship expects no ultimate losses.

Example 2. Exam style. Which policy answers each claim? (1) A bookkeeper is discovered to have skimmed $30,000 over three years. (2) An accountant's error costs a client a $30,000 tax penalty. (3) A surgeon's error injures a patient. (4) Shareholders sue a corporation's officers over a disastrous merger decision.

A. 1-crime (employee theft), 2-E&O, 3-malpractice, 4-D&O

B. 1-E&O, 2-crime, 3-D&O, 4-malpractice

C. 1-CGL, 2-malpractice, 3-E&O, 4-crime

D. 1-D&O, 2-CGL, 3-malpractice, 4-E&O

Show solution

1. Claim 1 is employee dishonesty — commercial crime's employee theft coverage, the fidelity line.
2. Claim 2 is a professional's financial harm to a client — errors and omissions.
3. Claim 3 is a professional's bodily harm to a patient — malpractice.
4. Claim 4 attacks management decisions — directors and officers liability. Sorting by the wound (stolen money, lost money, hurt body, bad governance) gives the answer without memorizing scenarios.

Answer: A. Dishonesty to crime, financial error to E&O, bodily harm to malpractice, boardroom decisions to D&O.

Example 3. A pretend insurance agent — call her the future you — forgets to submit a client's application for flood coverage before the river rises, and the uninsured client suffers $80,000 in flood damage. Walk the claim: who sues whom, under what policy, and what makes this claims-made coverage tricky if the agent changed insurers last year?

Show solution

1. The client sues the agent for professional negligence: the loss is financial (an $80,000 gap that competent service would have closed), so the agent's errors and omissions policy answers.
2. The E&O insurer defends the agent and pays what she is legally obligated to pay, within limits — note the CGL could never respond, since professional services are excluded.
3. The claims-made wrinkle: the mistake happened last policy year, the claim arrives this year. Coverage requires the claim to be made while a policy is in force and the error to postdate the retroactive date.
4. If the agent switched E&O carriers and let the new policy's retroactive date advance to the switch date, last year's error is uninsured — the very trap she learned to warn clients about in Lesson 8.2, now with her own license and savings at stake.

Answer: Client sues agent; the agent's E&O policy defends and pays; and continuous claims-made coverage with an unmoved retroactive date (or a purchased tail) is what keeps the agent's own past work insured.

PRACTICE

1. Easy Name the three parties to a surety bond and what each does.

Show answer

The principal owes the performance, the obligee is protected and receives payment on default, and the surety guarantees the performance and pays the obligee if the principal fails.

2. Easy What does a fidelity bond (employee theft coverage) protect an employer against?

Show answer

Dishonest acts of its own employees — theft of money, securities or other property — whether or not the particular thief can be identified.

3. Easy Which professional liability coverage protects an insurance agent who makes a costly mistake for a client?

Show answer

Errors and omissions (E&O) insurance — professional liability for financial harm caused by negligent professional service.

4. Medium State two ways suretyship differs from insurance.

Show answer

Any two of: a bond has three parties while insurance has two; the surety expects no losses while insurers price for expected losses; the surety recovers its payment from the principal by indemnity while an insurer cannot collect a covered loss from its insured; the bond protects the obligee though the principal pays for it.

5. Medium Match the contract bond to its promise: bid bond, performance bond, payment bond.

Show answer

Bid bond — the bidder will sign the contract and furnish required bonds if awarded. Performance bond — the work will be completed according to the contract. Payment bond — laborers and material suppliers will be paid, keeping liens off the owner.

6. Medium A store's yearly inventory count shows $18,000 of goods missing, with no other evidence of how. Will employee theft coverage pay on the count alone?

Show answer

Commonly no. Inventory shortage by itself is excluded or restricted as sole proof of employee theft, because shrinkage has many causes — miscounts, shoplifting, breakage. The insured needs evidence beyond the count that employees stole.

7. Medium Who is the obligee on an auto dealer's license bond, and what does the bond guarantee?

Show answer

The state (and through it, injured members of the public). The bond guarantees the dealer will comply with the laws governing the license, giving the state and harmed customers a fund to claim against if he does not.

8. Hard Sort by policy: a dentist injures a patient's jaw; an architect's error forces $200,000 of rework; a board's officers are sued over a reckless acquisition.

Show answer

Dentist — malpractice (bodily injury by a professional). Architect — E&O (financial harm by a professional). Officers — D&O (wrongful management decisions).

9. Hard Why does a surety demand indemnity from its own principal when no fire insurer demands repayment from its insured? Answer in two or three sentences.

Show answer

Insurance transfers the risk of fortuitous losses: the insurer prices expected fires into premiums and keeps the losses it pays. Suretyship transfers no risk of the principal's own default — it lends the surety's credit and name, like a cosigner, on the premise that the principal can and will perform. When the premise fails, the loss morally and legally belongs to the defaulting principal, so the surety pays the obligee and collects from the one who broke the promise.

10. Hard Explain why Congress required payment bonds on federal construction (Heard Act 1894, Miller Act 1935) rather than relying on mechanic's liens.

Show answer

A mechanic's lien lets unpaid builders and suppliers claim the property they improved — but no one may lien a federal courthouse or post office. The payment bond substitutes a surety's guarantee for the lien: laborers and suppliers on public work claim against the bond instead of the building, so the government gets built without honest tradesmen bearing a contractor's default.

11. **Challenge** A pretend contractor complains: “I pay the performance bond premium, yet the bond protects the owner, and if I default the surety comes after me. What am I buying?” Answer him honestly in three sentences.

    Show answer

    He is buying credibility he cannot manufacture alone: the surety's investigation and guarantee are what let an owner hand a million-dollar project to a firm it has never met — no bond, no contract. The premium is the fee for that lent reputation, like the regents’ trusted names behind Haarlem’s hospital funds. The indemnity right simply keeps the promise his: the surety vouches for him, but performing the contract was never anyone's job but his own.

12. **Challenge** Proverbs 11:15 warns that “he that is surety for a stranger shall smart for it.” Corporate sureties guarantee strangers all day and prosper. In three sentences, reconcile the proverb with the industry.

    Show answer

    The proverb warns against casual, uninvestigated pledges — staking your family's goods on a stranger's character you never examined, as the old private sureties for bank clerks did. The corporate surety is the proverb taken seriously: it refuses to guarantee strangers, making every principal known through character, capacity and capital before lending its name, securing indemnity, and declining the risks a rash cosigner would shake hands on. Scripture does not forbid standing behind another; it demands you count the cost first — which is, almost word for word, the underwriting manual of a surety company.

COMMON MISTAKES

- Mixing up the bond triangle — the principal's performance is guaranteed, the obligee is protected, and the surety pays then recovers; exam answers that protect the principal are traps.
- Saying a surety prices for expected losses like an insurer; the surety expects no losses, underwrites character, capacity and capital, and holds indemnity rights against its principal.
- Treating an inventory shortage alone as proof of employee theft — shrinkage without other evidence is commonly excluded or limited.

- Sorting professional claims by profession instead of by harm: bodily injury goes to malpractice, financial loss to E&O, management decisions to D&O.
- Forgetting that professional liability is excluded from the CGL and the BOP — it is always a separate purchase, including the agent's own E&O.
- Assuming cyber losses fall under standard property or liability forms; data is not tangible property and a breach is not bodily injury, so cyber coverage is its own policy or endorsement.

Make it a game · Principal, Obligee, Surety!. Write twelve scenarios on slips: a contractor abandons a road job; a notary falsifies a signature; an executor drains an estate; a bidder walks away after winning; suppliers go unpaid on a school project; a bookkeeper skims the till; an agent forgets a flood policy; a surgeon's slip; a board's ruinous merger; a hacker steals customer card data; a clerk forges checks; a dealer sells cars outside the license law. The reader draws and reads; you have ten seconds to call the instrument — WHICH BOND, CRIME COVERAGE, or WHICH PROFESSIONAL POLICY — and for every bond, name all three corners of the triangle in order. One point per correct call, one bonus per complete triangle. Ten of twelve and the surety lends you its pen.

Scripture. “He that is surety for a stranger shall smart for it: and he that hateth suretiship is sure.” (Proverbs 11:15, KJV)

Scripture's blunt warning against rash pledges is the founding wisdom of the surety business, not a contradiction of it. The proverb condemns guaranteeing a stranger — someone whose character you never weighed — and every sound surety agrees, which is why it investigates character, capacity and capital before signing, and why it keeps indemnity against the one it vouches for. Prudence in promises is the lesson: stand behind others deliberately, never casually, and count the cost before your name is on the line.

UNIT 8

Commercial Lines

Every shop on Main Street is a family's livelihood wearing a storefront. In this unit you cross from personal lines to **commercial lines** — the policies that protect businesses — and you will find the same ideas you already know, grown to commercial scale. You will meet the **building and personal property coverage form** and discover that when a mill burns, the flames are only half the loss: the income stops too, which is why **business income insurance** exists. You will study the **commercial general liability policy**, the CGL, and learn why a plumber's customers demand a certificate of insurance before he touches a pipe, and what the strange pair **occurrence** and **claims-made** means. You will package it all into the **businessowners policy** — the HO-3 of Main Street — and learn when a business is too big or too odd for the package and needs a **commercial package policy** built part by part.

Then the unit goes traveling: business autos and their coverage symbols, cargo crossing oceans under **ocean marine** policies whose rules reach back past Edward Lloyd's coffee house to the sailors of ancient Rhodes, and **inland marine** floaters that follow tools and goods over the road. The unit closes with the policies that guard a business from dishonesty and from its own mistakes: crime insurance and **fidelity bonds**, the three-party **surety bond** that is not insurance at all, and **professional liability** — including the errors and omissions coverage that will one day protect you, the agent. Roughly a quarter of a property and casualty licensing exam lives in this territory. Master it, and the hard part of the P&C outline is behind you.

PREREQUISITES

- Has completed Units 6 and 7 (personal property and liability lines) and can state the difference between named-peril and open-peril coverage
- Can compute a coinsurance recovery with the did-over-should formula and subtract a deductible in the right order
- Can define negligence, bodily injury, property damage and legal liability in one sentence each
- Can keep a tidy exam notebook and look up a figure at a state insurance department website

MASTERY CHECKLIST

- ☐ I can name the three property coverages of the building and personal property coverage form and sort any item of a business's property into the right one.
- ☐ I can tell the basic, broad and special causes of loss forms apart and explain business income and extra expense coverage, including the period of restoration.
- ☐ I can name the CGL's three coverages, tell premises/operations from products/completed operations, and keep per-occurrence and aggregate limits straight.
- ☐ I can explain an occurrence form and a claims-made form, including the retroactive date and the extended reporting period.
- ☐ I can state what a businessowners policy packages together, who is eligible for one, what it never covers, and when a commercial package policy is the right tool instead.
- ☐ I can read the main business auto coverage symbols and explain hired and non-owned auto liability.
- ☐ I can name the four coverages of ocean marine insurance, work a general average problem, and give three examples of inland marine floaters.

- ☐ I can diagram the three parties of a surety bond, contrast a bond with insurance, and tell malpractice, E&O and D&O coverage apart.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **SBA: Get Business Insurance**: Free, official. The U.S. Small Business Administration's plain-language page on the policies a new business needs, with a six-step buying guide. Read it with Lesson 8.3 and notice how closely its list tracks this unit's table of contents. Ages 14 and up.
- **Insurance Information Institute: Business Insurance Basics**: Free. The industry's own consumer-education institute explains commercial property, liability, BOPs, commercial auto and more in short articles. Use it as a second voice throughout the unit whenever a coverage feels fuzzy. Ages 14 and up.
- **California Department of Insurance: Commercial Insurance Guide**: Free, official. A state regulator's complete walk through commercial coverages, from the BOP to surety bonds — the same material this unit teaches, in a department's own words. Skim the matching section after each lesson; your own state's department publishes figures that may differ. Ages 15 and up.
- **Texas Department of Insurance: Business Insurance Publication**: Free, official. A second state's consumer bulletin on business coverage — useful for the habit this course keeps preaching: every state says it a little differently, so always check the department where you will be licensed. Compare it with the California guide during Lesson 8.5. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

8.1	**Commercial Property and the Income That Stops**	3 sessions of 50 minutes
8.2	**The CGL: Commercial General Liability**	3 sessions of 50 minutes
8.3	**The Businessowners Policy: Main Street's Package**	3 sessions of 50 minutes
8.4	**Commercial Auto, Inland and Ocean Marine**	3 sessions of 50 minutes

Unit 8 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about one minute per question — set a timer for 25 minutes and finish inside it, as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example” or “commonly,” use the figures given, and remember that real eligibility rules, limits and bond amounts vary — the live figures are at your state insurance department's website. On a state licensing exam 70% — 14 of 20 here — is a pass, but aim higher. Choose the one BEST answer.

1. **5 pts**

   A watch-repair shop's covered fire destroys the shop's workbenches, a customer's watch awaiting repair, and shelving the shop installed in its rented space. Under the building and personal property coverage form, the customer's watch is:

   A. Building property

   B. The shop's business personal property

   C. Personal property of others in the insured's care, custody or control

   D. Uninsurable under commercial property forms

2. **5 pts**

   In this example, a building worth $600,000 carries an 80% coinsurance clause and $360,000 of insurance with a $1,000 deductible. A covered loss of $40,000 occurs. The policy pays:

   A. $40,000

   B. $29,000

   C. $30,000

   D. $24,000

3. 5 pts

Under the special causes of loss form, which statement is TRUE?

A. Only the perils listed in the form are covered

B. The insured must prove a named peril caused the loss

C. Flood and earth movement are automatically covered

D. All direct physical loss is covered unless excluded, and the insurer must show an exclusion applies

4. 5 pts

Business income coverage commonly begins paying:

A. After a waiting period, commonly 72 hours, following direct physical loss by a covered cause

B. Immediately upon any drop in revenue

C. After a dollar deductible is exhausted

D. Only if the business closes permanently

5. 5 pts

A flower shop's radio advertisement copies a competitor's slogan, and the competitor sues. Which CGL coverage responds?

A. Coverage A — property damage

B. Coverage B — personal and advertising injury

C. Coverage C — medical payments

D. None; the CGL excludes all advertising disputes

6. 5 pts

A CGL carries a $1,000,000 per-occurrence limit and a $2,000,000 general aggregate. After two premises judgments of $950,000 and $850,000 this year, a third occurrence produces a $500,000 judgment. The policy pays:

A. $500,000

B. Nothing — the aggregate is exhausted

C. $200,000

D. $1,000,000

7. 5 pts

A claims-made CGL for calendar 2025 has a retroactive date of January 1, 2021. Which claim is covered?

A. A claim made in 2026, after expiration with no tail, for a 2024 injury

B. A claim made in 2025 for a 2019 injury

C. A claim made in 2024 for a 2025 injury

D. A claim first made in 2025 for a 2023 injury

8. 5 pts

A homeowner hiring a contractor receives a certificate of insurance naming her as certificate holder. The certificate:

A. Is evidence that the coverage shown existed on the date issued, and confers no policy rights on her

B. Makes her an insured under the contractor's CGL

C. Guarantees the policy cannot be canceled during her project

D. Amends the contractor's policy to cover her home

9. 5 pts

Under common eligibility rules, which business is MOST likely to qualify for a businessowners policy?

A. A tavern earning most of its revenue from alcohol

B. A 3,500-square-foot stationery store with modest annual sales

C. An automobile dealership

D. A regional bank

10. 5 pts

Business income coverage in a BOP is commonly written:

A. With an 80% coinsurance requirement

B. With a scheduled dollar limit and monthly limitation

C. On an actual loss sustained basis for up to twelve months, with no coinsurance

D. Only by endorsement for extra premium

11. 5 pts

Which exposure is NEVER covered by an unendorsed businessowners policy?

A. A customer's slip-and-fall in the shop

B. Fire damage to the insured building

C. Lost income during covered repairs

D. An employee's on-the-job injury

12. 5 pts

A commercial package policy consists of:

A. Common declarations and common policy conditions plus two or more coverage parts selected for the risk

B. A fixed bundle of property, liability and auto coverage identical for every insured

C. A homeowners form adapted for business use

D. A single line of insurance written at a package discount

13. 5 pts

A business auto policy shows liability coverage with symbol 7 (specifically described autos). An employee causes a crash while driving her own car to deliver company documents. The business is sued. The policy:

A. Covers the suit — any business driving is included

B. Does not cover it; the employee's car is a non-owned auto, outside a symbol 7 grant

C. Covers it only if the employee is uninsured

D. Covers it under physical damage coverage

14. 5 pts

In ocean marine insurance, the shipowner's legal liability for injury to crew members and damage to piers and cargo is covered by:

A. Hull coverage

B. Freight coverage

C. Protection and indemnity

D. General average

15. 5 pts

A master jettisons $50,000 of cargo, saving a venture whose remaining values are hull $600,000, cargo $300,000 and freight $100,000. The hull interest's general average contribution is:

A. $30,000

B. $50,000

C. $15,000

D. $20,000

16. 5 pts

Which of the following is one of the implied warranties of ocean marine insurance?

A. The cargo is new merchandise

B. The premium is paid in advance

C. The vessel carries a full crew roster filed with the insurer

D. The vessel is seaworthy

17. 5 pts

A city requires a contractor to furnish a performance bond on a bridge project. In this bond, the city is the:

A. Principal

B. Surety

C. Obligee

D. Underwriter

18. 5 pts

Which statement correctly contrasts suretyship with insurance?

A. The surety expects no losses and may recover its payment from the defaulting principal; an insurer expects losses and cannot recover a covered payment from its insured

B. Both expect losses, but only insurers charge premiums

C. A bond has two parties; insurance has three

D. Insurance protects the obligee; a bond protects the insured

19. 5 pts

An insurance agent fails to submit a client's application, leaving the client uninsured when a loss strikes. The client's suit against the agent is covered by the agent's:

A. Commercial general liability policy

B. Errors and omissions policy

C. Fidelity bond

D. Directors and officers policy

20. 5 pts

A retailer's annual inventory count shows $25,000 of unexplained shrinkage, and the owner files an employee theft claim offering the count as the only evidence. The claim is commonly:

A. Paid in full — shrinkage proves theft

B. Paid at half under the coinsurance clause

C. Denied unless the employee confesses in writing

D. Denied or limited, because inventory shortage alone is excluded as sole proof of employee theft

ANSWER KEY

1. C. Ownership controls the classification: the watch belongs to a customer and is in the insured's care, custody or control. B is the trap — possession is not ownership — and the shelving, not the watch, is the insured's business personal property as improvements and betterments.
2. B. Required: $0.80 \times \$600{,}000 = \$480{,}000$; ratio $360/480 = 0.75$; $0.75 \times \$40{,}000 = \$30{,}000$, minus the $1,000 deductible = $29,000. C forgets the deductible, which comes off last.
3. D. The special form is open peril: coverage for all direct physical loss except exclusions, with the burden of proof shifted to the insurer. A and B describe named-peril forms, and C names two losses the special form still excludes.
4. A. Business income carries a time deductible — commonly a 72-hour waiting period — and requires suspension of operations caused by direct physical loss from a covered cause. B pays on mere revenue dips (no trigger), and C invents a dollar deductible the coverage does not use.
5. B. Using another's advertising idea is a personal and advertising injury offense under Coverage B — no bodily injury or property damage is required. A needs physical harm, and C pays only small no-fault medical bills.
6. C. The aggregate began at $2,000,000 and the first two losses consumed $1,800,000, leaving $200,000 — the most the third claim can collect regardless of the per-occurrence limit. A ignores the aggregate; B empties it too soon.
7. D. The claims-made trigger needs both: claim first made during the policy period and injury after the retroactive date. A fails the made-during test (no tail), B fails the retroactive date, and C was made before this policy existed.
8. A. A certificate is information only — proof that coverage existed when issued. It adds no insureds, blocks no cancellation and amends nothing, which is exactly why B, C and D are the classic wrong answers.
9. B. The BOP fence admits small, predictable Main Street risks — small retail is the textbook case. Bars, auto businesses and financial institutions are commonly ineligible classes, whatever their size.
10. C. The package includes business income automatically on an actual loss sustained basis, commonly twelve months, with no coinsurance to compute — one of the BOP's chief conveniences. A and B describe options on the standard commercial form instead.

11. D. Workers' compensation is always a separate policy — no BOP includes it. A, B and C are the package's three core protections: liability, property and business income.
12. A. The CPP is custom-built: shared declarations and conditions up front, chosen coverage parts behind — property, general liability, crime, inland marine, commercial auto and others. B describes the BOP's pre-built approach, and D describes a monoline policy, which is the package's opposite.
13. B. Symbol 7 reaches only scheduled autos; an employee's personal car on company business is the classic non-owned auto, which needs symbol 9 (or the sweep of symbol 1) for the business's liability to be covered.
14. C. P&I is the liability member of the marine quartet. Hull covers the vessel, freight covers the carrier's lost revenue, and general average is a loss-sharing rule, not a coverage.
15. A. Total saved values are $1,000,000; the hull's share is $\frac{600{,}000}{1{,}000{,}000} \times \$50{,}000 = \$30{,}000$. B charges the hull the whole sacrifice; C is the freight-plus trap from misreading the proportions.
16. D. The three implied warranties — binding without being written — are seaworthiness, no deviation from the voyage, and legality of the venture. The others are invented conditions no marine form implies.
17. C. The obligee is the protected party owed the performance — here the city. The contractor is the principal whose performance is guaranteed, and the surety is the company lending its guarantee.
18. A. Suretyship is lent credit — underwritten to zero expected loss, with indemnity against the principal — while insurance pools expected losses it keeps. B, C and D each reverse one of the classic distinctions.
19. B. A professional's negligent service causing financial harm is E&O territory — the agent's own malpractice coverage. The CGL excludes professional services, a fidelity bond covers employee dishonesty, and D&O answers management decisions.
20. D. Crime forms commonly refuse inventory computations as the only proof, since shrinkage has many non-theft causes. A confession is not required (C overshoots) — the insured simply needs evidence beyond the count that employees stole.

PORTFOLIO PIECE: MY PATHWAY FILE: THE COMMERCIAL DESK

Assemble the commercial-lines section of your Pathway File: the Mill Inspection pages from Lesson 8.1 (the three-drawer property schedule and shutdown worksheet for Hollis & Daughters), the Certificate Desk kit from Lesson 8.2 (coverage map, limits ladder, two clocks and the pretend certificate stamped INFORMATION ONLY), the BOP-or-CPP pages from Lesson 8.3 with their eligibility fences and gaps boxes, the Moving-Property Map from Lesson 8.4 with its symbols, floaters and general average finale, and the Trust Map from Lesson 8.5 ending with THE AGENT'S OWN SHIELD. Staple them behind a one-page cover memo written to the Hollis family, summarizing in plain words the complete program you built them — what each policy protects, what remains uncovered and must be bought separately, and what their agent will review with them each year. The memo is the real test: a program you can explain to a baker is a program you understand.

LOOK FOR	WHAT IT MEANS
Property pages	Property pages classify every item correctly into the BPP's three coverages, and the coinsurance and business income computations are accurate with the deductible and waiting period handled properly.
CGL pages	The CGL pages sort claims correctly among Coverages A, B and C, run the aggregate ledger without error, and show both the occurrence and claims-made timelines with the retroactive date and tail labeled.
Package pages	The package pages walk both businesses through the eligibility fence with correct results, and the gaps box names workers' compensation, owned autos, professional liability and flood with the policy that fills each.
Moving-property map	The moving-property map assigns correct symbols to every vehicle, distinguishes the shipper's and carrier's coverages, and the general average contributions are computed in proportion to saved values and sum to the sacrifice.
Trust map	The trust map labels every bond triangle correctly and contrasts suretyship with insurance accurately, and the E&O page states the claims-made rules an agent must keep for her own coverage.
Cover memo	The cover memo explains the whole program honestly in language a non-insurance reader can follow, names what is not covered as plainly

LOOK FOR	WHAT IT MEANS
	as what is, and reflects the unit's Scriptures on diligence and trust without decoration.

UNIT 9

The Law of the License

Every policy you have studied — the whole-life contract, the homeowners form, the auto policy, the annuity — lives inside a cage of law, and this unit walks the cage. You will meet the **commissioner of insurance**, the state officer who licenses you, examines insurers, hears complaints and can take your license away, and you will learn where his power came from: Elizur Wright forcing honest reserves on Massachusetts in 1858, and the McCarran-Ferguson Act of 1945 confirming that insurance regulation belongs to the states. You will walk the whole life of a license — application, lines of authority, appointment by an insurer, renewal, continuing education, the thirty-day reporting duties — and then the law's list of sins: **twisting**, **churning**, **rebating**, unfair discrimination, false advertising and the unfair claims practices that regulators punish as patterns of business.

One warning governs everything here. Licensing law is state law, written state by state on the pattern of the NAIC's model acts, so this unit teaches the *common pattern* — the rules most states share and the numbers most states use — and flags every figure that varies. When a lesson says a temporary license "commonly" runs 180 days or continuing education is "commonly" 24 hours per two-year term, your state's number may differ, and the habit this unit builds is the professional's habit: check your own state insurance department before you rely on any number. The unit ends where the law ends and conscience begins — the best-interest standard, and selling what the client actually needs.

PREREQUISITES

- Has completed Units 1–8 and can define the major life, health, property and casualty policy types in one sentence each
- Can read a numbered list of rules and turn it into an outline or chart without losing any item
- Can look up a state insurance department website and record what it says, with the date checked
- Can keep a tidy, dated exam notebook and a growing flashcard box

MASTERY CHECKLIST

- ☐ I can name the commissioner's chief powers — license, examine, investigate, hold hearings, fine, suspend and revoke, issue cease-and-desist orders — and two things he cannot do.
- ☐ I can explain how states came to regulate insurance, naming Paul v. Virginia (1869), South-Eastern Underwriters (1944) and the McCarran-Ferguson Act (1945).
- ☐ I can walk a license through its whole life — application, exam, lines of authority, appointment, renewal with continuing education — flagging which numbers vary by state.
- ☐ I can state the common reporting duties (address changes, criminal prosecutions and other-state actions, commonly within 30 days) and the common temporary-license pattern (up to 180 days).
- ☐ I can define twisting, churning, rebating, defamation, boycott-coercion-intimidation and unfair discrimination, and tell them apart in scenarios.
- ☐ I can list at least five unfair claims settlement practices and explain what “general business practice” adds to the test.
- ☐ I can explain the privacy and fraud layer: Gramm-Leach-Bliley notices, the Fair Credit Reporting Act, hard

versus soft fraud, fraud warnings and 18 U.S.C. §1033.

- ☐ I can state the four best-interest obligations of the NAIC annuity model regulation — care, disclosure, conflict of interest, documentation — and apply them to a sale.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: Find Your State Insurance Department**: Free, official. The National Association of Insurance Commissioners' directory of all fifty-plus state and territorial departments, with links to each commissioner's site. Use it in Lesson 9.1 to find your own commissioner, and in every lesson after to check your state's actual numbers. Ages 14 and up.
- **NIPR: National Insurance Producer Registry**: Free to browse, official. The portal where real producers apply for, renew and update licenses in most states. Explore the licensing and renewal pages with Lesson 9.2 to see the paperwork of the license lifecycle before you ever file it. Ages 15 and up.
- **NAIC: How to File a Complaint**: Free, official. The regulators' own explanation of the consumer-complaint process — what a department can investigate and what it cannot. Read it with Lessons 9.1 and 9.4 to see the complaint arm from the consumer's side of the counter. Ages 14 and up.
- **Insurance Information Institute**: Free. The industry's consumer-education site, with plain-English articles on policies, claims and buying wisely — the honest selling this unit's laws exist to protect. Browse an article or two with Lessons 9.3 and 9.5. Ages 14 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

9.1 The Commissioner: Powers, Examinations and Penalties 3 sessions of 50 minutes

9.2 Getting and Keeping the License: Renewals, CE and Appointments

3 sessions of 50 minutes

9.3 Unfair Trade Practices: Twisting, Rebating and False Promises

3 sessions of 50 minutes

9.4 Unfair Claims Practices, Privacy and Fraud

3 sessions of 50 minutes

9.5 Suitability and Best Interest: Selling What the Client Needs

3 sessions of 50 minutes

Unit 9 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about a minute per question — set a timer for 25 minutes and finish inside it, as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example” or gives day-counts and dollar figures, use the figures given — the live numbers for your own state come from your state insurance department, and on exam day the state-law section will test that state's exact figures. A licensing exam commonly passes at 70% — 14 of 20 here — but aim well above it. Choose the one BEST answer.

1. **5 pts**

   Which of the following is a power of the state insurance commissioner?

   A. Enacting the state's insurance statutes

   B. Examining the market conduct of admitted insurers

   C. Sentencing convicted insurance felons

   D. Awarding damages to wronged policyholders

2. **5 pts**

   A rule issued by the commissioner under authority granted in the insurance code:

   A. Overrides the statute if newer

   B. Is only advisory until the legislature approves it

   C. Has the force of law but may not exceed or contradict the statute

   D. Applies only to insurers, never to producers

3. 5 pts

Before the commissioner suspends a producer's license for cause, the common pattern requires:

A. Written notice of the charges and a hearing, with the order appealable to the courts

B. A criminal conviction

C. Approval by the NAIC

D. A unanimous vote of the legislature

4. 5 pts

The McCarran-Ferguson Act of 1945 provided that:

A. Insurance would be regulated exclusively by a new federal agency

B. Insurance contracts are not interstate commerce

C. The FTC must approve all insurance advertising

D. State regulation of insurance continues, with federal law yielding to the extent states actually regulate

5. 5 pts

A producer licensed in her resident state wants to sell in a neighboring state under the common reciprocity pattern. She must:

A. Pass the neighboring state's licensing exam

B. Hold a good-standing resident license and file a non-resident application with the fee

C. Be appointed by the neighboring state's commissioner

D. Complete that state's pre-licensing course

6. 5 pts

A newly licensed producer immediately sells his neighbor a policy from an insurer that has not appointed him. Under the common pattern he has:

A. Violated the code — a producer must be appointed by each insurer he represents

B. Done nothing wrong, since his license is valid

C. Violated federal law under 18 U.S.C. §1033

D. Converted his license to a temporary license

7. 5 pts

In this example state, CE is 24 hours per two-year term including 3 hours of ethics. A producer with 21 general hours and no ethics hours needs:

A. Nothing — 21 hours rounds up to 24

B. 3 more hours of any subject

C. 3 more hours of ethics

D. To retake the licensing exam

8. 5 pts

Under 18 U.S.C. §1033, a person convicted of a felony involving dishonesty or breach of trust may work in the business of insurance:

A. Never again, under any circumstances

B. After five years automatically

C. Only in a non-selling clerical role

D. Only with the written consent of the insurance regulator

9. 5 pts

A producer persuades a client to surrender an existing whole life policy by falsely claiming its insurer is near insolvency, then sells her a replacement from another company. This is:

A. Lawful replacement

B. Twisting — and the false statement about the insurer is also defamation

C. Churning

D. Rebating

10. 5 pts

Which of the following is rebating under the common pattern?

A. Offering to refund a buyer $200 of the producer's commission if she signs today

B. Giving prospects an $8 calendar printed with the agency's name

C. Explaining a policy's cash value accurately

D. Recommending a cheaper policy that fits the client's need

11. 5 pts

Two 35-year-old nonsmoking women in the same rating class apply for identical policies. The producer quietly arranges a lower premium for one as a personal favor. This is:

A. Lawful classification

B. Twisting

C. Coercion

D. Unfair discrimination — and, if funded from commission, rebating as well

12. 5 pts

Under an unfair trade practices act, penalties are most severe when a violation is:

A. Committed by a new licensee

B. Discovered by a consumer rather than an examiner

C. Committed knowingly, or so frequently as to indicate a general business practice

D. Committed in a small town

13. 5 pts

An insurer routinely offers claimants a small fraction of documented losses and improves offers only when suit is filed. Under the unfair claims settlement practices act this is:

A. Permissible hard bargaining

B. The listed practice of compelling litigation by offering substantially less than amounts ultimately recovered

C. A violation only if a court first awards damages

D. Twisting

14. 5 pts

A policyholder asks her state insurance department to force her insurer to pay her disputed $30,000 claim plus damages. The department can:

A. Investigate, fine violations and order practices corrected — but not award her the claim or damages

B. Enter judgment for $30,000 against the insurer

C. Add punitive damages for bad faith

D. Nothing, since claims are purely private disputes

15. 5 pts

An insurer declines an applicant based partly on a consumer credit report. Under the Fair Credit Reporting Act the applicant is entitled to:

A. A free policy from another insurer

B. The adjuster's internal notes

C. Automatic approval on reapplication

D. Notice of the adverse action including the name of the reporting agency, so she can obtain and dispute her file

16. 5 pts

Exaggerating the value of items taken in a genuine burglary is best described as:

A. Hard fraud

B. A lawful negotiating position

C. Soft fraud — a crime committed by padding a real claim

D. Rebating

17. 5 pts

Under the NAIC best-interest annuity standard, the four obligations of a producer making a recommendation are:

A. Care, disclosure, conflict of interest and documentation

B. Suitability, delivery, underwriting and claims

C. Licensing, appointment, renewal and reporting

D. Guarantee, illustration, replacement and rescission

18. 5 pts

The best-interest standard requires a producer to:

A. Recommend the lowest-priced product available anywhere

B. Refuse commission compensation

C. Monitor every client's finances for life

D. Not place his own financial interest ahead of the consumer's

19. 5 pts

A producer recommends a deferred annuity with a 10-year surrender schedule to a 81-year-old whose only other savings are $4,000 and who expects to need the money within a few years. The product was honestly described and all forms were signed. The producer has:

A. Satisfied the standard, because the description was honest

B. Violated only the documentation obligation

C. Breached the care obligation — no reasonable basis connects this product to her situation and needs

D. Committed defamation

20. 5 pts

A producer wants to add variable annuities to his practice. Under the common pattern he needs:

A. Only his life insurance license

B. His insurance license plus FINRA securities registration

C. A temporary license

D. The commissioner's written consent under §1033

ANSWER KEY

1. B. Examinations — financial and market conduct — are core commissioner powers. Statutes come from the legislature (A), criminal sentences from courts (C), and damages from lawsuits (D), not the department.
2. C. Regulations carry legal force within the statute's boundaries — they fill in detail; they cannot enlarge or contradict the code. A inverts the hierarchy, B understates a rule's force, and D is false: rules bind licensees of every kind.
3. A. Due process — notice (commonly 10 to 30 days ahead), hearing, order, appeal — governs license actions. No conviction is required for administrative action (B), the NAIC has no enforcement role in a state case (C), and the legislature plays no part in individual licenses (D).
4. D. McCarran-Ferguson confirmed state primacy after South-Eastern Underwriters (1944) held insurance to be interstate commerce. B restates Paul v. Virginia, which South-Eastern overruled; A and C describe federal machinery the act was written to avoid.
5. B. Reciprocity grants the non-resident license on the strength of the resident one — application and fee, no second exam (A) and no new coursework (D). Appointments come from insurers, never from commissioners (C).
6. A. The license is the state's permission; the appointment is the insurer's designation, filed by the insurer — and selling without it violates the code even on a valid license (so not B). §1033 concerns felons of dishonesty (C), and temporary licenses are succession devices (D).
7. C. The ethics hours are a carve-out inside the 24, so her remaining 3 hours must all be ethics. B ignores the carve-out, A invents rounding, and the exam returns only if a lapsed license passes the reinstatement window (D).
8. D. The federal bar lifts only with the regulator's written consent — the 1033 waiver. It is not an absolute lifetime ban (A), nothing lifts automatically (B), and the bar covers the business broadly, not merely selling roles (C).
9. B. Misrepresentation inducing replacement is twisting, and the false attack on an insurer's financial condition is defamation besides. Replacement is lawful only when honest (A); churning is the same-insurer commission harvest (C); no value outside the policy was given (D).
10. A. Sharing commission — any value not specified in the policy, offered to induce the sale — is the classic rebate. Small promotional items within the state's cap are commonly allowed (B), and C and D are simply honest practice.

11. D. Same class, equal expectation of life, different rates — the definition of unfair discrimination; a favor funded from commission adds rebating. Classification by actuarial factors is lawful between classes (A), and no replacement (B) or leverage (C) appears.
12. C. Knowledge and frequency are the statute's aggravation tests, multiplying fines and reaching the license. Who discovers it, where, and the licensee's tenure change nothing in the statute's design.
13. B. Routine lowballing that forces claimants to sue is a listed practice, and "routinely" supplies the general-business-practice element — no prior court award is needed (C). One tough negotiation might be bargaining (A); twisting is a sales practice, not a claims practice (D).
14. A. The department polices conduct — investigation, fines, orders, examinations. Money judgments and damages belong to the courts (B, C), yet the department is far from powerless over claim-handling patterns (D).
15. D. FCRA's adverse-action rule: tell the applicant, name the consumer reporting agency, enable dispute. The act grants information rights — not free coverage (A), internal work product (B) or approval (C).
16. C. Padding a real loss is soft fraud — opportunistic, and still criminal, with the claim form's fraud warning making the falsehood knowing. Hard fraud invents or causes the loss itself (A); B launders a lie; D is a sales violation.
17. A. Care, disclosure, conflict of interest, documentation — the 2020 model's working parts. B mixes course vocabulary, C is the license lifecycle from Lesson 9.2, and D is a grab-bag — no standard guarantees results.
18. D. That sentence is the standard itself. It operates within the producer's disclosed product scope (not A), leaves disclosed commissions lawful (not B), and attaches to the recommendation rather than imposing perpetual monitoring (not C).
19. C. Care judges the fit of product to portrait: locking nearly all liquid savings past the client's own horizon fails any reasonable basis, and honest description plus signatures cannot cure it (A). The file might be perfect and the sale still unfit (B); defamation concerns statements about insurers (D).
20. B. Variable products' values ride on securities, so securities registration (Series 6 or 7) is required besides the insurance license — the crossover fact this course shares with its Series 65 neighbor. A temporary license is a succession device (C), and §1033 consent concerns convicted felons (D).

PORTFOLIO PIECE: THE LAW FILE

Assemble the unit's artifacts into one Law File — the section of your Pathway File that proves you know the rules you will be licensed under. In order: the commissioner's CAN/CANNOT powers chart with your dated state facts sheet (Lesson 9.1); the license lifecycle map with its MY STATE blanks filled where your department's site answers (Lesson 9.2); the field guide to forbidden practices with your state's promotional-gift cap on its footer (Lesson 9.3); the claim-clock timeline and examiner's findings memo from the claim file audit (Lesson 9.4); and the suitability worksheet completed for both pretend families, closed by your signed ethics commitment (Lesson 9.5).

Then write the file's one-page cover: a letter to your future self on the day you pass the state exam, explaining in your own words why every number in the file carries the flag “check your state,” which single practice from Lesson 9.3 you believe will tempt ordinary agents most and how you intend to refuse it, and what Philippians 2:4 requires of a salesman that no statute can inspect. Date the letter — you will read it again at the end of Unit 10.

LOOK FOR	WHAT IT MEANS
Commissioner pages	the powers chart is complete and correct, the three CANNOTs name who actually holds each power, and the state facts sheet is dated with commissioner, selection method and complaint contact recorded.
Lifecycle map	all five zones are present with the common numbers (30-day reports, 180-day temporary license, 12-month reinstatement, CE with ethics carve-out) and MY STATE blanks filled or flagged for Unit 10.
Field guide	all eight practices carry a correct field mark, example and lawful cousin, and the student can sort spoken scenarios — including twisting versus churning and rebate versus promotional gift — without looking.
Claim audit	the timeline makes every missed clock visible, the findings memo correctly names each listed practice and federal statute violated, and the remedy paragraph separates what the department can do from what courts must.

LOOK FOR	WHAT IT MEANS
Suitability section	both worksheets gather all twelve facts, the Alvarez page rejects the unfit product with a written basis naming surrender schedule and liquidity, and the ethics commitment is in the student's own words, signed and dated.
Cover letter	thoughtful, specific and honest — it names a real temptation and a real refusal, states the check-your-state rule as a working habit, and connects Philippians 2:4 to the unwatched moment of a sale.

9.1 The Commissioner: Powers, Examinations and Penalties

OBJECTIVES

- Describe the office of the state insurance commissioner and whether the officer is appointed or elected in your state.
- List the commissioner's chief powers: licensing, examinations, investigations, subpoenas, hearings, fines, suspension and revocation, and cease-and-desist orders.
- Distinguish the legislature's power to make statutes from the commissioner's power to issue rules and regulations.
- Explain the due-process pattern of a license hearing: notice, the right to be heard, the order, and appeal to the courts.
- Tell how regulation came to the states, from Paul v. Virginia (1869) through the McCarran-Ferguson Act (1945).

> **Warm-up.** In five minutes, write down every power you think the head of your state's insurance department has over an agent like you — just a quick list, one power per line. Keep the paper. At the end of the lesson, check your list against the real one and circle the power you missed that surprises you most.

WATCH

The Commissioner or Director of Insurance for the Insurance Exam

Insurance Exam Queen · 7:18

https://www.youtube.com/watch?v=5v1Zp75c7D0

> **WHEN TO WATCH**
> Watch after reading the big idea; every time a power is named, add it to a two-column chart in your notebook — CAN on the left, CANNOT on the right.

BACKUP VIDEO

Life Insurance Exam [National] 00 – State Insurance Commissioner Explained

Open Exam Prep · 3:55

https://www.youtube.com/watch?v=f2EQo70Nrzs

A brisk second pass through the commissioner's powers in exam language; watch it before the project if your CAN/CANNOT columns still feel thin.

KEY TERMS

commissioner of insurance

The state officer who administers the insurance code — called the director or superintendent in some states — appointed by the governor in most states and elected in about eleven.

statute

A law passed by the state legislature and signed by the governor; the insurance code itself is statute law.

certificate of authority

The commissioner's license to an insurance company permitting it to transact insurance in the state; a company holding one is an admitted (authorized) insurer.

cease-and-desist order

The commissioner's written command that a person or insurer stop a specified unlawful practice immediately.

NAIC

The National Association of Insurance Commissioners, founded in 1871 — the commissioners' own body, which writes model laws and regulations that states may adopt but which have no force until a state enacts them.

rule (regulation)

A detailed requirement issued by the commissioner under authority granted by statute; rules have the force of law but may not exceed or contradict the statute.

market conduct examination

The commissioner's inspection of how an insurer treats the public — its sales, underwriting, advertising and claims practices — as distinct from a financial examination of its solvency.

hearing

The due-process proceeding — written notice stating time, place and charges, commonly 10 to 30 days ahead — at which a person may appear, be represented and answer before the commissioner acts against a license.

suspension and revocation

Suspension removes a license's authority for a stated time; revocation terminates it, commonly with a waiting period — often one year or more — before the person may reapply.

guaranty association

The state fund, financed by assessments on licensed insurers, that pays covered claims within limits when a member insurer becomes insolvent — a backstop agents may not advertise when selling.

CORE IDEAS

The story. In 1844 a Connecticut-born actuary and abolitionist named **Elizur Wright** stood in the Royal Exchange in London and watched old men auctioned. Not their bodies — their life insurance policies. Englishmen who could no longer pay premiums sold their policies to speculators, who kept up the payments and collected when the insured died; the companies themselves offered a lapsing policyholder little or nothing for years of premiums already paid. Wright went home sickened and spent a decade doing arithmetic. He computed, year by year, what a life policy is actually worth — the reserve a company must hold against its promise — and he hammered the Massachusetts legislature until it listened. In 1858 Massachusetts made him one of its first insurance commissioners, and he came armed: a law requiring companies to hold full net-value reserves, tables he calculated himself, and the will to shut down companies that could not pay. Insolvent insurers left the state or died. In 1861 his nonforfeiture law made Massachusetts companies give a lapsing policyholder credit for the value he had built. Wright is remembered as the father of American insurance regulation, and his office is the one you will answer to: the commissioner.

How they figured it out. Why is your regulator a state officer and not a federal one? The question went to the Supreme Court in *Paul v. Virginia* (1869), which held that issuing an insurance policy was not interstate commerce — so the states, not Congress, would regulate insurance. For seventy-five years that settled it, and the commissioners organized themselves to make state regulation workable, founding the **NAIC** in 1871 to coordinate across borders. Then *United States v. South-Eastern Underwriters Association* (1944) reversed course: insurance *was* interstate commerce, and suddenly federal antitrust law threatened the whole state system. Congress answered within a year. The **McCarran-Ferguson Act of 1945** declared that state regulation and taxation of insurance is in the public interest and that federal law

yields to the extent states actually regulate the business. The states scrambled to regulate in earnest — licensing laws, unfair trade practices acts, rate standards — most of them drafted as NAIC model acts and enacted state by state. That is why this unit teaches a common pattern with varying numbers: fifty-plus codes, one family tree.

The big idea. The **commissioner of insurance** — director or superintendent in some states, appointed by the governor in most and elected in about eleven — administers the state insurance code, and his powers form a list the exam loves. He *licenses*: producers like you, and insurers through the certificate of authority. He *regulates the paper*: in most states policy forms, and in many states rates, must be filed with or approved by the department. He *examines*: financial examinations test an insurer's solvency, market conduct examinations test its treatment of the public, commonly at least once every three to five years — your state's interval may differ. He *investigates* complaints and suspected violations, with subpoena power to compel witnesses and records. He *enforces*: hearings, cease-and-desist orders, fines, suspension and revocation of licenses, and referral of criminal matters to prosecutors. And he *rescues*: when an insurer fails, the commissioner petitions to rehabilitate or liquidate it, and the state guaranty association pays covered claims within limits.

Mark the boundary between making law and applying it, because examiners test it every season. The *legislature* makes statute law — the insurance code itself, including the definitions of unfair practices and the ranges of penalties. The *commissioner* issues rules and regulations that fill in the details, under authority the statute grants; a rule has the force of law, but it cannot contradict or enlarge the statute. The commissioner is an executive officer, not a court and not a legislature: he cannot send anyone to prison (that takes a prosecutor and a judge), he cannot award damages to a wronged consumer (that takes a lawsuit), and he cannot rewrite the code (that takes the legislature). What he can do, swiftly and without anyone's permission, is open an investigation, call a hearing and act on your license — which, for a working producer, is the power that matters most.

Due process runs through everything the commissioner does against a person. The common pattern: written **notice** of a hearing stating the time, place and conduct charged, delivered commonly 10 to 30 days in advance — in this example, say 20 days; your state sets its own number. At the **hearing** the accused may appear, be represented by counsel, present evidence and cross-examine. The commissioner

then issues findings and an **order** — dismissal, a fine, probation, suspension for a stated period, or revocation — and the order can be appealed to the state's courts. In urgent cases a **cease-and-desist order** may issue first, halting the conduct, with the hearing to follow. Penalties scale with knowledge: the NAIC pattern fines an unwitting violation modestly — commonly on the order of a thousand dollars per violation in this example — and multiplies the fine, commonly tenfold or more, for knowing or willful violations, with license action and aggregate caps on top. Violating a cease-and-desist order draws the heaviest fines of all.

Two more rooms of the department concern you. The **consumer services division** is the complaint arm: any policyholder may file a complaint free of charge, the department forwards it to the insurer and demands a response within a stated time, and patterns of complaints trigger market conduct examinations — which is how one mishandled claim becomes an insurer's examination. And the department keeps the **records**: every license, appointment, termination and disciplinary action, most of it public. The commissioner also represents the state within the NAIC, where accreditation standards press every department toward sound solvency regulation. One caution for your selling years: the existence of the guaranty association is a safety net, not a sales aid — in nearly every state it is illegal to use it in advertising or solicitation, because “the state will pay anyway” is exactly the false comfort that lets weak insurers sell.

On the exam today. State exams ask the commissioner questions in predictable shapes. First, the powers list: expect “all of the following are powers of the commissioner EXCEPT” — the right answer is usually making statute law, imprisoning violators or awarding damages. Second, the appointed-versus-elected fact and the rule-versus-statute distinction, often in one question. Third, numbers with blanks: days of notice before a hearing, the examination interval, penalty amounts — learn your own state's figures from the department site, because the exam's state-law section tests them exactly. Fourth, the order of process: investigation, notice, hearing, order, appeal — a question that has the commissioner revoking first and hearing later is describing a violation of due process unless it names a summary or emergency power. And the quiet trap: the guaranty association question, where the tempting wrong answer has the agent reassuring a client with it. He may not.

PICTURE STUDY



The Judgment of Solomon, Nicolas Poussin, 1649 · Oil on canvas · The Louvre, Paris

Image: Wikimedia Commons, public domain

Nicolas Poussin, the most disciplined French painter of his century, composed this courtroom like an argument: the king exactly at center, the two claimants balanced left and right, every gesture legible from across a room. The case is the oldest hearing on record — two women, one living child, and a judge who must find the truth with no witness but the parties themselves. It opens this lesson because the commissioner's work is Solomon's work scaled to an industry: parties with opposite stories, a hearing where both are heard, and an order that must rest on evidence and wisdom, not on rank or noise.

Look closely

- Find Solomon's two hands: one raised, one open. Which is deciding, and which is still weighing?
- Compare the two mothers — the kneeling pleader and the pointing accuser. What does each gesture ask the judge to do?
- Notice the courtiers crowding both margins, every face turned to the throne. What does the painter say about how many people a single just decision serves?
- Look at the symmetry of the room — columns, steps, balanced figures. Why would Poussin make justice look like architecture?

Talk about it

1. Solomon heard both women before ruling. Which pieces of the license-hearing pattern — notice, the right to appear, evidence, an appealable order — can you find in this scene, and which had to wait three thousand years for statutes?
2. The true mother was willing to lose the case to save the child. How can a regulator tell which party in a hearing cares about the truth rather than the victory?
3. Scripture says the powers that be are ordained of God. Solomon asked God for wisdom to judge, not for power to rule. What should a commissioner — or an agent facing one — ask for first, and why?

PROJECT

The Commissioner's Powers Chart and Your State Facts Sheet

You will build two pages for your Pathway File. The first is the powers chart — every power the commissioner holds, and the three he does not — drawn so you can redraw it from memory. The second is the page no book can write for you: your own state's facts, looked up tonight from your own department's website, with the date you checked.

You will need

- Two sheets of paper or two spreadsheet pages
- Your exam notebook and two ink colors
- The NAIC state-department directory from the kit, to find your department's site

Steps

1. Head page one THE COMMISSIONER CAN / THE COMMISSIONER CANNOT, two columns.
2. Fill the CAN column from the lesson: license producers and insurers, approve forms (and rates where required), examine finances and market conduct, investigate and subpoena, hold hearings, fine, suspend and revoke, issue cease-and-desist orders, petition to rehabilitate or liquidate a failed insurer.
3. Fill the CANNOT column: make statute law, imprison anyone, award damages to consumers — and write beside each who actually holds that power.
4. Head page two MY STATE, with today's date. Using your department's own site, record: the department's name and website, the commissioner's name and title, whether the office is elected or appointed, and the consumer complaint phone number or form link.
5. Add your state's numbers where you can find them: days of notice before a hearing, examination interval, and penalty ranges for unfair practices. Mark anything you cannot find with a question mark to resolve during Unit 10.

6. Draw a small flow arrow across the bottom of page one: investigation → notice → hearing → order → appeal.
7. Clip both pages into your Pathway File.

EXAM NOTEBOOK

1. Make a flashcard for each key term in this lesson and add them to your box; put the three CANNOTs on one extra card titled “Not his powers.”
2. Draw the due-process arrow — investigation → notice → hearing → order → appeal — with the common day-counts penciled above it and “CHECK MY STATE” beneath.
3. Write a five-line trap list titled “Commissioner traps,” ending with: he refers crimes, he never sentences them.

> **From history.** The Armstrong Investigation of 1905 showed what a determined inquiry could do before most departments had teeth. New York's legislature, alarmed by scandal at the great life insurers, hired a little-known lawyer named Charles Evans Hughes as counsel; his patient questioning of executives filled the papers for months and produced the sweeping New York reform laws of 1906 — limits on expenses, bans on rebates and misleading sales — that other states copied for a generation.

Example 1. Exam style. All of the following are powers of the state insurance commissioner EXCEPT:

A. Issuing a cease-and-desist order against an agent who is twisting

B. Examining the market conduct of an admitted insurer

C. Sentencing a convicted insurance felon to prison

D. Suspending a producer's license after notice and a hearing

Show solution

1. Sort each choice into the commissioner's three roles: license, examine, enforce administratively.
2. A is classic enforcement — the commissioner may order unlawful conduct stopped at once.
3. B is the examination power — market conduct exams test how insurers treat the public.
4. D is the license power exercised with due process — notice, hearing, order.
5. C crosses the boundary: imprisonment is a criminal sentence, which only a court can impose after prosecution. The commissioner refers criminal matters; he does not judge them.

Answer: C. The commissioner is an executive regulator, not a criminal court — he can fine, suspend, revoke and refer for prosecution, but never imprison.

Example 2. A department receives a complaint that producer Marta forged a client's signature on an application. Walk the common due-process pattern from complaint to final order, using example numbers and flagging what varies by state.

Show solution

1. Investigation: the department's investigators gather the application, interview the client and may subpoena Marta's records — no license action has happened yet.
2. Notice: if the evidence warrants charges, Marta receives written notice of a hearing stating time, place and the conduct charged — commonly 10 to 30 days ahead; in this example, 20 days. Your state sets the exact number.
3. Hearing: Marta may appear with counsel, present evidence and cross-examine witnesses before the commissioner or a hearing officer.
4. Order: the commissioner issues findings and an order — here, likely revocation plus a fine, since forgery is a knowing violation, and referral to prosecutors because forgery is also a crime.
5. Appeal: Marta may appeal the administrative order to the state courts; the criminal case, if any, runs separately.

Answer: Investigation → notice (commonly 10–30 days) → hearing → order (fine, suspension or revocation, plus criminal referral) → appeal to the courts. The sequence is the due process; the day-counts are state numbers to verify.

Example 3. Exam style. In this example state, the insurance code fines an unknowing violation of the unfair trade practices act up to $1,000 per violation, and a knowing violation up to $10,000 per violation. An agent is found to have knowingly misrepresented policy terms in 3 separate sales. What is the maximum fine, and what else should the agent expect?

Show solution

1. Each sale is a separate violation: 3 violations.
2. Knowing violations use the higher figure: $3 \times \$10{,}000 = \$30{,}000$ maximum in this example.
3. Because the violations were knowing, license action rides along — suspension or revocation after notice and hearing is the common companion to maximum fines.
4. Flag the numbers: $1,000 and $10,000 are example figures on the NAIC pattern; your state's statute sets its own amounts and aggregate caps.

Answer: Up to $30,000 in this example — three knowing violations at $10,000 each — plus probable suspension or revocation after a hearing. Real dollar caps come from your state's code.

PRACTICE

1. Easy Who makes the state's insurance statutes, and who issues the regulations under them?

   Show answer

   The legislature makes statutes; the commissioner issues rules and regulations under authority the statutes grant. Rules carry the force of law but cannot exceed or contradict the statute.

2. Easy What document must an insurance company hold before transacting business in a state, and what is such a company called?

   Show answer

   A certificate of authority from the commissioner; the company is then an admitted or authorized insurer.

3. **Easy** What is the difference between a financial examination and a market conduct examination?

Show answer

A financial examination tests an insurer's solvency — its reserves and accounts; a market conduct examination tests its treatment of the public — sales, underwriting, advertising and claims.

4. **Medium** The commissioner learns an agency is running a misleading advertisement today and wants it stopped before any hearing can be scheduled. Which tool fits, and what follows?

Show answer

A cease-and-desist order halts the practice immediately; a hearing follows, and violating the order draws the statute's heaviest fines.

5. **Medium** Which of the following best describes the NAIC?

A. A federal agency that licenses multistate insurers

B. The commissioners' national association, whose model laws take effect only when a state enacts them

C. A trade association of insurance companies

D. The federal court that hears insurance appeals

Show answer

B. The NAIC, founded in 1871, is the commissioners' own body; its model acts are templates with no force of law until a legislature adopts them. It is not federal, not a company group and not a court.

6. **Medium** Put these in order for a license action: hearing, investigation, appeal, order, notice.

Show answer

Investigation → notice → hearing → order → appeal. Notice commonly comes 10 to 30 days before the hearing — the exact count is your state's.

7. Medium A client asks a producer whether a policy is safe, and the producer answers, “Even if the company fails, the state guaranty association pays, so you can't lose.” What is wrong here?

Show answer

Using the guaranty association in solicitation or advertising is illegal in nearly every state. The association is a limited backstop for insolvencies, not a sales promise of safety.

8. Hard In this example state, unknowing violations are fined up to $1,000 each and knowing violations up to $10,000 each. An insurer's agents unknowingly used a misleading brochure in 14 sales. What is the maximum fine, and what fact would multiply it?

Show answer

$14 \times \$1{,}000 = \$14{,}000$ in this example. Proof that the insurer knew the brochure was misleading would make the violations knowing — up to $10,000 each, or $140,000 — plus likely license action.

9. Hard Explain how one policyholder's complaint can end in a market conduct examination of an entire insurer.

Show answer

Complaints go to the consumer services division, which demands the insurer's response and logs every complaint. A pattern of similar complaints is exactly the trigger regulators use to open a market conduct examination of the company's sales and claims practices.

10. Hard From the story: what did Elizur Wright see in London in 1844, and what two Massachusetts reforms answered it?

Show answer

He watched lapsing policyholders auction their life policies to speculators because insurers gave nothing for premiums paid. As commissioner from 1858 he forced companies to hold full net-value reserves, and his 1861 nonforfeiture law made them credit a lapsing policyholder with the value he had built.

11. **Challenge** Trace the legal seesaw: Paul v. Virginia (1869), South-Eastern Underwriters (1944), McCarran-Ferguson (1945). What did each hold or do, and why does an agent in 2026 answer to a state commissioner because of them?

    Show answer

    Paul v. Virginia held insurance was not interstate commerce, leaving regulation to the states. South-Eastern Underwriters reversed that, exposing insurance to federal antitrust law. McCarran-Ferguson then declared state regulation of insurance in the public interest, yielding federal law to the extent states regulate. States responded with real codes — licensing, trade practices, rates — built on NAIC models, which is why your license is a state license.

12. **Challenge** A classmate says, "The commissioner is judge, jury and legislature for insurance." Write three sentences correcting each word of that claim.

    Show answer

    Not legislature: only the state legislature writes the insurance code, and the commissioner's rules must stay inside it. Not jury in a criminal sense: he refers crimes to prosecutors and can never imprison. Judge only administratively: he holds hearings and issues orders on licenses and practices, but his orders are appealable to real courts, and damages for wronged consumers come from lawsuits, not from him.

COMMON MISTAKES

- Saying the commissioner makes insurance law — the legislature makes statutes; the commissioner issues rules under them and enforces them.
- Giving the commissioner criminal powers: he fines, suspends, revokes and refers for prosecution, but courts alone imprison and award damages.
- Treating the NAIC as a federal regulator — it is the commissioners' association, and its model acts bind no one until a state enacts them.
- Forgetting due process: license actions require written notice and a hearing, with the commissioner's order appealable to the courts.
- Memorizing one state's day-counts and dollar figures as if they were national — notice periods, exam intervals and penalty caps vary by state; the department website holds the live numbers.

- Mentioning the guaranty association to reassure a prospect — in nearly every state that is itself a violation.

Make it a game · Power or Not?. Write fifteen slips, each naming an action: revoke a license, pass a new statute, examine an insurer's claims files, sentence a fraudster to prison, issue a cease-and-desist order, award a consumer damages, fine a twisting agent, approve a policy form, subpoena records, and so on — mix true powers with impostors. A parent or sibling draws and reads each slip; you have five seconds to call POWER or NOT HIS, then name who holds it if not (legislature, court, prosecutor). One point per correct call, bonus point for naming the right holder. Miss the three CANNOTs and the round restarts. Best of fifteen wins; swap roles and let the reader defend any call you challenge.

Scripture. “Let every soul be subject unto the higher powers. For there is no power but of God: the powers that be are ordained of God.” (Romans 13:1, KJV)

Paul wrote this about magistrates who were no friends of his, yet he calls submission to lawful authority a duty owed finally to God. The agent who obeys the insurance code only when an examiner is watching has missed the verse's point: the license is held under authority, and the authority is held under God.

9.2 Getting and Keeping the License: Renewals, CE and Appointments

OBJECTIVES

- Distinguish resident and non-resident licenses and explain how reciprocity makes a multistate practice possible.
- Explain appointment: why a producer must be appointed by each insurer he represents, and how terminations — including termination for cause — are reported.
- State the common renewal pattern: a two-year term with continuing education, commonly 24 hours including about 3 of ethics, flagging state variation.
- List the common reporting duties — address changes, criminal prosecutions and administrative actions in other states, commonly within 30 days.
- Describe the temporary license pattern (commonly up to 180 days), license lapse and reinstatement, and the federal consent rule of 18 U.S.C. §1033.

> **Warm-up.** In five minutes, list every card, pass or license you or your family hold that must be renewed — driver's license, library card, passport, hunting tag, anything. Beside each, write what renewal requires: a fee, a test, proof of something. Keep the list; by the end of the lesson you will see which renewal the insurance license most resembles, and why the law chose that pattern.

WATCH

Property & Casualty Exam Prep 61, Producer Licensing and Appointments

Open Exam Prep · 4:27

https://www.youtube.com/watch?v=gJpEctFvpDs

> **WHEN TO WATCH**
> Watch after the big idea; each time the video names a step — license, appointment, termination — mark where it sits on the lifecycle map you will draw in the project.

BACKUP VIDEO

Producer Appointments and Terminations on the Insurance Exam

Insurance Exam Queen · 6:20

https://www.youtube.com/watch?v=BL_AXJyRkf4

Watch before the project if license-versus-appointment still blurs — the appointment and termination-for-cause rules are this video's whole subject.

KEY TERMS

producer

The model-act word for a person licensed to sell, solicit or negotiate insurance — covering both agents, who represent insurers, and brokers, who represent buyers.

resident license

The license issued by the state where the producer lives or keeps his principal place of business, earned by examination.

non-resident license

A license issued by another state on the strength of a good-standing resident license, commonly without a second exam — the fruit of reciprocity.

reciprocity

The agreement pattern under which states honor one another's resident licenses, granting non-resident licenses on application and fee alone.

line of authority

A category of insurance a license covers — life; accident and health; property; casualty; personal lines; variable products — each requiring its own exam, and variable products requiring securities registration besides.

appointment

An insurer's filed designation of a producer as its agent; a producer must be appointed by each insurer whose policies he sells, and the insurer files and pays for it.

termination for cause

An insurer's ending of an appointment for misconduct, which the insurer must report to the commissioner — a report that follows the producer.

continuing education (CE)

The study hours a producer must complete each renewal term — commonly 24 hours per two years including about 3 hours of ethics, varying by state.

temporary license

A license issued without examination — commonly for up to 180 days — so that a deceased or disabled producer's business can be serviced or sold, under a sponsor's oversight.

18 U.S.C. §1033

The federal law barring anyone convicted of a felony involving dishonesty or breach of trust from working in insurance without the regulator's written consent.

NIPR

The National Insurance Producer Registry, the electronic gateway through which most license applications, renewals and address changes are actually filed.

CORE IDEAS

The story. In May 1871, insurance commissioners from nineteen states met in New York City — the first gathering of what became the **NAIC** — because the states' separate rules were strangling a national business. A company sound in Hartford might be forbidden in Albany; an agent licensed in one state was a stranger in the next; every legislature invented its own forms, deposits and taxes. The commissioners resolved to coordinate: model laws any state could adopt, shared

financial statements, comity between departments. It took more than a century to finish the thought. In 1999 Congress lost patience with fifty incompatible licensing systems and wrote a threat into the Gramm-Leach-Bliley Act: if a majority of states did not achieve licensing reciprocity, a national registry called NARAB would override them. The states moved fast. The NAIC's **Producer Licensing Model Act** (2000) gave legislatures a common script — one license per state, uniform lines of authority, reciprocity for non-residents — and the **NIPR** gateway made the filings electronic. That is why, today, an agent licensed in his home state can be licensed in a second state with an application and a fee, no second exam.

How they figured it out. The licensing system balances two interests the 1871 commissioners already understood. The public's interest: no one should sell promises as complex as insurance without proving minimum competence (the exam), submitting to a background check (fingerprints in most states, and the federal §1033 bar on felons of dishonesty), and remaining answerable to a regulator who can take the license away. The market's interest: a qualified person should not have to run fifty gauntlets to serve clients across a state line. The solution is the pattern you must memorize: a **resident license** earned the hard way — pre-licensing study where the state still requires it, the proctored exam, fingerprints, application — and **non-resident licenses** granted by reciprocity on the strength of it. The resident state does the vetting once; the other states trust the vetting and keep the power to discipline. One resident state, any number of non-resident states, every one of them able to act on your conduct.

The big idea. Think of the license as a living thing with a lifecycle, because the exam tests every stage. *Birth:* qualify (commonly age 18, honesty in the application, any required study), pass the exam for each **line of authority** you want — life; accident and health; property; casualty; personal lines; and variable products, which also require FINRA securities registration (the Series 65 course next door covers that world). *Work:* a license lets you sell, solicit and negotiate — but only for insurers that have **appointed** you. *Maintenance:* renew each term, commonly every two years, with **continuing education** — commonly 24 hours including about 3 of ethics — and report what the department must know. *Death and resurrection:* a license not renewed lapses; most states allow reinstatement within a grace window — commonly 12 months — on payment of a penalty fee, without retaking the exam. Past the window,

you test again. Every number in this paragraph is the common pattern; your state's own figures live on its department site.

Appointment deserves its own look, because students confuse it with licensure. The license is the *state's* permission to transact insurance; the appointment is an *insurer's* declaration that you act for it. The insurer files the appointment with the commissioner and pays the fee — commonly within 15 days of your first application for that insurer, in this example — and the insurer can end it at will. When an insurer terminates an appointment **for cause** — misconduct, misappropriation, fraud — it must say so in its notice to the commissioner, and that report follows the producer to every state where he holds a license. An unappointed producer who sells a company's policy anyway has violated the code even though his license is perfectly valid, and a producer whose last appointment ends may find his license itself in question at renewal. Independent agents hold many appointments; captive agents commonly hold one.

Now the duties that keep a license healthy, each with its common clock. **Address changes**: report to the department commonly within 30 days — a license that cannot be reached is a license in trouble. **Criminal matters**: report any felony prosecution, and in many states any criminal charge beyond minor traffic, commonly within 30 days of the initial pretrial hearing. **Administrative actions**: discipline by another state or another financial regulator, reported commonly within 30 days. **Name changes and assumed names**: registered with the department before use. **Commissions**: payable only to a person licensed for the line at the time of the sale — and commission sharing is lawful only between producers licensed for the same lines. A retired producer may commonly keep receiving renewal commissions on business he wrote while licensed; what he may not do is earn new ones. And over it all stands federal law: under **18 U.S.C. §1033**, a person convicted of a felony involving dishonesty or breach of trust may not work in the business of insurance at all without the regulator's written consent — the 1033 waiver.

Two special passes round out the pattern. The **temporary license** exists for emergencies of succession: a producer dies or is disabled, or enters active military service, and someone — a surviving spouse, an employee, a personal representative — needs authority to service the book or sell the agency. The commissioner may issue a temporary license without examination, commonly for up to 180 days, under the oversight of a sponsoring insurer or licensed producer, and it exists to preserve

the business, not to launch a career. Second, **exemptions**: not everyone who touches insurance needs a producer license. The common pattern exempts salaried officers and employees who do not sell or solicit and take no commissions, clerical staff, and people who merely advertise without selling. The dividing line is always the same two questions: does the person sell, solicit or negotiate? Is the person paid by commission? Two yeses demand a license; two nos commonly do not.

On the exam today. The state-law section mines this lesson heavily, and the question shapes repeat. Expect the clock questions: how many days to report an address change, how long a temporary license lasts, how many CE hours per term — learn the common pattern here (30 days, 180 days, 24 hours with 3 ethics) and then overwrite it with your own state's exact figures before test day. Expect the appointment trap: a newly licensed producer sells a policy before any insurer appoints him — licensed, yet in violation. Expect commission puzzles: sharing with an unlicensed friend (never), with a producer licensed for a different line (no), renewals to a retired producer (commonly yes, for business written while licensed). Expect the reciprocity fact: a non-resident license requires a good-standing resident license, an application and a fee — not a second exam. And expect §1033 stated exactly: a felony involving dishonesty or breach of trust bars insurance work without the regulator's *written consent* — not forever, and not for every felony.

PICTURE STUDY



The Merchant Georg Gisze, Hans Holbein the Younger, 1532 · Oil on panel · Gemäldegalerie, Berlin

Image: Wikimedia Commons, public domain

Hans Holbein the Younger painted this portrait in London in 1532 for Georg Gisze, a thirty-four-year-old merchant of the Hanseatic Steelyard, and loaded it with the proofs of a trustworthy trader: letters from correspondents pinned where visitors could see them, the balance for weighing coin, seals and signet rings for binding agreements, his motto lettered on the wall. A merchant's standing was his paperwork, displayed and verifiable. The picture opens this lesson because a producer's license lives the same way — in records: the application sworn honest, the appointment filed by each insurer, the CE certificates, the thirty-day reports — a career you could pin to a wall and let any examiner read.

Look closely

- Count the kinds of paper in the picture — letters, tags, the one being opened. Who wrote them all, and why does Gisze keep them in sight?
- Find the balance hanging at the upper left and the seals and rings on the table. What did each instrument prove to a stranger doing business with him?
- Read the vase of carnations against all that paperwork. Why would a man advertise something fragile and fresh among his records?

- Look at his eyes, which meet yours mid-task. Is this a man interrupted, or a man who wants to be seen working? What is the difference worth?

Talk about it

1. Gisze's wall of letters let any visitor verify his standing. What is the modern producer's equivalent — and who can read it?
2. Seals and signet rings made agreements binding and traceable. How do appointments and termination-for-cause reports do the same work between insurers, producers and the state?
3. Christ's rule — faithful in least, faithful in much — judged a merchant by his small papers before his big bargains. Which small paper in this lesson's lifecycle would most tempt you to carelessness, and what would carelessness there reveal?

PROJECT

The License Lifecycle Map

You will draw the whole life of a producer's license on one page — birth, work, maintenance, lapse and reinstatement — with every common number penciled in and a blank beside each for your own state's figure. This map becomes the second page of your Law File, and in Unit 10 you will fill the blanks from your state's candidate handbook and department site.

You will need

- One sheet of unlined paper turned sideways, ruler, pencil, two ink colors
- Your exam notebook
- The NIPR site and your state department site from the kits, for the blanks you can fill tonight

Steps

1. Draw a long arrow across the page, left to right, and divide it into five zones: QUALIFY, LICENSE, APPOINT, MAINTAIN, LAPSE/REINSTATE.
2. In QUALIFY write: age 18 common, honest application, fingerprints in most states, pre-licensing study where required, §1033 bar — felony of dishonesty needs written consent.
3. In LICENSE list the lines of authority — life; accident & health; property; casualty; personal lines; variable (plus securities registration) — and note: resident by exam, non-resident by reciprocity.
4. In APPOINT write: one appointment per insurer, filed and paid by the insurer, commonly within 15 days of the first application; termination for cause is reported and follows you.
5. In MAINTAIN draw a two-year circle: renewal fee, CE commonly 24 hours with 3 ethics, and the 30-day reporting flags — address, criminal prosecution, other-state actions.
6. In LAPSE/REINSTATE write the common pattern: reinstate within 12 months with penalty fee, no re-exam; after that, test again. Add the temporary license as a side box: no exam, commonly 180 days, sponsor required, succession emergencies only.

7. Beside every number on the map draw a small blank — ____ — labeled MY STATE, and fill tonight whichever ones your department site answers.
8. Date the map and clip it into your Law File behind the commissioner pages.

EXAM NOTEBOOK

1. Make flashcards for every key term, plus one card titled “The clocks” listing the common 30-day reports, the 180-day temporary license, the 15-day appointment filing and the 12-month reinstatement window.
2. Draw the license-versus-appointment diagram: one circle STATE PERMISSION (license), one circle INSURER DESIGNATION (appointment), and under them the sentence “Licensed but unappointed = may not sell that company's policies.”
3. Write a five-line trap list titled “Commission traps,” ending with: share only with the like-licensed; renewals may follow retirement, new commissions never do.

> **From history.** Pre-licensing classroom hours, once the universal first step, are quietly disappearing. Washington dropped its requirement in 2023, Alabama in January 2024, Maryland that October, Pennsylvania in April 2025 — and California, which long required 20-hour courses per line, retired them on January 1, 2026, keeping only a 12-hour code-and-ethics course. More than thirty states now let candidates simply study and sit the exam, betting that a hard test filters better than counted hours.

WORKED EXAMPLES

Example 1. Dana is licensed for life and health in her resident state and wants to serve clients across the river in the next state, then begin selling for two life insurers. List the steps, in order, with the common pattern's requirements.

Show solution

1. Confirm her resident license is in good standing — reciprocity rides on it.
2. Apply for a non-resident license in the second state through NIPR, paying its fee. No second exam under the common reciprocity pattern.
3. Before selling either insurer's policies, be appointed by each: every insurer she represents files its own appointment with the commissioner and pays the appointment fee — commonly within 15 days of her first application for that insurer, in this example.
4. Mark her calendar for both states' renewals and CE: her resident state's CE commonly satisfies the non-resident state under reciprocity, but the renewal fees and dates are each state's own.
5. Note her reporting duties now run to both departments — an address change or any administrative action must be reported to each, commonly within 30 days.

Answer: Good-standing resident license → non-resident application and fee (no new exam) → one appointment per insurer, filed by each insurer → two renewal calendars, one CE obligation under reciprocity, and reporting duties owed to both states.

Example 2. Exam style. A producer's license renews every 2 years with 24 hours of CE required, including 3 hours of ethics, in this example state. The producer has completed 18 hours, none of them ethics, and the term ends in 60 days. Which plan satisfies the requirement?

A. Complete 6 more hours of any approved courses

B. Complete 6 more hours including at least 3 of ethics

C. Carry the shortfall into the next term

D. Nothing — 18 hours exceeds the yearly average of 12

Show solution

1. Total the need: 24 hours per 2-year term in this example, so $24 - 18 = 6$ hours remain.
2. Check the ethics carve-out: 3 of the 24 must be ethics, and none are done — so the remaining 6 must include all 3 ethics hours.
3. A fails the ethics carve-out; D misreads the term as an annual average; C fails because hours are due by the renewal date — most states do not let a shortfall ride.
4. B completes 24 total with 3 ethics inside the term.

Answer: B. Six more hours, at least three of them ethics, finished before the term ends. CE is due by renewal, and the ethics hours are a carve-out inside the total, not an extra.

Example 3. Producer Tom dies suddenly. His widow, Alice, has never held a license, but the agency's clients need service and the book must be sold. What does the common pattern provide, and what are its limits?

Show solution

1. The commissioner may issue Alice a temporary license without examination — the emergency the temporary license exists for.
2. Its clock: commonly up to 180 days in this example pattern; some states allow extension for good cause, and your state's number may differ.
3. Its oversight: a sponsoring insurer or licensed producer commonly supervises, because Alice has passed no exam.
4. Its purpose test: Alice may service existing clients and arrange the sale of the business; the temporary license is not a back door to a selling career — for that she must qualify and test like anyone.

Answer: A temporary license, commonly up to 180 days, issued without exam under sponsorship, so the book can be serviced and sold. To keep selling beyond it, Alice must earn a regular license by examination.

PRACTICE

1. Easy What is the difference between a license and an appointment?

   Show answer

   The license is the state's permission to sell, solicit or negotiate insurance; the appointment is a particular insurer's filed designation of the producer as its agent. A producer needs both — one license, plus an appointment from every insurer he represents.

2. Easy Name the common lines of authority, and say which one requires a securities registration besides.

   Show answer

   Life; accident and health (sickness); property; casualty; personal lines; and variable life and annuities — the variable line also requires FINRA securities registration (Series 6 or 7).

3. **Easy** Under the common reciprocity pattern, what must a producer do to be licensed in a second state?

Show answer

Hold a good-standing resident license, file a non-resident application (commonly through NIPR) and pay the fee — no second exam.

4. **Medium** A producer moves apartments across town and does nothing else. What duty has he triggered, and on what common clock?

Show answer

He must report the address change to the department — commonly within 30 days, through NIPR in most states. A department that cannot reach a licensee treats that as a problem all by itself.

5. **Medium** Which of the following persons most clearly needs a producer license?
A. A receptionist who schedules an agency's appointments
B. A salaried claims adjuster who never sells
C. An office manager paid a commission override on policies she solicits by phone
D. A printer who produces the agency's brochures

Show answer

C. She solicits and is paid by commission — both yeses. A, B and D neither sell, solicit nor negotiate for commission, which is the common exemption pattern.

6. **Medium** An insurer terminates a producer's appointment after discovering he pocketed a client's premium. What must the insurer do beyond ending the appointment?

Show answer

Report the termination for cause to the commissioner, stating the misconduct. That report follows the producer to every state where he is licensed and will surface in any future application.

7. Medium A producer retires and lets his license lapse. May he keep receiving renewal commissions on policies he sold while licensed? May he be paid for a new sale he helps close next month?

Show answer

Renewals on business written while licensed: commonly yes. New business: no — commissions for new sales may be paid only to a person licensed for that line at the time of the sale, and sharing with the unlicensed is prohibited.

8. Hard In this example state, CE is 24 hours per 2-year term with 3 hours of ethics. A producer licensed in January 2024 completed 10 hours in 2024 and 8 in 2025, including 2 ethics hours. What must she do before her January 2026 renewal, exactly?

Show answer

She has 18 of 24 hours and 2 of 3 ethics hours. She needs $24 - 18 = 6$ more hours before renewal, at least 1 of them ethics — and all inside the term, since shortfalls do not ride into the next term in the common pattern.

9. Hard A producer is charged with felony embezzlement in a neighboring state where she also holds a non-resident license. List every report the common pattern now requires of her.

Show answer

She must report the criminal prosecution to her resident state and to every state where she is licensed, commonly within 30 days of the initial pretrial hearing. If she is later convicted, 18 U.S.C. §1033 bars her from insurance work entirely unless a regulator grants written consent — embezzlement is a felony of dishonesty.

10. Hard Why does the law make the insurer, not the producer, file and pay for the appointment — and what does termination for cause add to the system? Answer in three sentences.

Show answer

The appointment is the insurer's own declaration that this producer acts for it, so the filing duty sits with the party making the claim and choosing the agent. That makes insurers gatekeepers: they must know whom they appoint, and they answer for ending appointments honestly. Termination for cause forces the insurer to tell the regulator about misconduct rather than quietly passing a bad producer to the next company.

11. Challenge Trace the road from the 1871 NAIC founding to a 2026 producer getting a non-resident license in an afternoon: name the 1999 federal law, the 2000 model act and the electronic gateway, and say what pressure each applied.

Show answer

The NAIC organized state cooperation from 1871 but licensing stayed fifty separate gauntlets. The Gramm-Leach-Bliley Act (1999) threatened a federal registry (NARAB) unless a majority of states achieved reciprocity, the NAIC's Producer Licensing Model Act (2000) gave legislatures the uniform script — one license, uniform lines, reciprocity — and NIPR made the filings electronic. Federal threat, model law, shared plumbing: that is the whole modern pattern.

12. Challenge A friend says: “Once you pass the exam, the license is yours — the rest is paperwork.” Using the lifecycle, write three sentences showing what that attitude costs, naming at least four maintenance duties.

Show answer

The exam only births the license; it lives by maintenance — renewal on time, CE with its ethics hours, 30-day reports of address changes, criminal matters and other-state actions, and appointments kept current with every insurer served. Miss renewal and the license lapses, recoverable commonly only within 12 months and with a penalty. Treat the duties as paperwork and the first forgotten report becomes the department's first question at your hearing.

COMMON MISTAKES

- Thinking a license alone permits selling a company's policies — the producer must also be appointed by that insurer, and the insurer files the appointment.

- Assuming a non-resident license requires another exam — under reciprocity it takes a good-standing resident license, an application and a fee.
- Treating CE's ethics hours as extra — they are a carve-out inside the total (commonly 3 of 24), and both numbers are state-set.
- Forgetting the 30-day family of reports: address changes, criminal prosecutions, and administrative actions by other states or regulators.
- Misreading §1033 as a lifetime ban on all felons — it bars felonies involving dishonesty or breach of trust, and written regulatory consent can reopen the door.
- Believing a temporary license is a shortcut into the business — it is a no-exam, commonly 180-day, sponsored pass for succession emergencies, not a career entrance.

Make it a game · Thirty Days or Else. Write twelve event slips: moved apartments, charged with felony DUI, fined by another state's regulator, finished only 20 of 24 CE hours, insurer terminated appointment for cause, got married and changed names, license lapsed eight months ago, hired as a salaried clerk, and so on. A parent draws each slip and reads it; you have ten seconds to call the duty and its common clock — REPORT IN 30, REINSTATE WITHIN 12 MONTHS, NO DUTY, and the rest — then one sentence of why. One point per correct call, bonus for naming that your state's number might differ. Best of twelve wins; then swap and write four slips of your own mixing two duties in one event.

Scripture. “He that is faithful in that which is least is faithful also in much: and he that is unjust in the least is unjust also in much.” (Luke 16:10, KJV)

Nothing in this lesson is glamorous — address changes, ethics hours, appointment filings. But Christ's rule makes the small duties a proving ground: the producer who fudges a CE certificate has told the regulator, and heaven, exactly what he would do with a widow's premium check.

9.3 Unfair Trade Practices: Twisting, Rebating and False Promises

OBJECTIVES

- Define misrepresentation and false advertising as the unfair trade practices acts define them.
- Distinguish twisting from lawful replacement, and churning from twisting, in concrete scenarios.
- Define rebating and illegal inducements, and state the common exceptions — small promotional gifts and the few states permitting disclosed rebates.
- Explain unfair discrimination between members of the same class and contrast it with lawful actuarial classification.
- Identify defamation of an insurer and boycott, coercion and intimidation as trade-practice violations.

> **Warm-up.** In five minutes, write a two-line sales pitch for an imaginary life policy that is technically true but misleading — then, below it, rewrite the same pitch honestly. Keep both versions. By the end of the lesson you will be able to name exactly which practice your first pitch committed, and what it would cost a licensed producer.

WATCH

Rebating, Coercion, Twisting, Defamation, Unfair Discrimination, & Controlled Business | Exam Prep

Elite Insurance Group · 7:32

https://www.youtube.com/watch?v=12cPXlOdlq4

> **WHEN TO WATCH**
> Watch after the big idea with a sheet divided into six boxes, one per practice; as each is defined, write its one-line definition and one example in its box.

BACKUP VIDEO

Life Insurance Exam [National] 06 – Unfair Trade Practices Explained

Open Exam Prep · 4:14

https://www.youtube.com/watch?v=Xl4tgbgMvhk

A compact second pass through the whole list in exam language; watch it the day before you quiz yourself with the field guide.

KEY TERMS

unfair trade practices act

The state statute, built on the NAIC model, that defines and prohibits deceptive and anticompetitive acts in the business of insurance and arms the commissioner to punish them.

misrepresentation

A false or misleading statement about a policy's terms, benefits, dividends or the insurer's condition, made to induce a sale or keep one — including calling a life policy a “savings plan.”

false advertising

Untrue, deceptive or misleading statements in any public advertisement of insurance — the same lie as misrepresentation, broadcast instead of spoken.

twisting

Misrepresentation — of either the old policy or the new — used to induce a policyholder to lapse, surrender or replace insurance, commonly to the policyholder's harm.

churning

A producer's practice of replacing policies within the same insurer's book, feeding on cash values, chiefly to generate new first-year commissions.

replacement

The lawful exchange of one policy for another, permitted when done with the required notices, comparisons and free-look rights — deception, not replacement, is the violation.

rebating

Giving a buyer anything of value not specified in the policy — a share of the commission, a premium refund, a gift beyond the small promotional items most states allow — as an inducement to buy.

illegal inducement

Offering benefits outside the contract — stock, employment, special favors — to procure a sale; rebating's broader cousin.

unfair discrimination

Charging individuals of the same class and equal expectation of life or risk different rates, or offering different terms, for reasons outside sound actuarial classification.

defamation

Making or circulating false, maliciously critical or derogatory statements about the financial condition of an insurer.

boycott, coercion and intimidation

Agreements or acts of pressure that restrain or monopolize the insurance trade — for example, a lender requiring that insurance be bought from its own agency as a condition of the loan.

CORE IDEAS

The story. In the autumn of 1905, in a committee room in Albany, a methodical lawyer named **Charles Evans Hughes** — years before his fame as a judge — questioned, one by one, the officers of the mightiest life insurance companies in America. The **Armstrong Investigation**, launched by New York's legislature after a scandal over an executive's costume ball and a public fight inside the Equitable Life Assurance Society, ran four months and filled thousands of pages. What Hughes

drew out, politely and relentlessly, shocked the country: commissions so rich that agents routinely handed part of them back to buyers as **rebates**; armies of agents trained to talk policyholders of rival companies into dropping good policies for new ones — the practice the trade already called **twisting**; "deferred dividend" policies whose promised payouts evaporated in expenses; and advertising that dressed speculation as thrift. New York's reform laws of 1906 banned rebating and misrepresentation outright and capped the machinery that fed them, and legislatures across the country copied the work. The sins you will learn to name in this lesson were all on Hughes's table a hundred and twenty years ago.

How they figured it out. The 1906 laws spread state by state, but the modern, uniform list has a second birthday. When the McCarran-Ferguson Act of 1945 left regulation with the states *to the extent they actually regulated*, there was a catch: federal law — including the Federal Trade Commission's power over "unfair methods of competition" — would fill any gap the states left. The NAIC answered in 1947 with a model **Unfair Trade Practices Act**, a statute every state could enact to occupy the field, and nearly every state did. That is why the list is so similar from Maine to Arizona: misrepresentation, false advertising, defamation of an insurer, boycott-coercion-intimidation, false financial statements, unfair discrimination, rebating — one model, fifty-plus enactments, each with its own penalty numbers. The act's test matters as much as its list: a single honest mistake is handled as a mistake, but an act committed knowingly, or so often that it shows a *general business practice*, brings the statute's full weight — fines per violation, multiplied for knowing conduct, and the license itself.

The big idea. Start with the deception family. **Misrepresentation** is any false or misleading statement about a policy — its terms, benefits, dividends, or the insurer behind it — made to induce a purchase, a lapse or a surrender. The exam's favorite specimen: calling a life insurance policy a "savings plan" or "retirement plan" and hiding what it is. **False advertising** is the same lie with a megaphone — print, broadcast or online — and it includes advertising a product the advertiser has no intention of selling as presented. Two statements about dividends are so often tested they deserve their own sentence: dividends may never be *guaranteed*, because they are not, and past dividends may not be misrepresented as promises of future ones. The deception family's common thread is simple: the buyer must be able to believe

what the licensed professional tells him, so the law punishes the lie itself, whether or not the policy behind it happened to fit.

Now the replacement family, where the distinctions earn exam points. **Replacement** — exchanging an old policy for a new one — is *legal* when done honestly with the required notices and comparisons; sometimes it genuinely serves the client. **Twisting** is replacement procured by misrepresentation: the producer lies about the old policy, the new one, or both, to make the client drop coverage — typically costing the client new acquisition charges, a fresh contestability period and higher attained-age premiums. **Churning** is the same predation turned inward: a producer mines his *own* book, or his own company's, replacing policies and feeding on their cash values chiefly to harvest first-year commissions. Keep the sorting rule: honest exchange with disclosure — replacement, lawful; deception to induce the exchange — twisting; replacement within the same insurer's book for commissions — churning. Unit 4's replacement mechanics (notices, comparison statements, free-look periods) are the lawful path this lesson's violations abandon.

The inducement family. **Rebating** is giving the buyer anything of value not specified in the policy as an inducement to buy — most classically, handing back part of the commission, but equally a premium "discount" from the agent's pocket, a lavish gift, or anything else off the contract's page. The common pattern allows small promotional items — pens, calendars, modest gift items, commonly capped somewhere between $25 and $100 in this example range; your state sets its figure — and a handful of states, following court decisions and recent reforms, now permit certain disclosed rebates, which is exactly why the lesson's refrain matters: check your state. **Illegal inducements** widen the net to stock, employment promises and special favors. Why ban generosity at all? Because rebates sell the discount instead of the coverage, favor the customers who bargain hardest at the expense of those who do not, and in the 1880s nearly destroyed agent compensation altogether — the "rebate evil" the 1906 reforms buried.

The fairness-and-competition family. **Unfair discrimination** is charging people of the same class and equal expectation of life or risk different rates or terms: two forty-year-old nonsmoking women in the same rating class must be offered the same rate, and a producer may not shade one's premium as a favor — that is discrimination and usually rebating at once. Classification itself — age, health, smoking, occupation, driving record — is lawful and necessary; the violation is

deviating from the class, not building classes on sound actuarial ground. **Defamation** protects the market's honesty in the other direction: circulating false or maliciously derogatory statements about an insurer's financial condition — whispering that a rival carrier "won't be around to pay" — is a violation, even in friendly conversation. And **boycott, coercion and intimidation** reach organized pressure: a lender conditioning a loan on buying insurance through its own agency, agents conspiring to freeze out a competitor, an insurer threatening to pull all business from anyone who deals with a rival. Fair fight, honest words, posted prices — that is the whole family's demand.

On the exam today. This lesson is pure exam fuel, and the questions sort into three shapes. Definition matches: a scenario, four practice names — learn each practice's one signature detail (twisting: misrepresentation *plus* replacement; churning: *same insurer*, commissions the motive; rebating: value *outside the policy*; defamation: about an *insurer's financial condition*; coercion: tying insurance to a loan or other leverage). Legal-or-illegal calls: replacement with full disclosure is legal; sharing commission with the client is rebating even if the client suggested it; a $20 logo calendar is commonly fine; "guaranteed dividends" never are. And the aggravation question: what turns a violation severe — doing it knowingly, or so frequently it is a general business practice, which multiplies fines and reaches the license. The trap to respect most: the exam loves a kindly framed rebate — the generous agent "helping a struggling family" with part of his commission — and the right answer is still rebating.

PICTURE STUDY



The Quack, Gerrit Dou, 1652 · Oil on panel · Museum Boijmans Van Beuningen, Rotterdam

Image: Wikimedia Commons, public domain

Gerrit Dou, Rembrandt's first pupil and Leiden's most meticulous painter, set up this little theater of deception in 1652: a quack — a seller of false medicine — flourishing his flask over a table of official-looking papers and seals, while a monkey mocks him from the stall and the villagers weigh his promises. Dou painted his own face into the window beside the stall, watching the con with us. The picture opens this lesson because every unfair trade practice is this stall in modern dress — the confident pitch, the impressive documents, the cure that cures nothing — and because the law's whole purpose is to make the insurance table unlike this one: what is sold must be what is said.

Look closely

- Study the quack's table: jars, papers, dangling seals like credentials. What work are the documents doing in the sale?
- Find the monkey on the stall. Painters used monkeys to mock false imitation — whom is this one imitating?
- Read the crowd one face at a time: the mother, the hunter, the laughing boys. Who believes, who doubts, and how can you tell?
- Find Dou himself at the window, palette in hand. Why would the painter put himself in the picture as a watcher rather than a buyer?

Talk about it

1. The quack's medicine show worked because he left town before the cure failed. How does licensing — a name, a record, a regulator — change the seller's arithmetic?
2. The stall's papers and seals imitate authority. Which practices in this lesson dress deception in authority's clothes, and what honest versions do they imitate?
3. Proverbs says a false balance is abomination to the LORD. The quack cheats strangers; a twisting agent cheats people who trusted him. Why does Scripture treat the scale itself — not just the victim's loss — as the offense against God?

PROJECT

The Field Guide to Forbidden Practices

You will build a one-page field guide — like a birdwatcher's card, but for violations — that lets you identify any unfair trade practice from its field marks in three seconds. This page joins your Law File and becomes your fastest review sheet for the exam's scenario questions.

You will need

- One sheet of unlined paper or a spreadsheet page, ruled into a grid
- Your exam notebook and two ink colors
- This lesson's key terms and your six-box video notes

Steps

1. Rule a grid of eight rows: misrepresentation, false advertising, twisting, churning, rebating, unfair discrimination, defamation, boycott-coercion-intimidation.
2. Give each row four columns: FIELD MARK (the one detail that identifies it), EXAMPLE (one vivid sentence), COMMONLY CONFUSED WITH (and the difference), and LAWFUL COUSIN (the honest act it corrupts — replacement for twisting, classification for discrimination, a small logo gift for rebating, honest comparison for defamation).
3. Fill the grid from the lesson, keeping every cell under ten words — a field guide, not an essay.
4. Across the bottom, write the aggravation rule in one line: knowing, or frequent enough to be a general business practice → multiplied fines and the license.
5. Add a one-line footer: “Rebate states exist — check MY state,” with a blank to fill from your department site.
6. Test the guide: have a parent read the six warm-up and worked-example scenarios from this lesson in random order while you identify each from the grid alone.
7. Date the page and clip it into your Law File.

EXAM NOTEBOOK

1. Make a flashcard for each of the eight practices with the field mark on the back; shuffle them into your box and quiz until sorting is instant.
2. Draw the replacement fork: one path labeled HONEST (notices, comparison, free look — lawful replacement), one labeled LIES (twisting), with a side loop labeled SAME INSURER, FOR COMMISSIONS (churning).
3. Write a five-line trap list titled “Kindly rebates,” ending with: generosity off the policy's page is still rebating.

> **From history.** The rebate wars the 1906 reforms ended had grown absurd: in the 1880s, big-city life agents competing for prestige cases routinely handed back half or more of their first-year commission, and companies looked away because volume made the annual report. New York's 1889 anti-rebate statute — among the first — was openly flouted until Armstrong gave it teeth. The modern wrinkle runs the other way: a few states have lately re-legalized limited, disclosed rebates, betting that transparency cures what secrecy corrupted — one more number to check at your own department.

Example 1. Exam style. A producer tells a prospect, “Drop that old whole life policy — that company is shaky anyway — and I'll get you a modern one that does everything better.” The statement about the old insurer is false. Which practices has the producer committed?

A. Lawful replacement only

B. Twisting and defamation

C. Churning and rebating

D. Coercion and false advertising

Show solution

1. Name the conduct: inducing lapse and replacement of an existing policy by a false statement — that is twisting.
2. Name the second wrong: the false statement attacks a rival insurer's financial condition — that is defamation, even spoken to one prospect.
3. Rule out C: nothing was replaced within the same insurer's book (churning) and nothing of value outside the policy was offered (rebating).
4. Rule out A and D: the deception removes lawfulness, there is no leverage or tying (coercion), and a private conversation is not advertising.

Answer: B. Misrepresentation inducing replacement is twisting, and the false attack on the insurer's financial condition is defamation — one sentence, two violations.

Example 2. A client balks at a $1,200 annual premium. The producer, whose first-year commission in this example is 50%, offers to “cover the first $300 myself — call it a welcome gift.” Walk the analysis: what practice is this, would a $15 logo mug differ, and what if the producer instead offered the same $300 off to every member of the client's rating class?

Show solution

1. The $300 is value given the buyer that is not specified in the policy, offered to induce purchase: rebating, regardless of the friendly label — and sharing commission is its classic form.
2. The $15 mug falls within the common promotional-gift allowance (commonly $25–$100 caps, state-set in this example range), so it is commonly lawful.
3. Offering $300 off to the whole class does not cure it: the producer cannot reprice the policy at all — rates are the insurer's filed rates, so the “class-wide discount” is still rebating, now on a grand scale.
4. Note the discrimination angle: had he given the $300 to this client only while charging classmates full rate, he would add unfair discrimination to the rebate.

Answer: The $300 is rebating in every version — a small logo gift inside the state's cap is the only lawful token. A producer has no power to discount filed rates, alone or class-wide; only the handful of rebate-permitting states, by disclosed arrangement, vary this — check your state.

Example 3. Exam style. Producer Kim systematically reviews her own clients' whole life policies each year and moves any with meaningful cash value into new policies with the same insurer, earning first-year commissions each time. The clients sign all forms. Which practice is this?

A. Lawful replacement, since forms were signed

B. Twisting

C. Churning

D. Rebating

Show solution

1. Identify the pattern: replacements within the same insurer's book, repeated as a system, motivated by first-year commissions, funded by the clients' own cash values.
2. That is churning — the same-insurer, commission-harvest practice. Twisting (B) would require misrepresentation inducing replacement, often toward another insurer.
3. A fails because paperwork does not launder purpose: the replacements systematically injure clients (new charges, new contestability) for the producer's gain, and the frequency shows a general business practice.
4. D fails: no value outside the policy was given to the buyers.

Answer: C. Same insurer, cash values consumed, commissions the motive: churning — and its systematic frequency is exactly what regulators call a general business practice, with penalties to match.

PRACTICE

1. Easy What is twisting, in one sentence, and what single element separates it from lawful replacement?

   Show answer

   Twisting is inducing a policyholder to lapse, surrender or replace a policy by misrepresentation; the misrepresentation is the separating element — honest, disclosed replacement is legal.

2. Easy A producer offers to split his commission with a buyer “just this once.” Name the practice.

Show answer

Rebating — giving the buyer value not specified in the policy as an inducement. That the client is willing, or the occasion rare, changes nothing.

3. Easy May a producer tell prospects that a policy's dividends are guaranteed if the insurer has paid them for thirty straight years?

Show answer

No. Dividends are never guaranteed, and representing past dividends as promises of future ones is misrepresentation.

4. Medium An agent hands every prospect a wall calendar printed with his agency's name, worth about $8. Another agent gives a $500 grill to anyone who buys an auto policy. Sort the two.

Show answer

The calendar is a small promotional item within the common state caps (commonly $25–$100 in this example range) — lawful. The grill is value outside the policy given to induce purchase — rebating/illegal inducement, whatever it is called in the flyer.

5. Medium Which of the following is unfair discrimination?

A. Charging smokers more than nonsmokers in filed rates

B. Charging a 60-year-old more than a 30-year-old for new term insurance

C. Quietly charging one member of a rating class less than her classmates as a favor

D. Declining a hazardous occupation under filed underwriting rules

Show answer

C. Members of the same class with equal expectation of life must get the same rates and terms; the private favor deviates from the class (and, if funded from commission, is rebating besides). A, B and D are lawful actuarial classification.

6. Medium At a chamber-of-commerce lunch, an agent remarks that a competitor insurer is “quietly broke — I'd hate to hold their paper.” The remark is false. What practice, and does the small audience matter?

Show answer

Defamation — a false, derogatory statement about an insurer's financial condition. Making or circulating it is the violation; one listener at a lunch table is circulation enough.

7. Medium A bank tells a borrower his mortgage will close faster if he buys homeowners insurance from the bank's own agency. Name the practice family and the principle it violates.

Show answer

Boycott, coercion and intimidation — using lending leverage to tie insurance to the loan. The buyer must be free to choose his insurer; a lender may require that insurance exist, not where it is bought.

8. Hard Define churning so that it cannot be confused with twisting, then say which client harms the two share.

Show answer

Churning is replacing policies within the same insurer's book — commonly the producer's own clients — chiefly to generate new first-year commissions, often consuming cash values; twisting is misrepresentation inducing replacement, typically toward another insurer. Both saddle the client with new acquisition costs, a fresh contestability period and higher attained-age pricing.

9. Hard What does the phrase “general business practice” do in an unfair trade practices act? Answer in two or three sentences.

Show answer

It is the aggravation test: an isolated act may be handled as a mistake, but conduct committed knowingly or with such frequency as to indicate a general business practice draws the statute's full penalties — fines per violation, multiplied for knowing conduct, and suspension or revocation. It aims the law at patterns of business, not stray errors. The numbers attached to it are each state's own.

10. Hard From the story: name two abuses the Armstrong Investigation of 1905 exposed and the reform that answered them, and say who conducted the questioning.

Show answer

Hughes — Charles Evans Hughes, the committee's counsel — drew out systematic rebating of commissions and twisting of rival companies' policyholders, along with deceptive deferred-dividend products and misleading advertising. New York's 1906 reform laws banned rebating and misrepresentation and were copied widely by other states.

11. Challenge Explain why McCarran-Ferguson (1945) made the NAIC write a model Unfair Trade Practices Act in 1947, and what that history explains about the law you will actually be tested on.

Show answer

McCarran-Ferguson left insurance to the states only to the extent they actually regulated it; any gap would be filled by federal law, including the FTC's power over unfair competition. The NAIC's 1947 model act let every state occupy the field with its own statute, so nearly every state enacted the same list with different numbers. That is why your exam tests a national pattern of definitions and a state's own penalties and caps.

12. Challenge A struggling young family genuinely cannot afford the premium, and the agent, moved by compassion, pays a third of it himself each year in secret. Write three sentences: the violation, the real-world harm the rule prevents, and the honest alternatives open to the agent.

Show answer

The payments are rebating — value outside the policy inducing and sustaining the sale — however kind the motive. The rule exists because secret price-cutting sells discounts instead of coverage, favors clients who get favors, and historically collapsed into the rebate wars that corrupted the whole trade. Honestly, the agent can find a policy the family can afford — a smaller face amount, term instead of whole life — or point them to the insurer's own filed payment options; compassion works through the contract, not around it.

COMMON MISTAKES

- Calling every replacement twisting — replacement with honest disclosure and the required forms is legal; twisting requires misrepresentation.
- Confusing churning with twisting: churning is the same-insurer, commission-harvest version, typically mining the producer's own book.
- Thinking a rebate is lawful if the client proposes it, the amount is small, or the motive is kind — value outside the policy to induce the sale is rebating, with only the state's small promotional-gift cap (and a few disclosed-rebate states) excepted.
- Treating all rate differences as discrimination — actuarial classification by age, health or hazard is lawful; the violation is deviating within a class of equal expectation.
- Forgetting defamation is about an insurer's financial condition — false attacks on a rival carrier violate the act even in private conversation.
- Missing the aggravation test: knowing conduct, or frequency showing a general business practice, is what multiplies penalties and reaches the license.

Make it a game · Name That Violation. Write sixteen scenario slips, two per practice — a commission split, a "guaranteed dividend," a loan tied to the lender's agency, a whispered "that carrier's broke," a same-insurer cash-value shuffle, a lied-about replacement, a class-of-one discount, a $300 "welcome gift," plus two ringers that are perfectly legal (an $8 calendar; a disclosed, documented replacement). A parent reads each slip; you have eight seconds to call the practice or LEGAL, then give the field mark that proves it. One point per correct call, bonus for catching both ringers. Best of sixteen wins; then trade roles — inventing undetectable-sounding violations is the best review there is.

Scripture. "A false balance is abomination to the LORD: but a just weight is his delight." (Proverbs 11:1, KJV)

The proverb aims at the merchant's scale, the instrument a buyer cannot check — exactly what a policy explanation is to a family that cannot read actuarial tables. Every practice in this lesson is a thumb on that scale, and the verse says God himself delights in the agent whose word weighs true.

9.4 Unfair Claims Practices, Privacy and Fraud

OBJECTIVES

- List the principal unfair claims settlement practices and explain why the law punishes them as patterns of business conduct.
- Explain the common claim clocks — acknowledgment, investigation and decision after proof of loss — flagging that each state sets its own day-counts.
- Describe the privacy layer: Gramm-Leach-Bliley notices and opt-outs, the Fair Credit Reporting Act's adverse-action rules, and state insurance information acts.
- Distinguish hard fraud from soft fraud and state the purpose of application fraud warnings and good-faith reporting immunity.
- State what 18 U.S.C. §§1033 and 1034 criminalize and describe the producer's duty when he suspects fraud.

> **Warm-up.** In five minutes, imagine your family's kitchen was wrecked by a burst pipe and you filed a claim three weeks ago. Write down the three things an insurance company could do — short of refusing outright — that would make the experience miserable. Keep the list: by the end of the lesson you will find every item on it in a statute, with a name.

WATCH

Unfair Claims Settlement Practices on the Insurance Exam

Insurance Exam Queen · 6:51

https://www.youtube.com/watch?v=fBn9bNCEY4Y

> **WHEN TO WATCH**
> Watch after the big idea and tally the practices as they are named; for each, jot the honest behavior it forbids the insurer to skip.

BACKUP VIDEO

Life Insurance Exam [National] 07 – Unfair Claims Settlement Practices Explained

Open Exam Prep · 4:53

https://www.youtube.com/watch?v=byuFBztQNtI

A quick second pass through the claims list in exam phrasing; watch it before the audit project so the violation names come without looking.

KEY TERMS

unfair claims settlement practices act

The state statute, on the NAIC model, listing claim-handling acts forbidden to insurers when committed knowingly or as a general business practice.

acknowledgment

The insurer's required prompt response to a claim communication — commonly within 10 to 15 working days, state-set.

lowball offer

An offer so far below the amounts ultimately recovered that it shows an attempt to force claimants to litigate or give up — a listed unfair practice when habitual.

Fair Credit Reporting Act (FCRA)

The 1970 federal law governing consumer reports: applicants must be told when reports are used, and adverse action based on one requires notice and the reporting agency's name.

soft fraud

Exaggerating an otherwise real claim or lying on an application to lower premium — opportunistic padding, and still a crime.

general business practice

The frequency test of claims regulation: the statute reaches acts committed so often as to show how the insurer does business, not a single disputed claim.

proof of loss

The claimant's formal, commonly sworn statement of the loss, which starts the clock for the insurer's decision to affirm or deny.

Gramm-Leach-Bliley Act (GLBA)

The 1999 federal law requiring financial institutions, insurers included, to give customers privacy notices and a chance to opt out of sharing nonpublic personal information with nonaffiliated third parties.

hard fraud

Inventing or deliberately causing a loss to collect insurance — a staged collision, an arson, a faked theft.

fraud warning

The statement on applications and claim forms that knowingly false statements are a crime and may void coverage — required in most states.

18 U.S.C. §1033 / §1034

Federal statutes making dishonesty inside the business of insurance — embezzlement, false statements to regulators, threats against the process — federal crimes, with civil penalties under §1034.

CORE IDEAS

The story. When the earthquake and fire of April 1906 leveled San Francisco's business district, the insurance industry faced the largest claim bill in its history — and split in two. Some insurers paid like men keeping a promise: Lloyd's underwriter **Cuthbert Heath**, asked by his San Francisco agent what to do, cabled back the most famous instruction in insurance history — pay all policyholders in full, irrespective of policy terms — and the handful of companies that paid dollar for dollar wore the fact like a medal for fifty years. Others earned a different name. The "six-bit companies" offered burned-out merchants seventy-five cents on the dollar, take it or sue; some insisted the earthquake, not the fire, had destroyed each building — a defense aimed at the fire policy's exclusion — and a few foreign insurers simply went home. The lesson San Francisco taught the country is the premise of this lesson: a policy is only as good as the claim practice behind it, and an insurer that sells a promise and then grinds the promisee needs a law aimed specifically at the grinding.

How they figured it out. The grinding got its statute in stages. The states' unfair trade practices acts of the late 1940s aimed mostly at selling; claims abuse was handled complaint by complaint. In the early 1970s the NAIC added **unfair claims settlement practices** to its models — eventually a model act of their own — and the states enacted the familiar list: misrepresenting policy provisions or the facts at issue; failing to acknowledge and act promptly on claim communications; failing to adopt reasonable standards for prompt investigation; refusing to pay without a reasonable investigation; failing to affirm or deny within a reasonable time after proof of loss; offering so little that claimants are forced to litigate to recover what they are owed; attempting to settle for less than a reasonable person reading the insurer's own advertising would expect; delaying by demanding the same information again and again; and failing to explain, on request, the policy basis for a denial. Notice what

the list is: not one hard bargain, but the *methods* of grinding — each one a pattern the department can prove from files.

The big idea. Two features make this statute different from everything else in the unit, and both are tested. First, its target: the act regulates **insurers** (and those handling claims for them) — it is market-conduct law, the standard a claims department must meet, and the producer's role is sentinel: you will see mishandled claims before any regulator does, and your client's complaint to the department is often the remedy. Second, its test: most listed practices are violations only when committed *knowingly* or *so frequently as to indicate a general business practice*. One disputed claim, even one wrongly denied, is a contract fight for the courts; a drawer full of identical delays is a regulatory case. Remember what the department can and cannot do with it: it can investigate, examine, fine and order practices stopped — it cannot award your client damages. In most states the act creates no private right to sue; the client's lawsuit, where one lies, sounds in contract or in the common law of bad faith.

The clocks of a claim follow one rhythm everywhere, with each state setting the numbers — learn the rhythm, flag the numbers. A claim communication arrives: the insurer must **acknowledge** it promptly, commonly within 10 to 15 working days in this example range, and furnish the necessary forms. Investigation must begin on reasonable standards — commonly initiated within 15 working days in this example. The claimant files **proof of loss**; the insurer must then affirm or deny within a reasonable time — commonly 30 to 45 days in this example range, with written status updates if it genuinely needs longer. What is owed must be paid promptly, and where part of a claim is undisputed, the common pattern requires paying the undisputed part rather than holding it hostage to the argument. A denial must state its policy basis in writing on request. Every day-count in this paragraph varies by state; the pattern — acknowledge, investigate, decide, pay, explain — does not.

The privacy layer exists because claims and underwriting run on the most personal information a business can hold. The **Gramm-Leach-Bliley Act** (1999) requires insurers, like all financial institutions, to deliver privacy notices — at the start of the relationship and commonly annually — describing what nonpublic personal information they collect and share, and to give customers the chance to **opt out** of sharing with nonaffiliated third parties. The **Fair Credit Reporting Act** (1970) governs the consumer reports underwriters order: the applicant must be told a

report may be used, and any **adverse action** — a declination, a higher rate — based on one requires notice to the applicant with the reporting agency's name, so the applicant can see and dispute the file. Many states add an insurance information and privacy act on the NAIC pattern, with notice of information practices and reasons for adverse underwriting decisions. For the producer the duty is plain: client information is held for insurance purposes only — gossip, salesmanship to third parties and careless files are all the same violation.

The fraud layer cuts the other way: the same system that must treat honest claimants fairly must catch the dishonest ones, because fraud is paid for by every premium payer. The trade sorts it in two: **hard fraud** — inventing or causing the loss itself, the staged collision, the arson, the faked burglary; and **soft fraud** — padding a real claim, rounding the stolen laptop up to two, shading an application to shrink the premium. Both are crimes; softness is about method, not guilt. The machinery you must know: **fraud warnings** printed on applications and claim forms, putting every signer on notice that knowing falsehood is a crime; state fraud bureaus that take referrals; and **immunity statutes** protecting anyone who reports suspected fraud in good faith from defamation suits — the law wants the report. Above it all, **18 U.S.C. §1033** makes dishonesty inside the business federal — embezzling premiums, false statements in regulatory filings — and **§1034** adds civil penalties and injunctions. The producer's duty when he suspects fraud: do not wink, do not warn the client, report through the insurer's fraud unit or the state bureau — in good faith, with the facts.

On the exam today. Three question shapes carry this lesson. First, the identification set: a scenario — an adjuster who demands the same receipts four times, an offer of a third of repair estimates to "make them sue for the rest," a denial letter citing no policy language — and four practice names; learn the list well enough to name the method. Second, the scope set, where the traps live: the act regulates insurers' claim conduct, not producers' sales conduct; a single hard-fought claim is commonly not a violation without the knowing-or-frequent element; and the department fines and orders — it does not award the claimant damages. Third, the federal layer: GLBA means privacy notices and opt-out of sharing with nonaffiliated third parties; FCRA means notice when consumer reports are used and adverse-action disclosure naming the agency; §1033 means a felony of dishonesty bars insurance work absent written consent. And the fraud pair is free points: staged loss — hard; padded loss — soft; both criminal, and good-faith reporting is immune.

PICTURE STUDY



The Cheat with the Ace of Diamonds, Georges de La Tour, c. 1636–1638 · Oil on canvas · The Louvre, Paris

Image: Wikimedia Commons, public domain

Georges de La Tour, the great candlelight painter of Lorraine, built this scene like a trap: three pairs of sliding eyes — the cheat's, the courtesan's, the servant's — triangulating over the head of one oblivious young man with money on the table. The ace comes out of the sash, not the deck, and only we are shown it. The picture opens this lesson because insurance fraud is a card game with hidden aces played from both sides of the table — the staged loss, the padded claim, and equally the adjuster's drawer of delay — and because the law's answer to every version is the same as the painter's: bring the hidden hand into the light.

Look closely

- Find the ace of diamonds. Where is it kept, and who in the painting knows it exists besides you?
- Trace the three glances — cheat, lady, servant. None of them looks at the cards; what are they reading instead?
- Study the young player on the right: dress, posture, attention. What makes him the mark, and what would it take to warn him?
- Look at the coins on the table — the only thing in the picture that cannot look away. Who will hold them when the hand ends?

Talk about it

1. The cheat's advantage is information the mark cannot see. Which practices in this lesson — on the claimant's side and the insurer's — depend on exactly that advantage?
2. La Tour makes the viewer the only honest witness. Fraud statutes give good-faith reporters immunity so witnesses will speak. Why does the system need the watcher more than the policeman?
3. Proverbs says lying lips are abomination to the LORD, but they that deal truly are his delight. The young gambler will lose money; what does the cheat lose, win or lose, every time he plays?

PROJECT

The Claim File Audit

You will play department examiner. Below you will build a pretend claim file gone wrong, then audit it against the unfair-claims list and the privacy rules, producing the two artifacts for your Law File: a claim-clock timeline and an examiner's findings memo. Pretend family, pretend insurer, pretend dates — the method is the lesson.

You will need

- Two sheets of paper or a two-page document
- Your exam notebook and a ruler
- This lesson's core ideas, with the example day-counts (10 working days acknowledge, 15 begin investigation, 30 after proof of loss to decide)

Steps

1. Invent the claim: the pretend Harmon family's kitchen fire, $18,000 in documented repairs, reported March 3. Write a one-paragraph cover sheet.
2. Build the misconduct: write a dated log of eight insurer actions that violate the lesson — a first response in May, two duplicate document demands, a $6,000 take-it-or-sue offer, a denial threat citing no policy language, a file shared with a marketing firm without notice, and so on.
3. Draw the claim-clock timeline across page one: the example deadlines in one color above the line, the insurer's actual dated actions in another color below it, so every miss is visible as a gap.
4. On page two, write the examiner's findings memo: number each violation, name the listed practice or federal statute it offends, and quote the log line that proves it.
5. End the memo with the remedy paragraph: what the department can do (fines, orders, examination) and what it cannot (award the Harmons damages) — and what the Harmons' own remedies are.
6. Add the sentinel line: one sentence on what an honest producer servicing the Harmons should have done, and when.

7. Date both pages and clip them into your Law File.

EXAM NOTEBOOK

1. Make flashcards for the listed claims practices — one card each, scenario on the front, practice name on the back — plus cards for GLBA, FCRA, hard/soft fraud and §1033.
2. Draw the claim rhythm as a four-beat bar: ACKNOWLEDGE → INVESTIGATE → DECIDE → PAY/EXPLAIN, with blank day-boxes over each beat labeled MY STATE.
3. Write a five-line trap list titled “Who this law binds,” ending with: it binds insurers' claim conduct; the department fines — it never awards damages.

> **From history.** Fraud got its own machinery late. Most state insurance fraud bureaus — investigators with law-enforcement powers inside the department — date only to the late 1980s and 1990s, and the Coalition Against Insurance Fraud, which unites insurers, consumer groups and regulators, was founded in 1993. The federal layer is younger still: 18 U.S.C. §§1033–1034 arrived in the Violent Crime Control and Law Enforcement Act of 1994, after congressional hearings on looted insurers showed dishonesty inside the business could be as costly as any staged loss outside it.

Example 1. Exam style. An insurer's claims unit, as a matter of routine, offers homeowners 40% of documented repair costs and raises the offer only when a lawyer appears. Which listed practice fits best?

A. Misrepresenting pertinent policy provisions

B. Compelling litigation by offering substantially less than amounts ultimately recovered

C. Failing to acknowledge claims promptly

D. Unfair discrimination between classes

Show solution

1. Name the method: systematically low offers that move only under threat of suit.
2. That is the compelling-litigation practice — offers so far below what claimants ultimately recover that suing becomes the only path to full payment.
3. A would require false statements about coverage; C is about response time, not amounts; D belongs to rating law, not claims.
4. Note the aggravator: “as a matter of routine” is the general-business-practice element that makes this a regulatory case, not one hard bargain.

Answer: B. Routine lowball offers that force claimants to litigate are the listed practice; the routine is what makes it a general business practice.

Example 2. In this example state, insurers must acknowledge claims within 10 working days, begin investigation within 15 working days, and affirm or deny within 30 days of proof of loss. A fire claim is reported Monday, June 1; proof of loss is filed July 1; the insurer first responds August 15 with a request for documents already provided twice. Count the failures.

Show solution

1. Acknowledgment clock: due within 10 working days of June 1 — mid-June in this example. First response came August 15: failure one.
2. Investigation clock: reasonable standards require starting by mid-June in this example; nothing happened for ten weeks: failure two.
3. Decision clock: affirm or deny due within 30 days of the July 1 proof of loss — about July 31; no decision by August 15: failure three.
4. The August 15 letter demands documents already provided twice — the repeated-paperwork delay practice: failure four.
5. Flag the numbers: 10, 15 and 30 are example figures; the pattern of four failures is what a department would act on if the files show it is how this insurer does business.

Answer: Four: late acknowledgment, no timely investigation, no decision within the proof-of-loss clock, and delay by duplicative document demands — a textbook unfair-claims file under this example state's day-counts.

Example 3. An underwriter declines Maria's auto application because of a consumer report showing poor credit, and the insurer shares her application file with a marketing partner. Maria got no notices of any kind. Walk the federal violations.

Show solution

1. FCRA first: using a consumer report required telling Maria one might be used, and the declination is adverse action — she must receive notice of it, with the name and contact of the reporting agency so she can obtain and dispute her file. Silence violated both.
2. GLBA second: sharing nonpublic personal information with a nonaffiliated third party required a privacy notice and a chance to opt out before the sharing. She received neither.
3. Sort the remedies: these are federal statutes enforced by federal and state authorities; the state's own insurance information act, where enacted, commonly adds notice of the specific reasons for an adverse underwriting decision.
4. Note the producer's corollary: client files are held for insurance purposes only — the marketing hand-off is exactly what the opt-out exists to let Maria refuse.

Answer: An FCRA violation (no notice of report use and no adverse-action disclosure naming the agency) plus a GLBA violation (sharing with a nonaffiliate without privacy notice and opt-out) — two federal layers over whatever the state's own privacy act adds.

PRACTICE

1. Easy Name four unfair claims settlement practices from the common list.

Show answer

Any four: misrepresenting policy provisions or facts; failing to acknowledge claims promptly; failing to investigate on reasonable standards; refusing to pay without reasonable investigation; failing to affirm or deny within a reasonable time after proof of loss; lowball offers compelling litigation; repeated demands for the same paperwork; failing to explain a denial's policy basis.

2. Easy What is the difference between hard fraud and soft fraud? Give one example of each.

Show answer

Hard fraud invents or causes the loss — a staged collision or arson. Soft fraud pads a real claim or shades an application — claiming two stolen laptops when one was taken. Both are crimes.

3. Easy What statement must commonly appear on applications and claim forms, and what does it accomplish?

Show answer

A fraud warning — notice that knowingly false statements are a crime and may void coverage. It puts every signer on notice and strips the later excuse of ignorance.

4. Medium A claims adjuster writes to a claimant that her policy "excludes water damage of every kind," which is false — the policy excludes only flood. Which practice, and does it matter that only one claimant received the letter?

Show answer

Misrepresenting pertinent policy provisions. One letter can still be actionable if knowing, and a drawer of such letters shows a general business practice — the statute's frequency test — but even one knowing misrepresentation is the listed conduct.

5. Medium Which of the following does GLBA require of an insurer?

A. Approval of its rates by a federal agency

B. Privacy notices and a chance to opt out of sharing nonpublic personal information with nonaffiliated third parties

C. A fraud bureau in every state where it is admitted

D. Payment of all claims within 30 days

Show answer

B. Gramm-Leach-Bliley is the privacy-notice and opt-out law. Rates remain state business (A), fraud bureaus are state machinery (C), and claim clocks are state numbers, not a GLBA rule (D).

6. Medium An insurer declines an applicant partly because of a consumer report. List the FCRA duties that follow.

Show answer

The applicant must have been told a consumer report might be used, and the adverse action requires notice to the applicant including the reporting agency's name and contact, so the applicant can obtain the report and dispute errors.

7. Medium A producer suspects his own client staged a burglary. He says nothing, reasoning that loyalty runs to the client. Assess his duty.

Show answer

Wrong loyalty. The producer should report the suspicion in good faith — through the insurer's fraud unit or the state fraud bureau — and good-faith reporting statutes immunize him. Silence makes him part of the fraud every honest premium payer funds.

8. Hard Why does the unfair claims act mostly punish patterns — "knowingly or as a general business practice" — rather than single claim disputes? Answer in three sentences.

Show answer

A single dispute may be an honest disagreement about coverage or value, and courts of contract exist to resolve it. Regulation aims at the method of doing business — files that show routine delay, routine lowballing, routine misstatement — which no single lawsuit can see or fix. The pattern test keeps the department out of every quarrel while arming it against the grinder.

9. Hard A claimant asks the department to order her insurer to pay her $40,000 fire claim plus damages for the stress of delay. What can the department actually do?

Show answer

Investigate, demand the insurer's response, fine violations, order practices stopped and examine the company — but not award her the claim or damages. In most states the act gives no private right to sue; her money remedies are the contract claim and, where recognized, common-law bad faith in court.

10. Hard From the story: what did Cuthbert Heath's 1906 cable say in substance, and what did the “six-bit companies” do instead? What does the contrast teach about why claims law exists?

Show answer

Heath cabled his San Francisco agent to pay all Lloyd's policyholders in full, irrespective of policy terms; the six-bit companies offered seventy-five cents on the dollar or a lawsuit, some hiding behind the earthquake-versus-fire question. The contrast shows the promise is tested only at the claim — so the law regulates claim conduct itself, not just the selling of the promise.

11. Challenge 18 U.S.C. §1033 appears twice in this unit — as a licensing bar in Lesson 9.2 and as a criminal statute here. Write three sentences connecting its two faces.

Show answer

As a crime, §1033 reaches dishonesty inside the business of insurance — embezzling premiums or funds, false statements in regulatory filings — with §1034 adding civil penalties. As a bar, it forbids anyone convicted of a felony involving dishonesty or breach of trust from working in insurance without a regulator's written consent. The two faces are one policy: the business runs on other people's money and sworn paper, so dishonesty is both punished inside it and kept outside its doors.

12. Challenge A friend shrugs: “Padding a claim a little just gets back the premiums you paid — insurance companies build it in anyway.” Write a three-sentence answer using soft fraud, who pays, and the fraud-warning signature.

Show answer

Padding is soft fraud — a crime, not a rebate of premiums, and the signature under the fraud warning makes the lie knowing. Insurers do price expected fraud into premiums, which means the padding is collected from every honest family's premium, not from the company. Getting your premiums “back” by fraud is taking your neighbors' money with a pen instead of a crowbar.

COMMON MISTAKES

- Forgetting the pattern element: most unfair claims practices require knowing conduct or a general business practice — one hard-fought claim is commonly a contract dispute, not a violation.

- Thinking the department can award the claimant money — it fines, orders and examines; damages come from courts, and most states give no private right to sue under the act.
- Applying the claims act to producers' sales conduct — it governs insurers' and claim handlers' treatment of claims; selling sins live in Lesson 9.3's act.
- Treating soft fraud as not really fraud — padding a real claim is a crime, and the application and claim-form fraud warnings make the falsehood knowing.
- Confusing the federal layers: GLBA is privacy notices and opt-out of sharing; FCRA is consumer-report notice and adverse-action disclosure — swap them and the question is lost.
- Memorizing the example day-counts as law — acknowledgment, investigation and decision clocks are state numbers; learn the rhythm here and your own state's figures from its code.

Make it a game · Examiner's Desk. Deal a pretend claim file: a parent invents a two-sentence claim story, then reads five dated insurer actions one at a time — some proper (acknowledged in a week, paid the undisputed part), some violations (fourth request for the same receipts, 40% offer, denial citing nothing). After each action you have ten seconds to stamp it CLEAN or name the listed practice it violates. One point per correct stamp; a wrong CLEAN on a violation costs two. After five actions, give your one-sentence examiner's finding: pattern or no pattern? Swap roles each file; three files wins the desk.

Scripture. “Lying lips are abomination to the LORD: but they that deal truly are his delight.” (Proverbs 12:22, KJV)

The verse cuts both ways down this lesson: the padded claim and the lowball letter are the same lying lips in different mouths. Dealing truly — the insurer paying what the promise says, the claimant claiming what the loss was — is not merely compliance; the proverb calls it God's delight.

9.5 Suitability and Best Interest: Selling What the Client Needs

OBJECTIVES

- List the suitability information a producer must gather before recommending an annuity or life product.
- State the four obligations of the NAIC best-interest standard — care, disclosure, conflict of interest, and documentation — and apply them to a sale.
- Explain what best interest does and does not require, including why it does not demand the single lowest-cost product.
- Describe the senior-designation rules barring misleading “senior specialist” titles, and the producer-training requirements for annuity sales.
- Connect replacement duties and disclosure of role and compensation to the suitability framework, and state when a securities registration is also required.

> **Warm-up.** In five minutes, write the questions a good doctor asks before prescribing anything — age, symptoms, history, other medicines, allergies. Then cross out “doctor” and write “insurance producer,” and beside each medical question write its money twin (age stays; symptoms become goals; other medicines become existing policies…). Keep the sheet — it is the suitability profile, and you just invented it.

WATCH

Life Insurance Exam [National] 65 – Annuity Suitability Requirements Explained

Open Exam Prep · 3:44

https://www.youtube.com/watch?v=P7UgYZBrInk

> **WHEN TO WATCH**
> Watch after the big idea and list every suitability fact the video names; check your list against the lesson's twelve and star any you missed.

BACKUP VIDEO

Are You Compliant with New NAIC Annuity Suitability and Best Interest Standards? | SLA

Gordon Marketing · 7:24

https://www.youtube.com/watch?v=okTsWUuR94k

A working-agent compliance walkthrough of the same standard; watch it after the project to hear the four obligations discussed as daily practice rather than exam lines.

KEY TERMS

suitability

The requirement that a recommendation reasonably fit the consumer's financial situation, needs and objectives, based on information the producer must actually gather.

suitability information

The facts gathered before a recommendation — commonly age, income, financial situation and needs, objectives, intended use, time horizon, liquidity needs, liquid net worth, risk tolerance, tax status, and existing policies including any replacement.

best interest standard

The NAIC annuity model's 2020 standard: act in the consumer's best interest under the circumstances known at the time, without placing the producer's financial interest ahead of the consumer's.

care obligation

The duty to know the product and the consumer and to have a reasonable basis that the recommendation effectively addresses the consumer's situation and needs.

disclosure obligation

The duty to tell the consumer, in writing, the producer's role in the transaction, how he is compensated in kind, and the products and insurers he can actually offer.

conflict-of-interest obligation

The duty to identify and avoid or reasonably manage conflicts — incentives that would place the producer's interest ahead of the consumer's, such as sales contests tied to one product.

documentation obligation

The duty to make and keep a written record of the basis for the recommendation — the file that proves, years later, why this product fit this client.

senior-specific designation rules

The NAIC model (2008) barring use of certifications or titles that falsely imply special training in advising seniors — no weekend-course "senior expert" badges.

producer annuity training

The common requirement of a one-time annuity course — commonly four hours — plus insurer-provided product-specific training before selling annuities.

replacement duties

The notice, comparison and free-look requirements when a recommendation would replace existing coverage — suitability's hardest test, since replacement costs must be justified.

safe harbor

The model's provision that sales made under comparable securities rules — such as a registered representative's best-interest obligations — satisfy the insurance standard.

CORE IDEAS

The story. Through the mid-2000s a new invitation filled American mailboxes: a free steak dinner hosted by a "retirement specialist," no sales pitch promised. In September 2007, regulators published the results of a year of coordinated examinations of these **free-lunch seminars** — 110 firms examined by the SEC, state securities regulators and FINRA — and the findings were grim: every seminar examined was in fact a sales event; half used misleading advertising; nearly a

quarter featured unsuitable recommendations — often annuities sold to elderly people whose money would be locked behind surrender charges longer than their life expectancy. Many presenters wore invented credentials, “senior adviser” titles earned in a weekend. The regulators' answer came in layers you will now learn: the NAIC's senior-designation model (2008) banned the fake titles; its annuity-suitability model (2010) forced producers to gather real facts before recommending; and in 2020 the model was rewritten around a stronger phrase — the producer must act in the consumer's **best interest**.

How they figured it out. The regulators' problem was older than the steak dinners: how do you police a recommendation? A lie is easy to punish — Lesson 9.3's act already did. But a true statement about the wrong product — a 15-year surrender-charge annuity, honestly described, sold to an 83-year-old needing her savings liquid — defeats a fraud statute. The answer, borrowed from securities law and sharpened across three versions of the NAIC's **Suitability in Annuity Transactions Model Regulation** (2003 for seniors, 2006 for everyone, 2010 with teeth), was to regulate the *process*: define the facts a producer must gather, require a reasonable basis connecting facts to recommendation, make insurers supervise the system, and require training before anyone sells. The 2020 revision raised the standard to **best interest** — four enforceable obligations: care, disclosure, conflict of interest, documentation — aligned with the securities world's own best-interest rule. By 2026 more than forty states have adopted it, each on its own effective date: the pattern national, the enactments state by state, as always.

The big idea. The standard begins with facts, because no one can serve an interest he never learned. Before recommending an annuity — and, in the common pattern, any significant life product — the producer must make reasonable efforts to gather the **suitability information**: age; annual income; financial situation and needs, including the source of the money being used; financial objectives and the intended use of this product; time horizon; existing assets and insurance, including any policy this sale would replace; liquidity needs; liquid net worth; risk tolerance; and tax status. Say the list until it is boring, then notice what it is: a portrait of a household, the portrait Units 3 through 8 taught you to read. A recommendation then needs a *reasonable basis* — reasoning from portrait to product that a stranger could follow. A consumer may refuse to provide information, or insist on a product against advice;

the common pattern lets the sale proceed on a signed acknowledgment — but a producer cannot invent the portrait, and an insurer must supervise the whole flow.

The 2020 model's four obligations give best interest its working parts, and the exam asks them by name. **Care**: know the product (its charges, surrender schedule, features) and the consumer (the portrait above), and have a reasonable basis to believe the recommendation *effectively addresses* the consumer's situation — including, for annuities, that the consumer benefits from the annuity's actual features, not merely tolerates them. **Disclosure**: tell the consumer in writing your role, the scope of what you can sell (how many insurers, which products), and how you are compensated in kind — commission, fee or both — with more detail on request. **Conflict of interest**: identify and avoid or manage incentives that would place your interest first; the model flatly excludes contests, quotas and bonuses tied to selling *particular* products within a limited period. **Documentation**: write down the basis for the recommendation and keep it. Memorize the summary: the producer must not place his financial interest ahead of the consumer's — and the file must show he did not.

Mark the standard's edges, because the exam tests what best interest is *not*. It is not a guarantee of results: a recommendation is judged by the circumstances known when made. It is not a duty to find the one cheapest product in America: the producer recommends from the products he can actually offer, having disclosed that scope — a captive agent's best interest operates inside his shelf, honestly labeled. It is not perpetual monitoring: the duty attaches to the recommendation unless more is agreed. And it does not erase the client's freedom: an informed consumer can still choose otherwise, documented. What it does kill is the old excuse that a product was "suitable enough": when two products on the shelf both fit, and one pays the producer more while serving the client worse, suitability might have shrugged — best interest does not. One more edge: anything whose value rides on securities requires securities registration besides the insurance license, with the model's **safe harbor** recognizing sales properly made under those comparable rules — the Series 65 course across the hall is that world's door.

Around the core standard stand three guard rails. **Senior-designation rules** (the NAIC model of 2008): no certifications or professional titles that falsely imply special expertise in advising seniors — the weekend "senior specialist" badge is itself a violation, whatever is sold. **Training**: before selling annuities, the common pattern

requires a one-time annuity-suitability course — commonly four hours — plus product-specific training from each insurer whose annuity you sell; the insurer must verify it. **Replacement duties**, revisited from Unit 4 with sharper teeth: a replacement must be justified against what the client gives up — new surrender schedule, new contestability period, lost benefits, the exchange's tax treatment — with notices, comparisons and free-look rights delivered; regulators read replacement files first, because that is where bad selling hides. Beneath all three, one habit honesty always required: when a client asks how you are paid, answer plainly.

On the exam today. Expect the four obligations by name and a scenario asking which was breached: no written basis (documentation); a contest trip steering the sale (conflict); never asked about liquidity (care); dodged the how-are-you-paid question (disclosure). Expect the suitability-information list tested by omission: which fact was *not* gathered — tax status and liquid net worth are the commonly forgotten pair. Expect the edge questions: best interest does not require the lowest-cost product in existence, does not guarantee performance, and does not forbid commissions — it forbids placing your financial interest ahead of the client's. Expect the senior set: an 80-year-old, a long surrender schedule, a “certified senior consultant” title — name both violations. And the crossover fact: an indexed annuity commonly needs no securities registration; a *variable* annuity does, with the safe harbor for sales under the comparable securities standard.

PICTURE STUDY



Shepherdess with her Flock, Jean-François Millet, c. 1863 · Oil on canvas · Musée d'Orsay, Paris

Image: Wikimedia Commons, public domain

Jean-François Millet spent his life painting the peasants of the plain of Chailly with a gravity other painters saved for kings, and this shepherdess — exhibited at the Salon of 1864 to enormous acclaim — is his quietest sermon. She is not driving the flock or performing her watchfulness; she stands where she can see them all, hands busy with knitting, present for the one moment in a hundred when a sheep will need her. The picture closes this unit because that is the posture the best-interest standard writes into law: the professional stationed between a flock and its dangers, attending to others' needs as a plain, daily duty — and because Scripture's oldest word for such a person is shepherd.

Look closely

- Study her posture: head bowed, hands working, feet planted where the whole flock is in view. How does Millet show watchfulness without alarm?
- Follow the flock's long diagonal back toward the horizon. How many sheep can she actually see from where she stands — and how did she choose the spot?
- Find the dog at its post beside the flock. What does the shepherdess delegate, and what can she never delegate?

- Notice the breaking light on the plain. The day is almost over and she is still there. What does the hour add to the picture's meaning?

Talk about it

1. The shepherdess profits from the flock — wool, milk, her living — yet no one doubts whose good she serves at dusk on that plain. How can a commissioned producer earn the same presumption?
2. Her knitting is small faithful work done while watching. Which of the four best-interest obligations is the knitting, and which is the watching?
3. Scripture says to look not every man on his own things, but every man also on the things of others — and calls the Lord himself a shepherd. What does it change in a career when the seller starts to think of clients as a flock in his keeping rather than a market to be harvested?

PROJECT

The Suitability Worksheet and the Ethics Commitment

Two final artifacts complete your Law File. First, a working suitability worksheet — the fact-gathering form you would actually use across a kitchen table — tested on two pretend families. Second, one page in your own hand: the ethics commitments you will keep when you hold the license, signed and dated, written before anyone pays you to believe otherwise.

You will need

- Three sheets of paper or a three-page document
- Your exam notebook
- This lesson's suitability-information list and the four obligations

Steps

1. Build the worksheet on page one: the twelve suitability facts as labeled blanks (age; income; financial situation and needs; source of funds; objectives; intended use; time horizon; existing insurance and assets; replacement? ; liquidity needs; liquid net worth; risk tolerance; tax status), then a RECOMMENDATION box and under it the sentence stem “This effectively addresses the client's situation because...” with four ruled lines.
2. Add the four-obligations footer as checkboxes: CARE — basis written; DISCLOSURE — role, scope and compensation stated in writing; CONFLICT — no contest, quota or incentive steering this; DOCUMENTATION — this sheet filed.
3. Test it on pretend family one: the Okafors, both 34, two children, $68,000 income, $9,000 savings, no life insurance, goal: protect income to age 60. Complete the worksheet and write the reasonable basis for a simple recommendation (Unit 3's term insurance will serve you here).
4. Test it on pretend family two: Mrs. Alvarez, 79, widowed, $150,000 in savings, $2,100 monthly from Social Security and a small pension, wants “something safe” and may need assisted-living money within a decade. Complete the worksheet — then write the basis for what you would NOT recommend and why, naming surrender schedules and liquidity.

5. On page three, write your ethics commitment: five first-person sentences — what you will always gather, always disclose, never let steer you, always document, and the question you will answer plainly when asked. Sign and date it.
6. Clip all three pages into your Law File as its closing section.

EXAM NOTEBOOK

1. Make flashcards for the four obligations — one scenario per card on the front, the obligation breached on the back — plus a card listing all twelve suitability facts from memory.
2. Draw the two-shelf diagram: a captive agent's shelf and an independent's shelf, with the caption “Best interest works within the disclosed shelf — the disclosure is what makes the shelf honest.”
3. Write a five-line trap list titled “What best interest is NOT,” ending with: not the cheapest product on earth — the client's interest first, from the shelf you honestly disclosed.

> **From history.** The phrase “best interest” traveled a long road between regulators. The securities world adopted its own best-interest rule for brokers in 2019; the NAIC's 2020 annuity revision deliberately matched its vocabulary so one retirement sale would face one standard whichever regulator looked. Adoption then ran state by state, as insurance law always has — Iowa and Arizona among the first in 2020, the count passing forty states within five years — a living specimen of the model-act system this unit has taught, moving at fifty speeds toward one rule.

Example 1. Exam style. A producer recommends a deferred annuity with a 12-year surrender schedule to an 82-year-old widow whose savings, apart from this $90,000, total $6,000, and who says she may need money for assisted living within five years. The product is honestly described and she signs everything. Which obligation is breached?

A. Disclosure

B. Documentation

C. Care

D. None — honest description plus signatures satisfies the standard

Show solution

1. Build her portrait from the suitability information: age 82, nearly all liquid savings in this purchase, stated five-year liquidity need against a 12-year surrender schedule.
2. Apply the care obligation: the recommendation must effectively address her situation and needs; locking essential funds past her own stated horizon fails any reasonable basis.
3. Rule out A and B: disclosure and a documented file describe and record the sale — they cannot make an unfit product fit.
4. Rule out D: that is the old excuse the best-interest revision exists to kill. Honesty about the wrong product is still the wrong product.

Answer: C. The care obligation is breached — no reasonable basis connects a 12-year surrender product to an 82-year-old's five-year liquidity need. Signatures and honest description do not cure unfitness.

Example 2. An insurer announces a contest: producers who sell 15 of its new indexed annuity by June 30 win a resort week. Producer Ray, two sales short in late June, steers two undecided clients to that product. Analyze under the four obligations, and say what the model says about such contests.

Show solution

1. Name the pressure: a time-limited incentive tied to a particular product — exactly the conflict the model's conflict-of-interest obligation targets, and the model excludes such contests and quotas from permissible compensation design.
2. Test care: Ray's basis for these two recommendations is the calendar, not the clients' portraits — if the product does not best address their needs among what he offers, care fails too.
3. Test disclosure: cash compensation may have been disclosed, but the contest steering is precisely the interest placed ahead of the consumer's.
4. Assign the duties: the insurer designed an excluded incentive and must supervise recommendations; Ray owns his two files and whatever his documentation claims the basis was.

Answer: The contest itself violates the model's conflict rules — sales contests tied to particular products within a limited time are excluded — and Ray's steering breaches the conflict obligation and likely care. Both insurer and producer answer for it; the resort week is the textbook interest placed ahead of the client's.

Example 3. Exam style. A client asks producer Lena, “Straight answer — what do you get if I buy this?” Lena replies, “The company takes care of me; it doesn't cost you anything extra.” In this example her commission is 6% of the $50,000 premium. Evaluate the reply and compute the figure she avoided saying.

Show solution

1. Compute what the question asked: $0.06 \times \$50{,}000 = \$3{,}000$ in this example.
2. Test against the disclosure obligation: the consumer is owed a plain description of how the producer is compensated — and a direct question deserves a direct answer; evasion is the breach.
3. Note the half-truth's other edge: “costs you nothing extra” obscures that commissions are priced inside the product — a misleading impression bordering on Lesson 9.3's misrepresentation.
4. State the honest script: “I'm paid a commission by the insurer — on this policy, about $3,000. Ask me anything about how that works.”

Answer: Lena breached the disclosure obligation: asked directly, she owed the plain answer — a commission from the insurer, about $3,000 in this example. Compensation is lawful; hiding it from a direct question is not.

PRACTICE

1. Easy Name eight of the twelve suitability facts a producer gathers before an annuity recommendation.

   Show answer

   Any eight: age; annual income; financial situation and needs; source of funds; financial objectives; intended use of the product; time horizon; existing assets and insurance, including any replacement; liquidity needs; liquid net worth; risk tolerance; tax status.

2. Easy Name the four obligations of the NAIC best-interest standard.

   Show answer

   Care, disclosure, conflict of interest and documentation — together requiring that the producer not place his financial interest ahead of the consumer's.

3. Easy May a producer call himself a “Certified Senior Insurance Specialist” on the strength of a weekend seminar?

Show answer

No. Senior-specific designation rules bar certifications and titles that falsely imply special expertise in advising seniors; the title itself is the violation.

4. Medium A producer gathers every suitability fact, recommends well, and the client buys — but the producer writes nothing down. Years later the client's family complains. Which obligation failed, and why does it matter so much?

Show answer

Documentation. The written basis is the proof that care was taken when it was taken; without the file, a sound recommendation and a steered one look identical, and the producer has kept no defense.

5. Medium Which of the following does the best-interest standard require?

A. Recommending the lowest-cost product sold anywhere in the state
B. Guaranteeing the product performs as illustrated
C. Not placing the producer's financial interest ahead of the consumer's
D. Refusing all commission compensation

Show answer

C. That sentence is the standard. It does not require the universe's cheapest product (the shelf is disclosed), cannot guarantee performance, and commissions remain lawful when disclosed and not steering.

6. Medium Before selling her first annuity, what training does the common pattern require of a producer, and who verifies it?

Show answer

A one-time annuity-suitability course — commonly four hours — plus product-specific training for each insurer's annuity she sells; the insurer must verify the training before accepting her business. Hours and details are state-set.

7. Medium A client refuses to disclose her income and net worth but insists on buying the annuity. What does the common pattern allow, and what may the producer still not do?

Show answer

The sale may commonly proceed on the consumer's signed acknowledgment that she declined to provide information or is acting against the recommendation. The producer still may not invent a portrait, present the sale as recommended, or skip the disclosures and documentation.

8. Hard Why does a replacement recommendation face the hardest suitability test? Name four costs the file must justify.

Show answer

Because the client pays twice to change horses: a new surrender-charge schedule, a fresh contestability period, possible lost benefits or guarantees from the old contract, and transaction or tax consequences of the exchange. The documented basis must show the new product's advantages outweigh those concrete losses — which is why examiners read replacement files first.

9. Hard An indexed annuity and a variable annuity sit side by side. Which licenses does each sale require under the common pattern, and what is the model's safe harbor?

Show answer

The indexed annuity commonly requires the insurance license (with annuity training); the variable annuity requires the insurance license plus securities registration, since its value rides on securities. The safe harbor recognizes sales made under comparable securities best-interest rules as satisfying the insurance standard — one sale, one duty, either doorway.

10. Hard From the story: what did the 2007 joint examinations of free-lunch seminars find, and name the two NAIC models that answered.

Show answer

Of 110 firms examined by the SEC, state regulators and FINRA, all seminars were actually sales events, about half used misleading advertising, nearly a quarter involved unsuitable recommendations — often long-surrender annuities sold to the elderly — and many presenters wore invented senior credentials. The senior-designation model (2008) banned the fake titles, and the annuity-suitability model (2010, revised to best interest in 2020) regulated the recommendation itself.

11. Challenge A captive producer can offer only her one insurer's products, and its term policy is decent but pricier than a rival's. A client asks for term insurance. Walk what best interest requires of her — and what it does not — in three sentences.

Show answer

She must disclose her scope — one insurer's shelf — and her compensation, gather the client's portrait, and recommend from her shelf only what effectively addresses his need, documented. She is not obligated to sell the rival's product or to end the conversation; the disclosed shelf is the honest boundary of her duty. What she may never do is imply she searched the whole market, or let the shelf's limits go unsaid while trust assumes otherwise.

12. **Challenge** Write the capstone paragraph of your Law File in three or four sentences: how the commissioner (9.1), the license lifecycle (9.2), the trade-practice bans (9.3), the claims and fraud rules (9.4) and the best-interest standard (9.5) form one system — and what Philippians 2:4 adds that none of them can.

Show answer

One officer holds the gate (the commissioner), the license and its maintenance prove continuing fitness to stand inside it, and the trade-practice and claims acts fence out the lies that corrupt selling and settling. Best interest completes the arc by regulating the one thing the others cannot see: whether the recommendation itself served the client. But every statute works by inspection after the fact; Philippians 2:4 — look also on the things of others — governs the moment no examiner witnesses, the kitchen-table moment where the sale is actually made. Law builds the cage; love of neighbor is why the bird sings inside it.

COMMON MISTAKES

- Treating best interest as “find the cheapest product in America” — the duty operates within the producer's disclosed scope of products and insurers.
- Forgetting the four obligations are separately enforceable: a well-chosen product with no written basis still breaches documentation.
- Assuming honest description plus signatures cures unfitness — the care obligation judges the fit of product to portrait, not the politeness of the sale.
- Missing the excluded incentives: sales contests and quotas tied to particular products within a limited time are out, even though ordinary commissions remain lawful.
- Confusing suitability's survival with its replacement — the 2020 revision kept the fact-gathering and added the best-interest obligations; both can be tested.
- Forgetting the securities line: variable products require securities registration besides the insurance license, with a safe harbor for sales under comparable securities rules.

Make it a game · Which Obligation?. Write twelve slips, three per obligation: a producer who never asked about liquidity, a contest trip steering a sale, a dodged how-are-you-paid question, an empty client file, a known-nothing recommendation of an unfamiliar product, an undisclosed one-company shelf, and so on. A parent reads each slip; you have eight seconds to call CARE, DISCLOSURE, CONFLICT or DOCUMENTATION, then say the fix in one sentence. One point per correct call, bonus for the fix. Then play the lightning round: the reader names any suitability fact and you give the question that gathers it at a kitchen table, politely, in your own words. Best of twelve plus lightning wins.

Scripture. “Look not every man on his own things, but every man also on the things of others.” (Philippians 2:4, KJV)

Paul's sentence is the best-interest standard written thirty years after the Resurrection — with one difference. The regulation forbids placing your interest ahead of the client's; the apostle commands actually looking on the client's things, making their protection your business. A career built on that verse will never need to fear the file review.

UNIT 9

The Law of the License

Every policy you have studied — the whole-life contract, the homeowners form, the auto policy, the annuity — lives inside a cage of law, and this unit walks the cage. You will meet the **commissioner of insurance**, the state officer who licenses you, examines insurers, hears complaints and can take your license away, and you will learn where his power came from: Elizur Wright forcing honest reserves on Massachusetts in 1858, and the McCarran-Ferguson Act of 1945 confirming that insurance regulation belongs to the states. You will walk the whole life of a license — application, lines of authority, appointment by an insurer, renewal, continuing education, the thirty-day reporting duties — and then the law's list of sins: **twisting**, **churning**, **rebating**, unfair discrimination, false advertising and the unfair claims practices that regulators punish as patterns of business.

One warning governs everything here. Licensing law is state law, written state by state on the pattern of the NAIC's model acts, so this unit teaches the *common pattern* — the rules most states share and the numbers most states use — and flags every figure that varies. When a lesson says a temporary license "commonly" runs 180 days or continuing education is "commonly" 24 hours per two-year term, your state's number may differ, and the habit this unit builds is the professional's habit: check your own state insurance department before you rely on any number. The unit ends where the law ends and conscience begins — the best-interest standard, and selling what the client actually needs.

PREREQUISITES

- Has completed Units 1–8 and can define the major life, health, property and casualty policy types in one sentence each
- Can read a numbered list of rules and turn it into an outline or chart without losing any item
- Can look up a state insurance department website and record what it says, with the date checked
- Can keep a tidy, dated exam notebook and a growing flashcard box

MASTERY CHECKLIST

- ☐ I can name the commissioner's chief powers — license, examine, investigate, hold hearings, fine, suspend and revoke, issue cease-and-desist orders — and two things he cannot do.
- ☐ I can explain how states came to regulate insurance, naming Paul v. Virginia (1869), South-Eastern Underwriters (1944) and the McCarran-Ferguson Act (1945).
- ☐ I can walk a license through its whole life — application, exam, lines of authority, appointment, renewal with continuing education — flagging which numbers vary by state.
- ☐ I can state the common reporting duties (address changes, criminal prosecutions and other-state actions, commonly within 30 days) and the common temporary-license pattern (up to 180 days).
- ☐ I can define twisting, churning, rebating, defamation, boycott-coercion-intimidation and unfair discrimination, and tell them apart in scenarios.
- ☐ I can list at least five unfair claims settlement practices and explain what “general business practice” adds to the test.
- ☐ I can explain the privacy and fraud layer: Gramm-Leach-Bliley notices, the Fair Credit Reporting Act, hard

versus soft fraud, fraud warnings and 18 U.S.C. §1033.

- ☐ I can state the four best-interest obligations of the NAIC annuity model regulation — care, disclosure, conflict of interest, documentation — and apply them to a sale.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NAIC: Find Your State Insurance Department**: Free, official. The National Association of Insurance Commissioners' directory of all fifty-plus state and territorial departments, with links to each commissioner's site. Use it in Lesson 9.1 to find your own commissioner, and in every lesson after to check your state's actual numbers. Ages 14 and up.
- **NIPR: National Insurance Producer Registry**: Free to browse, official. The portal where real producers apply for, renew and update licenses in most states. Explore the licensing and renewal pages with Lesson 9.2 to see the paperwork of the license lifecycle before you ever file it. Ages 15 and up.
- **NAIC: How to File a Complaint**: Free, official. The regulators' own explanation of the consumer-complaint process — what a department can investigate and what it cannot. Read it with Lessons 9.1 and 9.4 to see the complaint arm from the consumer's side of the counter. Ages 14 and up.
- **Insurance Information Institute**: Free. The industry's consumer-education site, with plain-English articles on policies, claims and buying wisely — the honest selling this unit's laws exist to protect. Browse an article or two with Lessons 9.3 and 9.5. Ages 14 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

9.1 The Commissioner: Powers, Examinations and Penalties 3 sessions of 50 minutes

9.2 Getting and Keeping the License: Renewals, CE and Appointments

3 sessions of 50 minutes

9.3 Unfair Trade Practices: Twisting, Rebating and False Promises

3 sessions of 50 minutes

9.4 Unfair Claims Practices, Privacy and Fraud

3 sessions of 50 minutes

9.5 Suitability and Best Interest: Selling What the Client Needs

3 sessions of 50 minutes

Unit 9 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Pace yourself at about a minute per question — set a timer for 25 minutes and finish inside it, as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says “in this example” or gives day-counts and dollar figures, use the figures given — the live numbers for your own state come from your state insurance department, and on exam day the state-law section will test that state's exact figures. A licensing exam commonly passes at 70% — 14 of 20 here — but aim well above it. Choose the one BEST answer.

1. **5 pts**

   Which of the following is a power of the state insurance commissioner?

   A. Enacting the state's insurance statutes

   B. Examining the market conduct of admitted insurers

   C. Sentencing convicted insurance felons

   D. Awarding damages to wronged policyholders

2. **5 pts**

   A rule issued by the commissioner under authority granted in the insurance code:

   A. Overrides the statute if newer

   B. Is only advisory until the legislature approves it

   C. Has the force of law but may not exceed or contradict the statute

   D. Applies only to insurers, never to producers

3. 5 pts

Before the commissioner suspends a producer's license for cause, the common pattern requires:

A. Written notice of the charges and a hearing, with the order appealable to the courts

B. A criminal conviction

C. Approval by the NAIC

D. A unanimous vote of the legislature

4. 5 pts

The McCarran-Ferguson Act of 1945 provided that:

A. Insurance would be regulated exclusively by a new federal agency

B. Insurance contracts are not interstate commerce

C. The FTC must approve all insurance advertising

D. State regulation of insurance continues, with federal law yielding to the extent states actually regulate

5. 5 pts

A producer licensed in her resident state wants to sell in a neighboring state under the common reciprocity pattern. She must:

A. Pass the neighboring state's licensing exam

B. Hold a good-standing resident license and file a non-resident application with the fee

C. Be appointed by the neighboring state's commissioner

D. Complete that state's pre-licensing course

6. 5 pts

A newly licensed producer immediately sells his neighbor a policy from an insurer that has not appointed him. Under the common pattern he has:

A. Violated the code — a producer must be appointed by each insurer he represents

B. Done nothing wrong, since his license is valid

C. Violated federal law under 18 U.S.C. §1033

D. Converted his license to a temporary license

7. 5 pts

In this example state, CE is 24 hours per two-year term including 3 hours of ethics. A producer with 21 general hours and no ethics hours needs:

A. Nothing — 21 hours rounds up to 24

B. 3 more hours of any subject

C. 3 more hours of ethics

D. To retake the licensing exam

8. 5 pts

Under 18 U.S.C. §1033, a person convicted of a felony involving dishonesty or breach of trust may work in the business of insurance:

A. Never again, under any circumstances

B. After five years automatically

C. Only in a non-selling clerical role

D. Only with the written consent of the insurance regulator

9. 5 pts

A producer persuades a client to surrender an existing whole life policy by falsely claiming its insurer is near insolvency, then sells her a replacement from another company. This is:

A. Lawful replacement

B. Twisting — and the false statement about the insurer is also defamation

C. Churning

D. Rebating

10. 5 pts

Which of the following is rebating under the common pattern?

A. Offering to refund a buyer $200 of the producer's commission if she signs today

B. Giving prospects an $8 calendar printed with the agency's name

C. Explaining a policy's cash value accurately

D. Recommending a cheaper policy that fits the client's need

11. 5 pts

Two 35-year-old nonsmoking women in the same rating class apply for identical policies. The producer quietly arranges a lower premium for one as a personal favor. This is:

A. Lawful classification

B. Twisting

C. Coercion

D. Unfair discrimination — and, if funded from commission, rebating as well

12. 5 pts

Under an unfair trade practices act, penalties are most severe when a violation is:

A. Committed by a new licensee

B. Discovered by a consumer rather than an examiner

C. Committed knowingly, or so frequently as to indicate a general business practice

D. Committed in a small town

13. 5 pts

An insurer routinely offers claimants a small fraction of documented losses and improves offers only when suit is filed. Under the unfair claims settlement practices act this is:

A. Permissible hard bargaining

B. The listed practice of compelling litigation by offering substantially less than amounts ultimately recovered

C. A violation only if a court first awards damages

D. Twisting

14. 5 pts

A policyholder asks her state insurance department to force her insurer to pay her disputed $30,000 claim plus damages. The department can:

A. Investigate, fine violations and order practices corrected — but not award her the claim or damages

B. Enter judgment for $30,000 against the insurer

C. Add punitive damages for bad faith

D. Nothing, since claims are purely private disputes

15. 5 pts

An insurer declines an applicant based partly on a consumer credit report. Under the Fair Credit Reporting Act the applicant is entitled to:

A. A free policy from another insurer

B. The adjuster's internal notes

C. Automatic approval on reapplication

D. Notice of the adverse action including the name of the reporting agency, so she can obtain and dispute her file

16. 5 pts

Exaggerating the value of items taken in a genuine burglary is best described as:

A. Hard fraud

B. A lawful negotiating position

C. Soft fraud — a crime committed by padding a real claim

D. Rebating

17. 5 pts

Under the NAIC best-interest annuity standard, the four obligations of a producer making a recommendation are:

A. Care, disclosure, conflict of interest and documentation

B. Suitability, delivery, underwriting and claims

C. Licensing, appointment, renewal and reporting

D. Guarantee, illustration, replacement and rescission

18. 5 pts

The best-interest standard requires a producer to:

A. Recommend the lowest-priced product available anywhere

B. Refuse commission compensation

C. Monitor every client's finances for life

D. Not place his own financial interest ahead of the consumer's

19. 5 pts

A producer recommends a deferred annuity with a 10-year surrender schedule to a 81-year-old whose only other savings are $4,000 and who expects to need the money within a few years. The product was honestly described and all forms were signed. The producer has:

A. Satisfied the standard, because the description was honest

B. Violated only the documentation obligation

C. Breached the care obligation — no reasonable basis connects this product to her situation and needs

D. Committed defamation

20. 5 pts

A producer wants to add variable annuities to his practice. Under the common pattern he needs:

A. Only his life insurance license

B. His insurance license plus FINRA securities registration

C. A temporary license

D. The commissioner's written consent under §1033

ANSWER KEY

1. B. Examinations — financial and market conduct — are core commissioner powers. Statutes come from the legislature (A), criminal sentences from courts (C), and damages from lawsuits (D), not the department.
2. C. Regulations carry legal force within the statute's boundaries — they fill in detail; they cannot enlarge or contradict the code. A inverts the hierarchy, B understates a rule's force, and D is false: rules bind licensees of every kind.
3. A. Due process — notice (commonly 10 to 30 days ahead), hearing, order, appeal — governs license actions. No conviction is required for administrative action (B), the NAIC has no enforcement role in a state case (C), and the legislature plays no part in individual licenses (D).
4. D. McCarran-Ferguson confirmed state primacy after South-Eastern Underwriters (1944) held insurance to be interstate commerce. B restates Paul v. Virginia, which South-Eastern overruled; A and C describe federal machinery the act was written to avoid.
5. B. Reciprocity grants the non-resident license on the strength of the resident one — application and fee, no second exam (A) and no new coursework (D). Appointments come from insurers, never from commissioners (C).
6. A. The license is the state's permission; the appointment is the insurer's designation, filed by the insurer — and selling without it violates the code even on a valid license (so not B). §1033 concerns felons of dishonesty (C), and temporary licenses are succession devices (D).
7. C. The ethics hours are a carve-out inside the 24, so her remaining 3 hours must all be ethics. B ignores the carve-out, A invents rounding, and the exam returns only if a lapsed license passes the reinstatement window (D).
8. D. The federal bar lifts only with the regulator's written consent — the 1033 waiver. It is not an absolute lifetime ban (A), nothing lifts automatically (B), and the bar covers the business broadly, not merely selling roles (C).
9. B. Misrepresentation inducing replacement is twisting, and the false attack on an insurer's financial condition is defamation besides. Replacement is lawful only when honest (A); churning is the same-insurer commission harvest (C); no value outside the policy was given (D).
10. A. Sharing commission — any value not specified in the policy, offered to induce the sale — is the classic rebate. Small promotional items within the state's cap are commonly allowed (B), and C and D are simply honest practice.

11. D. Same class, equal expectation of life, different rates — the definition of unfair discrimination; a favor funded from commission adds rebating. Classification by actuarial factors is lawful between classes (A), and no replacement (B) or leverage (C) appears.
12. C. Knowledge and frequency are the statute's aggravation tests, multiplying fines and reaching the license. Who discovers it, where, and the licensee's tenure change nothing in the statute's design.
13. B. Routine lowballing that forces claimants to sue is a listed practice, and "routinely" supplies the general-business-practice element — no prior court award is needed (C). One tough negotiation might be bargaining (A); twisting is a sales practice, not a claims practice (D).
14. A. The department polices conduct — investigation, fines, orders, examinations. Money judgments and damages belong to the courts (B, C), yet the department is far from powerless over claim-handling patterns (D).
15. D. FCRA's adverse-action rule: tell the applicant, name the consumer reporting agency, enable dispute. The act grants information rights — not free coverage (A), internal work product (B) or approval (C).
16. C. Padding a real loss is soft fraud — opportunistic, and still criminal, with the claim form's fraud warning making the falsehood knowing. Hard fraud invents or causes the loss itself (A); B launders a lie; D is a sales violation.
17. A. Care, disclosure, conflict of interest, documentation — the 2020 model's working parts. B mixes course vocabulary, C is the license lifecycle from Lesson 9.2, and D is a grab-bag — no standard guarantees results.
18. D. That sentence is the standard itself. It operates within the producer's disclosed product scope (not A), leaves disclosed commissions lawful (not B), and attaches to the recommendation rather than imposing perpetual monitoring (not C).
19. C. Care judges the fit of product to portrait: locking nearly all liquid savings past the client's own horizon fails any reasonable basis, and honest description plus signatures cannot cure it (A). The file might be perfect and the sale still unfit (B); defamation concerns statements about insurers (D).
20. B. Variable products' values ride on securities, so securities registration (Series 6 or 7) is required besides the insurance license — the crossover fact this course shares with its Series 65 neighbor. A temporary license is a succession device (C), and §1033 consent concerns convicted felons (D).

PORTFOLIO PIECE: THE LAW FILE

Assemble the unit's artifacts into one Law File — the section of your Pathway File that proves you know the rules you will be licensed under. In order: the commissioner's CAN/CANNOT powers chart with your dated state facts sheet (Lesson 9.1); the license lifecycle map with its MY STATE blanks filled where your department's site answers (Lesson 9.2); the field guide to forbidden practices with your state's promotional-gift cap on its footer (Lesson 9.3); the claim-clock timeline and examiner's findings memo from the claim file audit (Lesson 9.4); and the suitability worksheet completed for both pretend families, closed by your signed ethics commitment (Lesson 9.5).

Then write the file's one-page cover: a letter to your future self on the day you pass the state exam, explaining in your own words why every number in the file carries the flag “check your state,” which single practice from Lesson 9.3 you believe will tempt ordinary agents most and how you intend to refuse it, and what Philippians 2:4 requires of a salesman that no statute can inspect. Date the letter — you will read it again at the end of Unit 10.

LOOK FOR	WHAT IT MEANS
Commissioner pages	the powers chart is complete and correct, the three CANNOTs name who actually holds each power, and the state facts sheet is dated with commissioner, selection method and complaint contact recorded.
Lifecycle map	all five zones are present with the common numbers (30-day reports, 180-day temporary license, 12-month reinstatement, CE with ethics carve-out) and MY STATE blanks filled or flagged for Unit 10.
Field guide	all eight practices carry a correct field mark, example and lawful cousin, and the student can sort spoken scenarios — including twisting versus churning and rebate versus promotional gift — without looking.
Claim audit	the timeline makes every missed clock visible, the findings memo correctly names each listed practice and federal statute violated, and the remedy paragraph separates what the department can do from what courts must.

LOOK FOR	WHAT IT MEANS
Suitability section	both worksheets gather all twelve facts, the Alvarez page rejects the unfit product with a written basis naming surrender schedule and liquidity, and the ethics commitment is in the student's own words, signed and dated.
Cover letter	thoughtful, specific and honest — it names a real temptation and a real refusal, states the check-your-state rule as a working habit, and connects Philippians 2:4 to the unwatched moment of a sale.

UNIT 10

The Career and the Capstone

Nine units taught you the policies, the mathematics and the law; this one walks you down the road itself. You will stand a pretend candidate at the door of the **testing center** and walk every step — the line of authority chosen, the vendor scheduled, the fingerprints taken, the application filed through **NIPR** — and then cross the threshold that surprises most new licensees: the **appointment**, the carrier's filed authorization without which a licensed producer still cannot sell. There you will face the first real career decision, the honest trade between the **captive** agent's support and the **independent** agent's ownership, learn to read an agency contract before signing it, and learn to recognize — by pattern, coldly, arithmetically — the pay-to-join recruiting pyramid that circles this profession's doorway.

Then the career itself. You will learn how an honest **book of business** is built — a natural market served rather than ambushed, referrals earned, the marketing law obeyed — and do the income arithmetic recruiters skip: **first-year commissions**, renewals, charge-backs, and the lean first three years that precede the compounding. The capstone assembles everything this course has had you build into the **Pathway File**, maps the ladders beyond the license — CLU, ChFC, CPCU, the adjuster and underwriter paths, the securities door for variable products — and ends at full dress: a 150-question practice licensing exam, sat like test day and scored like a state. The unit's hero is the agent the whole course has aimed at: the neighbor who shows up after the fire.

PREREQUISITES

- Has completed Units 1–9, including the licensing law of Unit 9 and the state facts sheet kept current since Lesson 1.5
- Can compute percents and compound simple year-over-year growth (a book retained at 90% with new policies added)
- Can look up a producer license, a candidate handbook and a state insurance department page online and record what each says
- Has the course portfolio to date — profession map, trap lists, corrected practice sets — gathered and ready to assemble

MASTERY CHECKLIST

- ☐ I can walk the licensing pipeline in order — line, study rule, vendor, exam day, fingerprints, NIPR application — with the common fee ranges and the 2–8 week adult timeline, and say where the live figures are checked.
- ☐ I can describe a testing-center day and the instant pass/fail result, and state the common retake waits and what a fail actually costs.
- ☐ I can define appointment and explain why a licensed but unappointed producer may not sell a carrier's policies.
- ☐ I can contrast captive and independent agents by carriers, support, commission share and ownership of expirations — without calling either one better.
- ☐ I can name the five agency-contract clauses to read before signing, and recognize a pay-to-join recruiting pyramid by its pattern.
- ☐ I can state the prospecting law — the Do Not Call Registry and its exceptions, the 8 a.m.–9 p.m. window, CAN-SPAM — and compute what a retention rate does to a book over several years.
- ☐ I can compute first-year, renewal, PMPM and P&C commissions and a charge-back, and build an honest

first-three-years income model with taxes and expenses included.

- ☐ I can assemble the Pathway File, name the designations and careers beyond the license, sit a full-length practice exam under test conditions, and map the score honestly to a next step.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NIPR: National Insurance Producer Registry**: Free to browse, official. The gateway through which real license applications flow to the states. Explore the licensing sections with Lesson 10.1 to see the actual forms and fees your checklist describes — but pay nothing; this course requires no purchase. Ages 15 and up.
- **NAIC: Directory of State Insurance Departments**: Free, official. The map to all fifty regulators. Use it in Lessons 10.1 and 10.2 to find your state's producer-licensing pages, candidate handbook link and public license lookup — the tool that verifies any agency's claims. Ages 14 and up.
- **BLS Occupational Outlook Handbook: Insurance Sales Agents**: Free, official. The federal government's sober data on the career — median pay, openings, outlook. Read it with Lesson 10.4 beside your income model as the reality check no recruiter provides. Ages 15 and up.
- **National Do Not Call Registry**: Free, official (FTC). The registry every prospecting call must respect. Visit it with Lesson 10.3 to see what consumers register and what sellers must honor — the law side of honest marketing. Ages 14 and up.
- **The Institutes: CPCU and Insurance Education**: Free to browse, official designation body. Skim the CPCU pages with Lesson 10.5 to see what the profession's upper ladder actually requires — years of study after the license, which is the point. For the life-side ladder, The American College's CLU pages serve the same purpose. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

10.1 Exam Day: Enrollment, Fingerprints and the Testing Center

3 sessions of 50 minutes

10.2 Appointed: Carriers, Contracts and the Captive–Independent Choice

3 sessions of 50 minutes

10.3 An Honest Book of Business: Prospecting, Referrals and Service

3 sessions of 50 minutes

10.4 The Agent's Income: Commissions, Renewals and the First Three Years

3 sessions of 50 minutes

10.5 The Capstone: Your Pathway File and the Practice Exam Plan

3 sessions of 50 minutes

Unit 10 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Time yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says "in this example" or "commonly," use the figures given, and remember that real fees, hours and waiting periods are your state's decision — the live numbers are at your state insurance department and in its candidate handbook. A licensing exam passes at 70% — 14 of 20 here — but you are one unit from the final: aim higher. Choose the one BEST answer.

1. **5 pts**

   Which of the following is required in nearly every state before a person may sit for a producer licensing exam?

   A. A sponsoring insurance company

   B. Being at least 18 years old

   C. An associate's or bachelor's degree

   D. Two years of related work experience

2. 5 pts

For most states, the insurance licensing exam is administered by:

A. The state legislature

B. The insurance company appointing the agent

C. A contracted testing vendor such as Pearson VUE, PSI or Prometric

D. The National Association of Insurance Commissioners

3. 5 pts

A candidate fails the licensing exam. What commonly follows?

A. She may retake it after a wait of anywhere from the next day to 30 days, paying another exam fee

B. She is barred from the profession for one year

C. She may retake it free within 90 days

D. Her pre-licensing education must be repeated before any retake

4. 5 pts

Federal law at 18 U.S.C. §1033 bars insurance work, without the regulator's written consent, by anyone convicted of:

A. Any misdemeanor whatsoever

B. Any traffic felony

C. Any offense committed after licensure only

D. A felony involving dishonesty or breach of trust

5. 5 pts

A newly licensed producer signs an agency agreement with a carrier but no appointment has been filed with the state. She may:

A. Sell the carrier's policies, since her license is valid

B. Not transact that carrier's business until it appoints her

C. Sell only renewals, not new business

D. Sell if a licensed coworker countersigns each application

6. 5 pts

Which statement correctly contrasts captive and independent agents?

A. The captive represents one carrier and typically does not own his book; the independent represents several and owns his expirations

B. The captive owns his expirations; the independent's book belongs to the carriers

C. The captive may not earn commissions; the independent may

D. The independent is always better paid than the captive

7. 5 pts

Which clause of an agency contract determines whether renewal commissions continue to a producer after she leaves the agency?

A. The commission schedule

B. The charge-back provision

C. The non-solicitation clause

D. The vesting provision

8. 5 pts

An organization charges new “agents” $400 to join, urges each to buy a policy on himself immediately, and pays rising overrides mainly for recruiting more members. The pattern is:

A. A legitimate captive agency system

B. An independent marketing cooperative

C. A pyramid-style recruiting scheme to walk away from

D. Acceptable if the insurance products are genuine

9. 5 pts

Under federal telemarketing rules, a prospecting call may be placed:

A. Any time before midnight in the agent's time zone

B. Between 8 a.m. and 9 p.m. in the called person's local time

C. Only between 9 a.m. and 5 p.m. on weekdays

D. At any hour, if the number is not on the Do Not Call Registry

10. 5 pts

An agent may lawfully cold-call which of the following numbers?

A. A consumer who bought a policy from him eight months ago

B. Any number on a lead list he paid for

C. A registry-listed number, if he keeps the call under two minutes

D. A registry-listed number, if he calls from his personal phone

11. 5 pts

The CAN-SPAM Act requires all of the following for commercial email EXCEPT:

A. Truthful, non-deceptive subject lines and headers

B. A physical mailing address identifying the sender

C. The recipient's written permission before any commercial email is sent

D. A working opt-out honored promptly

12. 5 pts

An agent's book of 500 policies retains 90% this year while she writes 120 new ones. Next year's book holds:

A. 620 policies

B. 500 policies

C. 450 policies

D. 570 policies

13. 5 pts

A life policy carries a $1,500 annual premium, with 70% first-year commission and 4% renewals. The first-year and each renewal-year commission are:

A. $1,050 and $60

B. $700 and $40

C. $1,050 and $420

D. $105 and $6

14. 5 pts

A carrier advances nine months of commission on a policy paying the agent $90 per month as earned. The policy lapses after month 4. The charge-back is:

A. $810

B. $450

C. $360

D. $90

15. 5 pts

Property & casualty commissions commonly differ from life commissions in that P&C:

A. Pays no commission on renewals

B. Pays commissions only to captive agents

C. Pays a much higher first-year percentage than life

D. Pays roughly the same rate — commonly about 10–15% — on new business and renewals

16. 5 pts

The Bureau of Labor Statistics (May 2024) reports the median pay of insurance sales agents as:

A. $29,500

B. $122,400

C. $60,370

D. $95,800

17. 5 pts

Before selling variable life insurance or variable annuities, a state-licensed life producer must also:

A. Register with FINRA by passing a securities exam such as the Series 6 or 7

B. Obtain a property & casualty license

C. Earn the CLU designation

D. Be appointed by at least three carriers

18. 5 pts

Continuing education for a licensed producer commonly requires:

A. 100 hours each year, all in ethics

B. Nothing, once the exam is passed

C. CE only for independent agents

D. About 24 hours per two-year renewal period, including roughly 3 hours of ethics

19. 5 pts

Which designation belongs to the property & casualty side of the profession?

A. CLU

B. ChFC

C. CPCU

D. Series 65

20. 5 pts

On the 150-question practice final, passing at the common state standard requires 105 correct. A student scores 96, with 20 of her misses concentrated in two units. The readiness map says:

A. Schedule a real exam immediately — 96 is close enough

B. Reteach and drill the two weak units, then re-sit a fresh timed final before scheduling anything

C. Abandon the career path

D. Retake the same final open-book to confirm the score

ANSWER KEY

1. B. The near-universal requirement is age 18. No state requires a college degree, a sponsor or prior experience for the entry license — the exam's favorite false requirements.
2. C. Most states contract with Pearson VUE, PSI or Prometric (Alabama tests through the University of Alabama, and Kentucky runs its own). Carriers appoint agents but never administer the state exam, and the NAIC coordinates regulators rather than testing candidates.
3. A. A fail costs another fee and a waiting period that runs, by state, from next-day to about 30 days — the candidate handbook states the rule. Nothing bars the career (B), the retake is never free (C), and education generally need not be repeated (D).
4. D. The statute turns on felonies of dishonesty or breach of trust, with written-consent relief available from the regulator. It does not reach every misdemeanor or traffic matter, and it applies whether the conviction came before or after licensure.
5. B. The license is the state's permission to transact insurance; the appointment is the carrier's filed authorization, and a producer must be appointed by each insurer whose policies he sells. No countersignature or renewals-only exception exists.
6. A. One carrier with support and (usually) a company-owned book versus several carriers, higher share and agent-owned expirations. B reverses the ownership, C is false, and D turns a trade-off into a ranking the facts — and the exam — refuse to make.
7. D. Vesting governs whether renewals survive departure, retirement or death. The schedule sets rates, charge-backs recover unearned advances, and non-solicitation limits whom a departing agent may contact.
8. C. Pay-to-join, pressured self-purchase and compensation driven by recruiting rather than by serving clients is the pyramid pattern, and its exponential arithmetic guarantees that late joiners — almost everyone — lose. Genuine products do not redeem the model (D), and no legitimate agency charges people for the right to work (A, B).
9. B. The window is 8 a.m. to 9 p.m. on the consumer's clock. Registry status (D) does not unlock the hours rule, and A uses the wrong time zone — the exam's favorite twist on this fact.

10. A. A recent purchase creates an established business relationship — an exception to the Do Not Call Registry. Paying for a list scrubs nothing (B), and neither brevity nor the phone used (C, D) excuses calling a registered number.
11. C. CAN-SPAM does not require advance permission for email — it requires honesty (A), identification (B) and a working opt-out (D). Prior express consent is the stricter rule for automated marketing texts, which is the distinction the exam likes to blur.
12. D. $500 \times 0.90 + 120 = 570$. A forgets the 50 lost to lapses, C forgets the new business — the formula is book × retention + new.
13. A. $\$1{,}500 \times 0.70 = \$1{,}050$ and $\$1{,}500 \times 0.04 = \$60$. C applies 4% to ten years at once, and D slips a decimal — the two classic arithmetic errors.
14. B. Advance $9 \times \$90 = \$810$; earned $4 \times \$90 = \$360$; charge-back $\$810 - \$360 = \$450$. A is the whole advance, C is the earned portion — the charge-back is the difference.
15. D. P&C's steady new-and-renewal rate is why a retained book compounds. Life is the big-then-small shape (large FYC, small renewals) — C reverses the comparison, and A describes neither line.
16. C. The median — half earn more, half less — is $60,370, with about 47,000 openings projected a year. The right tail runs high because renewals compound, but the median is the honest anchor this course quotes.
17. A. Variable products are securities, so FINRA registration rides on top of the state life license. Designations (C) are voluntary honors, and B and D invent requirements from the wrong shelves.
18. D. The common pattern — varying by state — is 24 hours per biennium with an ethics component. The license is a subscription renewed by diligence, not a one-time trophy (B), and CE binds captive and independent alike (C).
19. C. The Chartered Property Casualty Underwriter, first awarded in 1943, is the P&C profession's senior designation. CLU and ChFC are The American College's life and planning credentials, and the Series 65 is a securities exam, not an insurance designation.
20. B. Below the line means reteach, drill the concentrated weaknesses, and re-test under full conditions — the practice final just delivered the truth at zero cost. A pays a real fee to learn the same thing, C mistakes information for a verdict, and D's open book makes the score meaningless.

PORTFOLIO PIECE: THE PATHWAY FILE

Assemble the file this whole course has been building and this unit completed: the dated state facts sheet and the state-specific licensing checklist with its fee budget (Lesson 10.1); the contract reader's checklist and ten-question agency scorecard with its automatic walk-aways (Lesson 10.2); the honest market map and twelve-month service calendar with the marketing-law banner (Lesson 10.3); the 36-month income model with its chart and honest paragraph (Lesson 10.4); and the finished profession map with the career ladders, the signed one-page ethics commitments, and the scored 150-question practice final with its miss-map and readiness verdict (Lesson 10.5).

Order the file in its five sections — Facts, Map, Guards, Disciplines, Commitments — and place the scored final and verdict page at the front. A stranger opening this binder should be able to see what state it serves, what the road costs, what offers it will refuse, how its owner intends to treat clients, and exactly how ready its owner is — with the next step dated on a calendar.

LOOK FOR	WHAT IT MEANS
Licensing checklist and facts	The pipeline is complete and in order, every fee, wait and rule carries a real figure sourced from the state insurance department or candidate handbook, each is dated and marked verified, and the budget line includes a retake reserve.
Contract and agency tools	The five contract clauses are correctly explained with a question for each, the scorecard's ten items are present with its scoring rule, and the three pyramid-pattern questions are flagged as automatic walk-aways.
Service and marketing pages	The market map sorts its households defensibly into three rings, the service calendar schedules every pretend client's review and claim follow-ups, and the law banner states the registry, the calling window, CAN-SPAM and the no-cold-texts rule correctly.
Income model	The 36-month spreadsheet computes commissions, charge-backs, renewals, expenses and tax set-asides correctly from labeled example assumptions, the chart marks where renewals overtake expenses, and the closing paragraph is honest about year one.
Capstone and commitments	The profession map includes the designations, the adjuster, underwriter and owner paths and the Series 6/7 securities door;

LOOK FOR	WHAT IT MEANS
	the ethics page is first-person, one page, signed and dated.
Practice final and verdict	The final was sat in one proctored, closed-book, 150-minute sitting; it is scored as a state would score it (105 of 150 passes), the misses are mapped by unit, and the readiness verdict names a dated next step.

10.1 Exam Day: Enrollment, Fingerprints and the Testing Center

OBJECTIVES

- Walk the whole licensing pipeline in order: choose a line, meet the state's study rule, schedule with the testing vendor, pass the exam, clear fingerprints, and apply through NIPR.
- Describe a testing-center day — identification, lockers, the on-screen calculator, and the instant pass/fail result most states give.
- State the common ranges for exam fees, retake waits and the adult timeline from first study day to appointed agent, and say where the real figures live.
- Explain why fingerprints and a background check are required, including the federal rule of 18 U.S.C. §1033.
- Build a dated, state-specific licensing checklist from a candidate handbook.

> **Warm-up.** In five minutes, list every step you think stands between a person and a working insurance license — from “decides to become an agent” to “sells the first policy.” Number your steps. At the end of the lesson, compare your list with the real pipeline and count how many steps you missed.

WATCH

Test Taking Tips- What are the Questions You'll See on the Insurance Exam?

Insurance Exam Queen · 9:00

https://www.youtube.com/watch?v=2FPt1d1lOHQ

> **WHEN TO WATCH**
> Watch after the big idea; as the teacher describes each question style, note how you would handle it on test day, then walk your enrollment checklist once more with the exam formats fresh in mind.

BACKUP VIDEO

Pearson VUE Exam Day Experience

NCEES Media · 4:08

https://www.youtube.com/watch?v=U_oHtEydw1I

A licensing board's own walkthrough of a Pearson VUE test day — ID check, lockers, seating, the works. Watch it before the project so your test-day box describes a room you have already seen.

KEY TERMS

line of authority

The category of insurance a license permits a producer to sell — life, accident & health, property, casualty or personal lines — chosen on the exam registration and the license application.

testing vendor

The company a state hires to administer its licensing exam — for most states Pearson VUE, PSI or Prometric.

pre-licensing education

Classroom or online study hours some states require before a candidate may sit the exam; more than thirty states have eliminated the requirement, and those that keep it commonly require roughly 20–40 hours per line.

candidate handbook

The vendor's free official booklet for one state, listing that state's exam content outline, fees, identification rules, scheduling steps and retake policy.

proctor

The testing-center staff member who checks identification, secures belongings, seats candidates and supervises the exam.

instant score report

The printed pass/fail result handed to the candidate at the testing center in most states the moment the exam ends.

fingerprinting

The capture of a candidate's fingerprints for a criminal background check, required by most states before a license is issued.

18 U.S.C. §1033

The federal law barring anyone convicted of a felony involving dishonesty or breach of trust from working in insurance without the regulator's written consent.

NIPR

The National Insurance Producer Registry (nipr.com), the online gateway through which license applications and fees flow to the states.

retake waiting period

The time a failing candidate must wait before sitting the exam again — commonly anywhere from the next day to 30 days, set by the state and printed in the candidate handbook.

CORE IDEAS

The story. The exam you will sit someday was born in Kansas. In 1914 a young education professor named Frederick J. Kelly, troubled that two teachers grading the same essay could award it two different marks, designed the **Kansas Silent Reading Test** — the first widely used test made of questions with fixed answer choices. One question, one best answer, no grader's mood in the result: the multiple-choice test was intended as a machine for fairness. Three years later the United States Army, needing to sort 1.7 million recruits for the First World War, adopted the format for its *Army Alpha* examinations of 1917 and proved that an objective test could be given to millions and scored identically everywhere. State licensing boards noticed. A license is a public trust, and the public deserves proof that every agent cleared the same bar — not a friendly interview in one county and a hard one in the next. That is why, when you walk into a testing center, you will face a bank of four-choice questions scored by a computer that has never met you: the fairest examiner ever built.

How they figured it out. For most of a century each state gave its own paper exams in its own way — a room at the insurance department, a schoolhouse, a hotel

ballroom. As computers made testing continuous instead of quarterly, the states hired specialists. As of 2026 most states contract with one of three national **testing vendors** — **Pearson VUE**, **PSI** or **Prometric** — while a couple keep older arrangements (Alabama administers its exams through the University of Alabama, and Kentucky runs its own). The vendor publishes the document that governs everything about your test day: the **candidate handbook** for your state. It is free, official and updated — the content outline by topic, the number of questions, the time limit, the fee, the identification rules, the retake policy. This course teaches the material the states share; the handbook is where the course ends and your state begins. Download it the week you register, and believe it over any video, any prep book and any rumor.

The big idea. The pipeline from student to agent runs in one order, and knowing the order is half the lesson. *First*, choose your **line of authority** — life, accident & health, property, casualty or a combination — because everything downstream (study rule, exam, application) attaches to the line. *Second*, meet your state's study rule: more than thirty states have eliminated mandatory **pre-licensing education** (Washington in 2023, Alabama in January 2024, Maryland in October 2024, Pennsylvania in April 2025, and California dropped its line-specific 20-hour courses effective January 1, 2026, keeping a 12-hour code-and-ethics course), while the states that keep it require roughly 20–40 hours per line. *Third*, register with the vendor and pay the exam fee — commonly $40 to $150 per attempt, in this example range. *Fourth*, pass the exam. *Fifth*, clear **fingerprinting** and the background check. *Sixth*, apply for the license through **NIPR** or the state, paying a license fee commonly between $20 and $200. For an adult the whole road commonly takes two to eight weeks.

Now walk the day itself. You arrive early with the identification the handbook demands — typically a current government photo ID, often two forms. Everything else goes into a locker: phone, watch, notes, even your own calculator, because the testing software provides one on screen (some centers hand you a simple calculator or a dry-erase board instead — the handbook says which). The proctor photographs you, checks the ID against the registration, and seats you at a terminal. The exam is a combined or single-line test of roughly 50 to 150 scored questions depending on state and line; a combined life & health or property & casualty exam commonly runs about 150 questions in about two and a half hours. Some questions are unscored "pretest" items being tried out — you cannot tell which, so treat every question as

real. Budget about a minute a question, read the last line of the stem first, strike the two clearly wrong choices, and answer everything: there is no penalty for a wrong answer, and a blank is simply wrong.

Then the moment: in most states the screen — and a printed **instant score report** — tells you PASS or FAIL before you reach the parking lot. A pass does not expire that afternoon, but it does not last forever either; states commonly give a passing result a shelf life (often 90 days to a year) within which the license application must be filed, so the wise candidate applies the same week. A fail costs another exam fee and a **retake waiting period** — commonly anywhere from the next day to 30 days, by state — and the score report breaks down your performance by topic so you know what to restudy. Treat a fail as a bill, not a verdict: most states pass a prepared candidate, passing is usually 70% (a few states or lines use 60–65%), and the second attempt of a student who actually restudies the weak topics usually lands. The exam fee is the price of the attempt; shame is not part of the transaction.

The license is a public trust, so the state checks who is asking for it. Most states require fingerprints — captured at the testing center or at an approved vendor's office — and run a criminal background check. Federal law stands behind the state rule: **18 U.S.C. §1033** bars anyone convicted of a felony involving dishonesty or breach of trust from working in the business of insurance without the regulator's written consent. The application itself, filed through **NIPR** or the state's own portal, asks screening questions — criminal history, administrative actions, unpaid child support in some states — and a false answer on the application is a worse offense than most of the history it might hide. Once licensed, you can add non-resident licenses in other states by **reciprocity** through the same NIPR gateway, usually without another exam. One more distinction, learned in Unit 9 and tested everywhere: the license lets you transact insurance; you still cannot sell a single policy until a carrier **appoints** you — which is the next lesson.

On the exam today. State exams ask the mechanics of their own licensing law, and the traps are old friends. Know that licensing is state-by-state: the minimum age is 18 nearly everywhere, there is no college requirement, and no sponsoring company is needed to sit the exam — a question offering “a bachelor's degree” or “a sponsoring insurer” as a licensing requirement is testing exactly that. Know the order of the pipeline, that the exam is administered by the state's testing vendor rather than by the insurance company, and that variable life and variable annuities additionally

require FINRA securities registration (a Series 6 or 7 — the securities world the School Launch Series 65 course maps). Know §1033 by its idea: felony of dishonesty or breach of trust, written consent required. And when a question quotes a fee or an hour count, remember the magic words this course has used all year: figures differ by state and change — the candidate handbook and the state insurance department hold the live numbers.

PICTURE STUDY



The School Exam, Albert Anker, 1862 · Oil on canvas · Kunstmuseum Bern, Bern, Switzerland

Image: Wikimedia Commons, public domain

Albert Anker, the beloved painter of Swiss village life, shows the yearly examination at a country school: the examiners at their long table, one boy on his feet answering, every other child counting the minutes until his own turn. Anker had studied theology before he turned to painting, and he painted children and their schooling with a seriousness most artists saved for kings. The picture opens this lesson because an examination is an old and honorable thing — a community checking, in public, that what should have been learned was learned — and because the boy standing alone before the table is you, a testing-center chair away.

Look closely

- Find the boy who is being examined. How is he standing, and what does his posture say about how prepared he feels?
- Study the examiners' table — books, papers, spectacles. Are the men hostile or simply careful?
- Look at the waiting children on the benches. Find one who looks confident and one who looks afraid.
- Notice the villagers and parents at the edges. The exam is public — the whole community has an interest in what the school produced.

Talk about it

1. The examiners don't know the boy's excuses — only his answers. How is that like the computer that scores a licensing exam, and why is it fair?
2. The villagers watch because the school serves the village. Who is the "village" that a state serves by examining insurance agents before licensing them?
3. Preparation is the only cure for the fear on some of those benches. What does faithful preparation — for an exam or any duty — have to do with loving your neighbor as yourself?

PROJECT

My State's Licensing Checklist

You will build the single most practical page in your Pathway File: a dated, state-specific checklist that walks a candidate — your future self — from first study day to license in hand, with every step, fee and waiting period sourced from your own state. A pretend checklist teaches the pattern; this one, built from your state insurance department and its vendor's candidate handbook, is the real map.

You will need

- Your state insurance department's producer-licensing pages (find your state through the NAIC directory in the kit)
- Your state's exam candidate handbook, downloaded free from its testing vendor
- Your exam notebook, one clean page, and a pen
- The state facts sheet you have kept since Lesson 1.5

Steps

1. Head the page with your state's name, today's date, and the vendor that administers its exams (Pearson VUE, PSI, Prometric or another arrangement).
2. Write the pipeline as numbered checkboxes: choose the line; complete any required pre-licensing hours (write the number, or “none required”); register and pay the exam fee; test day; fingerprints; application through NIPR or the state portal; await issuance.
3. Beside each step, write the real figure from the handbook or the department site: hours, exam fee, fingerprint fee, application fee, retake wait, and how long a passing score stays valid.
4. Add a test-day box: the identification required, what may enter the room, what the center provides (calculator, dry-erase board), and the arrival time the handbook asks for.
5. Add a money line: total the certain costs, add a one-retake reserve, and write the sum as “save this first.”

6. Add an age line: the earliest date you could realistically hold this license, given your 18th birthday and graduation.
7. Check every figure once more against the source, write “verified” with the date beside each, and clip the page into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for the key terms, especially line of authority, NIPR, candidate handbook and 18 U.S.C. §1033, and add them to your course box.
2. Draw the pipeline as a seven-arrow diagram from LINE to APPOINTED, labeling each arrow with the common cost or wait (“$40–$150 exam fee,” “next day–30 days retake wait,” “2–8 weeks total”).
3. Write a five-line trap list titled “Licensing myths,” ending with: NO degree, NO sponsor, 18 nearly everywhere — the handbook has the live numbers.

> **From history.** The Army Alpha of 1917 had a quieter twin: the Army Beta, a pictorial exam for the many recruits who could not read English, scored with the same objectivity. The pair established the principle every licensing exam still follows — measure the knowledge, not the person's background — and several of the psychologists who built them went on to design the first standardized college admissions tests in the 1920s.

WORKED EXAMPLES

Example 1. Build the budget. In this example state, the exam fee is $75 per attempt, fingerprinting costs $55, the license application fee is $100, and a prudent candidate reserves one retake. What should the candidate have saved before scheduling, and what does the plan cost if the first attempt passes?

Show solution

1. Certain costs: $\$75 + \$55 + \$100 = \$230$.
2. Retake reserve: one more exam fee, $\$75$.
3. Total to save: $\$230 + \$75 = \$305$.
4. If the first attempt passes, the reserve is never spent and the road costs $230 — and every figure here is an example; the real ones are in your state's candidate handbook.

Answer: Save $305; spend $230 on a first-attempt pass. The retake reserve turns a possible fail from a crisis into a line item.

Example 2. Exam style. Which of the following is a requirement to sit for a state insurance producer licensing exam in nearly every state?

A. A bachelor's degree in business

B. Sponsorship by an insurance company

C. Being at least 18 years old

D. Two years of sales experience

Show solution

1. Recall what the license actually requires: age, any state study rule, the exam, the background check and the application.
2. A is the classic trap — there is no college requirement for an insurance license in any state.
3. B imports a rule from other industries; no sponsoring company is required to sit an insurance exam.
4. D invents an experience rule that does not exist for the entry license.
5. C states the near-universal rule: a producer must be at least 18.

Answer: C. Nearly every state requires only that a candidate be 18; there is no degree, sponsorship or experience requirement — which is exactly why this career is one of the most reachable licensed professions.

Example 3. Plan the calendar. An adult candidate's state requires 20 hours of pre-licensing study for her line. She can study 10 hours a week, the vendor has seats within 5 days of registration, fingerprint results take about 2 weeks to clear, and the state issues licenses about 1 week after a complete application. About how long is her road from first study day to license in hand, if she passes on the first attempt?

Show solution

1. Study: $20 \div 10 = 2$ weeks to finish the required hours (she registers for the exam during week 2).
2. Exam: a seat within 5 days puts test day early in week 3.
3. Fingerprints: she prints the same week as the exam; results clear about 2 weeks later, during week 5.
4. Application: filed through NIPR the day she passes; the state issues about 1 week after the file is complete — roughly the end of week 5 or week 6.
5. Total: about 5–6 weeks, squarely inside the common 2–8 week adult timeline.

Answer: About five to six weeks. The slow lanes are the fingerprint check and the state's processing, not the studying — which is why candidates print and apply immediately rather than celebrating first.

PRACTICE

1. Easy Name the three national testing vendors that administer most states' insurance licensing exams.

   Show answer

   Pearson VUE, PSI and Prometric — with a couple of exceptions (Alabama tests through the University of Alabama, and Kentucky runs its own exams).

2. Easy What is NIPR, and what does a new candidate use it for?

   Show answer

   The National Insurance Producer Registry (nipr.com) — the online gateway through which license applications, fees and later non-resident licenses flow to the states.

3. **Easy** In most states, when does a candidate learn whether she passed the licensing exam?

Show answer

Immediately — the testing center prints an instant pass/fail score report the moment the exam ends.

4. **Medium** A combined property & casualty exam in this example runs 150 questions in 150 minutes, and the state passes at 70%. How many questions must a candidate answer correctly, and what is the time budget per question?

Show answer

$0.70 \times 150 = 105$ correct answers, at $150 \div 150 = 1$ minute per question. Answer everything — a blank scores the same as a wrong answer.

5. **Medium** Which document is the authoritative source for one state's exam fees, identification rules and retake policy?

A. This course

B. The testing vendor's candidate handbook for that state

C. A national exam-prep video

D. The insurance company's agent manual

Show answer

B. The candidate handbook is the vendor's free official rulebook for that state. This course teaches the shared material and labels its figures as examples; videos and company manuals are not authorities on state licensing rules.

6. **Medium** True or false, and why: a candidate must be appointed by an insurance company before sitting the licensing exam.

Show answer

False. No sponsoring company is required to sit the exam. Appointment comes after licensing, when a carrier authorizes the new licensee to sell its policies — next lesson's subject.

7. Medium What does 18 U.S.C. §1033 prohibit, and what is the one path back it allows?

Show answer

It bars anyone convicted of a felony involving dishonesty or breach of trust from working in the business of insurance — unless the person obtains the regulator's written consent.

8. Hard A candidate fails her first attempt. Name the two costs the fail imposes, and the one thing the score report gives her for free.

Show answer

Another exam fee and a retake waiting period (commonly next-day to 30 days, by state). The report breaks her score down by topic, telling her exactly what to restudy — which is why a studied second attempt usually passes.

9. Hard In this example state the exam fee is $95, fingerprints cost $60, and the application fee is $150. A candidate fails once before passing. What did licensure cost her, and what would the one-attempt road have cost?

Show answer

With the retake: $\$95 + \$95 + \$60 + \$150 = \$400$. One attempt: $305. The fail cost exactly one exam fee — a bill, not a catastrophe, and the reason the project's budget line includes a retake reserve.

10. Hard Why have more than thirty states eliminated mandatory pre-licensing hours, and what did they keep in place? Answer in two or three sentences.

Show answer

The exam itself is the quality gate: a state that trusts its exam can let candidates prepare however they learn best, rather than mandating seat time. Every such state kept the exam, the fingerprint and background check, and the application screening — the requirements that actually protect the public. California's 2026 change shows the pattern: it dropped line-specific hour requirements but kept a 12-hour code-and-ethics course.

11. **Challenge** A candidate passes on March 1 in a state where a passing score is valid for 90 days, fingerprint results take about 3 weeks, and the state processes complete applications in about 2 weeks. If she delays starting her application until May 15, what is the risk, and what should she have done? Show the arithmetic.

    Show answer

    Her score expires about May 30 (90 days from March 1). Starting May 15 leaves about 15 days for roughly $3 + 2 = 5$ weeks of processing — she will likely have to re-test and re-pay. The right move was to fingerprint and file through NIPR the week she passed, finishing with two months to spare.

12. **Challenge** Frederick Kelly built the multiple-choice test to remove the grader's mood from the result. Write three sentences on what objective scoring protects — for the candidate, for the public, and for the profession.

    Show answer

    For the candidate, it guarantees that the same answers earn the same score in every county and for every person, with no favoritism to defeat her and no prejudice to fear. For the public, it certifies that every licensed agent cleared one identical bar before being trusted with a family's protection. For the profession, it means the license signals real knowledge — which is why a prepared candidate should welcome a hard, fair exam rather than resent it.

COMMON MISTAKES

- Believing a college degree or a sponsoring company is required — the insurance license needs neither, which is the exam's favorite false requirement.
- Treating this course's fees and hour counts as your state's figures; they are labeled examples, and the candidate handbook and state insurance department hold the live numbers.
- Leaving questions blank on the exam — there is no guessing penalty, so an unanswered question is simply a wrong one.
- Celebrating a pass and delaying the application; passing scores commonly expire (often 90 days to a year), so fingerprints and the NIPR filing happen the same week.
- Confusing the license with an appointment — the state licenses you to transact insurance, but you cannot sell a carrier's policies until that carrier appoints you.

- Forgetting that §1033 turns on felonies of dishonesty or breach of trust with written-consent relief — not on every offense of any kind.

Make it a game · Pipeline Scramble. Write the licensing steps on eight index cards: choose the line, pre-licensing hours (if any), register with the vendor, exam day, instant score report, fingerprints, NIPR application, appointment. Shuffle and deal them face down in a row. On “go,” the player flips and arranges them in correct order against a 60-second timer while a parent checks. Then round two: the parent pulls one card out behind the player's back, and the player must name the missing step from the gap alone. Round three, reverse roles. One point per correct order, two for naming the missing step; first to five points wins.

Scripture. “Seest thou a man diligent in his business? he shall stand before kings; he shall not stand before mean men.” (Proverbs 22:29, KJV)

The proverb is a picture of exam day: diligence practiced in private eventually stands inspection in public. The candidate who kept the notebook, drilled the trap lists and saved the fees walks into the testing center already approved — the exam only announces what the diligence built.

10.2 Appointed: Carriers, Contracts and the Captive–Independent Choice

OBJECTIVES

- Define appointment and explain why a licensed producer still cannot sell until a carrier files one.
- Contrast captive (exclusive) and independent agents by carriers represented, support received, commission share and ownership of the book of business.
- Read an agency contract for its five load-bearing clauses: commission schedule, vesting, charge-backs, book ownership and restrictive covenants.
- Recognize the pattern of a pay-to-join recruiting pyramid and distinguish it from a legitimate agency.
- Vet any agency offer with the state license lookup, compensation questions and a pressure test.

> **Warm-up.** In five minutes, write two job offers for an imaginary new agent: one from a company that gives training, office space and leads but keeps most of the commission, and one that pays far more per sale but provides nothing. Under each, write one kind of person who would thrive there. Keep the paper — the lesson will give these offers their real names.

WATCH

Captive vs. Independent Agent: Pros & Cons

The Brokerage Inc. · 3:45

https://www.youtube.com/watch?v=LiGg3bMDxpQ

> **WHEN TO WATCH**
> Watch after the big idea and keep two columns running in your notebook — one advantage and one cost per side — and notice that every advantage on one side is purchased with something from the other.

BACKUP VIDEO

Captive vs Independent Insurance Agents

Insurance Centers of America, Inc. · 3:36

https://www.youtube.com/watch?v=19pl2w12JNs

A second short pass through the two systems from a different desk; watch it before the practice set and note any trade-off it names that your two-column chart is still missing.

KEY TERMS

appointment

An insurer's official authorization, filed with the state, naming a licensed producer as its agent to sell its policies.

captive (exclusive) agent

A producer appointed by one carrier (or carrier group), typically receiving training, brand and leads in exchange for a lower commission share and a contract restricting outside sales.

independent agent

A producer appointed by several competing carriers, who owns his book of business, keeps a higher commission share and pays his own expenses.

book of business

The collection of clients and in-force policies an agent serves — the profession's central asset, whose renewal commissions compound as it grows.

ownership of expirations

The contract right to the client list and renewal relationships when an agent leaves — held by the independent agent, but by the carrier under most captive contracts.

commission schedule

The contract exhibit stating what percentage of premium the agent earns on each product, new and renewal.

vesting

The contract terms deciding whether renewal commissions keep paying an agent (or his family) after he leaves, retires or dies.

charge-back

The repayment an agent owes when a policy lapses or is cancelled before the commission advanced on it has been earned.

errors and omissions (E&O) insurance

Professional liability coverage that defends and pays when a client alleges the agent's mistake or oversight caused a loss — the agent's own shield.

restrictive covenant

A contract clause — non-compete or non-solicitation — limiting whom a departing agent may serve or contact, for a stated time and territory.

pyramid scheme

An operation that charges people to join and pays participants primarily for recruiting more participants rather than for selling a real product to real customers.

CORE IDEAS

The story. On June 7, 1922, a retired farmer named George Jacob Mecherle founded a mutual automobile insurer in Bloomington, Illinois, on a single stubborn observation: farmers drove fewer miles on emptier roads than city drivers, yet paid the same rates. His State Farm Mutual charged them what their risk actually cost, and to sell the policies he built a particular machine — a force of agents who represented his company and no other, trained by it, supplied with its rates and forms, and known in their towns as its people. This course names the company only as history, recommends nothing, and notes that the same story could be told of other carriers — but the machine matters: Mecherle's exclusive-agency system

showed how a carrier could put a trained, supervised, single-brand agent in every county seat in America. The opposite machine is older still: the **American agency system** of independent agents, village insurance men who, from the early 1800s, held appointments from several competing companies at once and placed each client with whichever fit. Both machines survive because both work — and your first real career decision as an agent will be choosing between them.

How they figured it out. The law's piece of this lesson is the **appointment**. Your license, from Lesson 10.1, is the state saying *you may transact insurance*; it is not any company saying *you may sell our policies*. That second permission is the appointment: the carrier files it with the state (commonly within about 15 days of your first application for it, with a small per-appointment fee the carrier usually pays), the state records it, and from then on the public can look up exactly which companies stand behind you. The appointment is also the carrier's accountability: an insurer answers for its appointed agents' conduct, so it screens before appointing, and when the relationship ends it must notify the state of the termination — and, if the cause was serious misconduct, say so. An agent may hold one appointment or forty; each is a separate filing. No appointment, no selling: a licensed but unappointed producer with a signed application in his hand has sold nothing yet.

The big idea. The **captive** (or exclusive) agent and the **independent** agent divide the profession, and neither is "better" — they price the same trade differently. The captive agent represents one carrier. He typically receives training, a known brand, office support, sometimes a salary or subsidy at the start, and leads — people already asking to buy. He pays for all that with a lower commission share, a contract that forbids selling for competitors, and, in most captive contracts, the hardest clause of all: the **book of business belongs to the company**, so if he leaves, the clients stay. The independent agent represents several competing carriers, places each client with the best fit, keeps a higher share of each commission, and — the crown jewel — **owns his expirations**: the renewals, the client list, the saleable asset. He pays for that with everything the captive got free: his own rent, his own marketing, his own training, no salary, no brand, and no leads but the ones he earns. Structure for a lower share, or freedom at your own expense: that is the honest trade, and different people rightly choose differently.

Whichever door you choose, a contract will slide across the table, and this paragraph is the checklist for reading it *before* signing. *One: the commission schedule* — the exhibit

listing your percentage on each product, new and renewal; if it is vague or "to be provided," stop. *Two: vesting* — do your renewals keep paying you if you leave, retire or die, and after how many years of service? *Three: charge-backs* — when a policy lapses early, how much advanced commission do you repay, over what period, and can the agency deduct it from future pay? *Four: ownership* — who owns the book, the expirations and even the clients' phone numbers when you go? *Five: restrictive covenants* — a non-compete (you may not work in the trade nearby for a time) or non-solicitation (you may not contact your old clients); read the years and the miles, because courts enforce many of them. And one purchase of your own: **E&O insurance**, the agent's professional liability shield, commonly a few hundred to a couple of thousand dollars a year in this example — because an honest mistake on a coverage limit can cost more than a career can repay.

Now the warning this unit owes you. Around the edges of this honest profession circles a counterfeit: the recruiting pyramid wearing an insurance-agency costume. The pattern — and it is a pattern, not a company name — looks like this. You are charged money to join: a "starter kit," a "platform fee," a "training package." You are pressed to buy a policy on yourself and your family right away, "to believe in the product." The opportunity meeting talks endlessly about recruiting — your "team," your "downline," the income of the person on stage — and hardly at all about serving clients, because the real money flows upward from each recruit's joining fees and self-purchased policies through layers of overrides. Commission splits start insultingly low and rise only by recruiting. The arithmetic condemns the model by itself: if each recruit must find five more, the eighth level alone needs 390,625 people, and the tenth needs more recruits than some states have adults. A legitimate agency charges you nothing to work, earns when clients are served, pays you for selling rather than for recruiting, and never needs you as its customer.

So vet every offer like an underwriter. *First, the license lookup:* your state insurance department's website lets anyone verify a license and its appointments free — check the agency, the recruiter, and the person on stage; no license or a trail of terminations ends the conversation. *Second, the money questions, asked plainly:* What do I pay to start — and why? What exactly is the commission schedule, in writing? How much of your own income, honestly, comes from your clients versus from your recruits? Who owns my book if I leave? *Third, the pressure test:* say "I'd like two weeks to review this contract with someone I trust" and watch. A sound agency respects

the request — it vets you too, and patience costs it nothing. A pyramid cannot afford thinking time, so the discount expires tonight, the seats are almost gone, and the hesitation is reframed as weakness. Pressure is information: the counterfeit must rush you precisely because inspection kills it. The simple believeth every word; the prudent agent looketh well to his going.

On the exam today. State exams test the appointment mechanics hard: a producer must be appointed by each insurer whose policies he sells; the carrier files the appointment (and the termination, with its required notices) with the state; and selling without an appointment is a violation even with a valid license in hand. Expect a question contrasting the agent — who legally represents the insurer — with the broker, who represents the buyer; and remember from Unit 2 that an agent's acts within his authority bind the company. Captive-versus-independent appears as a facts question: one carrier versus several, company-owned book versus agent-owned expirations — the exam stays as neutral between them as this course. Charge-backs and commission terms are contract matters more than exam matters, but commission *sharing* is tested: commissions may be shared only with persons licensed for the line, and paying commissions to the unlicensed is a violation (Unit 9's rebating rules live one door down). The pyramid pattern itself is not on the state exam — it is on the exam your career will set you, which this lesson intends you to pass.

PICTURE STUDY



Marriage A-la-Mode: 1. The Marriage Settlement, William Hogarth, c. 1743 · Oil on canvas · The National Gallery, London

Image: Wikimedia Commons, public domain

William Hogarth, London's great storyteller-painter, opens his famous six-scene satire *Marriage A-la-Mode* with a contract being signed for all the wrong reasons: the earl is selling his family name, the merchant is buying rank for his daughter, and the two young people whose lives the paper governs are not even looking at it — or at each other. Hogarth packs the consequences into the corners: the smooth lawyer already whispering, the chained dogs, the bankrupt half-built mansion out the window. It opens this lesson because one man in the room is doing the only thing this lesson asks of you — the merchant in spectacles, actually reading the terms — and because every disaster in the five scenes that follow was visible, to a careful reader, in this one.

Look closely

- Find the merchant in spectacles bending over the settlement. He is the only person in the room reading the document everyone else is merely signing.
- Find the earl's pointing hand and his parchment family tree. He is selling a name — what is he carefully not discussing?
- Study the young couple: the groom turned to the mirror, the bride to the whispering lawyer. The parties bound by the contract had no voice in its terms.

- Look through the window at the half-built mansion with no workmen, and find the chained dogs in the corner — Hogarth's two quiet verdicts on this bargain.

Talk about it

1. Only the man who reads the terms knows what is actually being traded. Which five clauses did this lesson tell you to read in any agency contract before your name goes on it — and which figure in this painting are you refusing to become?
2. The lawyer Silvertongue profits from the arrangement while owing loyalty to no one in it. How does his whisper resemble the recruiter whose discount expires tonight — and why is the smooth intermediary's hurry always information?
3. Hogarth shows a covenant entered for money and vanity, and the chained dogs tell the truth about it. What makes a binding promise — a marriage, an appointment, a contract — honorable instead of miserable, and what does that require of you before you sign?

PROJECT

The Contract Reader's Checklist and the Agency Scorecard

You will build two tools for your Pathway File: a one-page checklist of the five contract clauses every agent must read before signing, and a ten-question scorecard for vetting any agency — including the three questions that unmask a recruiting pyramid. Your future self, sitting across a desk from a friendly recruiter with a pen already uncapped, will be very glad these pages exist.

You will need

- Two sheets of paper or one spreadsheet with two tabs
- Your exam notebook and this lesson's core ideas
- Your state insurance department's license-lookup page (find it through the NAIC directory in the kit)

Steps

1. Page one, head it CONTRACT READER'S CHECKLIST and rule five numbered blocks: commission schedule, vesting, charge-backs, ownership of the book, restrictive covenants.
2. In each block write two lines: what the clause controls, and the one question to ask about it aloud (for example, under ownership: “If I leave in five years, who may call my clients the next morning?”).
3. Add a sixth block, E&O, with its purpose and an example annual cost range, labeled as an example.
4. Page two, head it AGENCY SCORECARD and write ten yes/no questions worth one point each: licensed and appointed (verified on the state lookup)? commission schedule in writing? nothing charged to join? no requirement to buy my own policy? income from clients rather than recruits? training offered? book ownership stated plainly? charge-back terms stated? references from current AND former agents? comfortable with a two-week review period?
5. Write the scoring rule beneath: 9–10 proceed, 7–8 proceed with questions answered in writing, below 7 walk away — and any “no” on the pay-to-join,

self-purchase or recruiting questions is an automatic walk-away regardless of score.

6. Test the scorecard on the two imaginary offers from your warm-up, then on one deliberately written pyramid pitch (write it yourself, make it charming), and record the three scores.
7. Date both pages and clip them into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for appointment, captive agent, independent agent, ownership of expirations, vesting, charge-back and E&O, and add them to the box.
2. Draw the two-machines diagram: one carrier feeding one captive agent (arrows labeled training, leads, brand; return arrow labeled lower share, company owns book) beside several carriers feeding one independent agent (arrows labeled appointments; return arrows labeled higher share, own expenses, agent owns book).
3. Write a five-line trap list titled “The counterfeit agency,” listing the pyramid's tells — pay to join, buy your own policy, recruiting talk, rising splits by recruitment, tonight-only pressure — and ending: PRESSURE IS INFORMATION.

KEY FORMULAS

$$\text{Agent's commission} = \text{premium} \times \text{commission rate} \times \text{agent's share}$$

$$\text{Recruits needed at level } n = r^n \text{ (each recruit finding } r \text{ more)}$$

From history. The independent agents organized early: local fire insurance agents formed a national association in 1896 to defend the agency system, and their successor body speaks for independent agencies to this day. The captive system has its own monuments — by the mid-twentieth century exclusive-agent companies had put an appointed, single-carrier agent within a short drive of most American families. The two machines have now competed for a century, which is strong evidence that each serves someone best.

WORKED EXAMPLES

Example 1. Two offers, one product. A captive contract pays the agent 50% of a 10% commission on each auto policy; an independent agent keeps 100% of a 12% commission but pays his own expenses, about $1,000 a month in this example. Each agent writes $30,000 of premium a month. Compare their monthly results.

Show solution

1. Captive: $\$30{,}000 \times 0.10 \times 0.50 = \$1{,}500$, with office, training and leads provided.
2. Independent, gross: $\$30{,}000 \times 0.12 \times 1.00 = \$3{,}600$.
3. Independent, net of expenses: $\$3{,}600 - \$1{,}000 = \$2{,}600$.
4. The independent nets more in this example — but his $30,000 of premium had no company leads behind it, and in a slow month his $1,000 of expenses arrives anyway. The captive's floor is higher; the independent's ceiling is higher, and he is building a book he owns.

Answer: Captive $1,500 with support; independent $2,600 net, alone, plus ownership of the renewals. The numbers are examples; the structure of the trade is the lesson.

Example 2. Exam style. A producer passes her exam, receives her license, and signs an agency agreement with Carrier X, which has not yet filed anything with the state. She sells a Carrier X homeowners policy that afternoon. What is wrong?

A. Nothing — her license authorizes the sale

B. She has not been appointed by Carrier X

C. Her license is invalid until she sells her first policy

D. Homeowners policies require a separate federal license

Show solution

1. Separate the two permissions: the state's license (she has it) and the carrier's appointment filed with the state (she does not).
2. A is the trap — a license alone never authorizes selling a particular insurer's policies.
3. C invents a rule; licenses do not activate by selling. D invents a federal license that does not exist for homeowners insurance.
4. The appointment must be filed by the carrier; until then she may not transact its business.

Answer: B. A licensed producer must be appointed by each insurer whose policies she sells; the agency agreement is a contract, but the appointment filing with the state is what the law requires.

Example 3. The pyramid's own arithmetic. A recruiter promises that you need only find 5 recruits, each of whom finds 5 more, and so on. How many people must join at the 8th level below the founder, and what does that say about the promise?

Show solution

1. Each level multiplies by 5: level n needs 5^n recruits.
2. Level 8: $5^8 = 390{,}625$ people — at that one level alone.
3. Level 10: $5^{10} = 9{,}765{,}625$ — more than the adult population of most states.
4. Every participant is promised the same growth, so the plan requires recruits that do not exist. The early joiners' income is the late joiners' fees; the structure guarantees that most participants, arriving late by definition, lose.

Answer: 390,625 at level 8 and nearly 9.8 million at level 10. Exponential recruiting exhausts any town, state or country; the promise is mathematically unkeepable, which is why the law treats pay-to-recruit schemes as frauds rather than businesses.

PRACTICE

1. Easy A producer holds a valid license. What one thing must still happen before she may sell a particular insurer's policies?

   Show answer

   The insurer must appoint her — an authorization the carrier files with the state. A license without an appointment permits no selling for that company.

2. Easy Which agent typically owns the book of business: captive or independent?

   Show answer

   The independent agent owns his expirations — clients and renewals. Under most captive contracts the carrier owns the book, and a departing captive agent leaves the clients behind.

3. **Easy** What is E&O insurance and who is it for?

Show answer

Errors and omissions insurance is the agent's own professional liability coverage — it defends and pays when a client alleges the agent's mistake caused a loss. It protects the agent, not the client's house or car.

4. **Medium** A captive agent is paid 50% of an 8% commission on a $2,400 annual premium. An independent agent on the same policy keeps all of a 10% commission. Compute both agents' commissions.

Show answer

Captive: $\$2{,}400 \times 0.08 \times 0.50 = \$96$. Independent: $\$2{,}400 \times 0.10 = \$240$. The gap pays for everything the captive's carrier provides — and everything the independent must buy himself.

5. **Medium** Which clause tells a departing agent whether his renewal commissions keep paying him after he leaves?
A. The commission schedule
B. The vesting provision
C. The charge-back provision
D. The appointment filing

Show answer

B. Vesting governs whether renewals survive the agent's departure, retirement or death. The schedule sets the rates (A), charge-backs claw back unearned advances (C), and the appointment is the state filing that authorizes selling (D).

6. **Medium** Name the three questions on the agency scorecard whose wrong answer is an automatic walk-away, whatever the rest of the score.

Show answer

Whether it costs money to join, whether you are pressed to buy your own policy, and whether income comes mainly from recruiting rather than from serving clients. Those three are the pyramid pattern itself.

7. Medium When a carrier terminates an agent's appointment, what must it do, and why does the rule exist?

Show answer

Notify the state of the termination — and disclose the cause when it involves serious misconduct. The rule keeps the public record accurate and prevents a dismissed agent from quietly carrying misconduct to the next carrier.

8. Hard A friendly recruiter says the enrollment discount expires tonight and the training seats are nearly gone. What does this lesson tell you the pressure itself means?

Show answer

Pressure is information: a legitimate agency can afford your two weeks of review because inspection costs it nothing, while a counterfeit must rush you because inspection kills it. The expiring discount is a tell, not an opportunity.

9. Hard An agency contract is silent on ownership of expirations and contains a two-year, fifty-mile non-solicitation clause. The recruiter says “don't worry, nobody enforces that.” Give the two-sentence answer a prudent candidate makes.

Show answer

Silence on ownership means the agency will claim the book, and restrictive covenants are enforced by courts often enough that no one should sign counting on mercy. The prudent answer: “Then you won't mind writing into the contract what you just said aloud” — terms that are true go into writing without complaint.

10. Hard In a recruiting scheme where each member must enroll 4 others, how many people are required at the 9th level, and why does the founder's testimony on stage prove nothing about your prospects?

Show answer

$4^9 = 262{,}144$ people at level 9 alone. The founder stands at the top of the flows of joining fees and overrides; his income is evidence of your position's cost, not its promise, because late joiners — which is almost everyone — are the source of early joiners' gains.

11. **Challenge** A new agent is choosing between the captive offer (50% of 10% commission, salary subsidy of $1,500 a month for the first year, carrier owns the book) and independence (100% of 12%, $1,200 monthly expenses, agent owns the book). At $20,000 of monthly premium, compute each first-year monthly income, then name the asset the arithmetic leaves out.

    Show answer

    Captive: $\$20{,}000 \times 0.10 \times 0.50 + \$1{,}500 = \$2{,}500$. Independent: $\$20{,}000 \times 0.12 - \$1{,}200 = \$1{,}200$. The captive more than doubles the independent's first-year pay in this example — but the independent is buying the omitted asset: a book of renewals he owns, which Lesson 10.4 will show compounding while the captive's book compounds for the carrier.

12. **Challenge** Proverbs 14:15 contrasts the simple, who believes every word, with the prudent, who looks well to his going. Write three sentences applying the verse to the opportunity meeting — including why checking a license lookup is an act of charity toward honest agencies, not an insult.

    Show answer

    The simple hears the stage testimony and signs; the prudent hears the same words and goes looking — at the state lookup, the written schedule, and the former agents. Verification is how the prudent man looks well to his going without having to call anyone a liar. And honest agencies are honored, not insulted, by inspection: every candidate who checks rewards the truthful and starves the counterfeit, which is charity with a spreadsheet.

COMMON MISTAKES

- Thinking the license authorizes selling — a producer must be appointed by each insurer whose policies he sells, and the carrier files that appointment with the state.
- Calling one side of the captive–independent divide “better”; each buys something real with something real, and the exam (and this course) stays neutral.
- Signing an agency contract without reading the commission schedule, vesting, charge-backs, ownership and restrictive covenants — the five clauses that decide what leaving costs.
- Assuming a non-compete or non-solicitation clause is unenforceable; many are enforced, and the time to negotiate one is before signing.

- Mistaking a recruiting pyramid for an agency because insurance products are present — a real product does not redeem a model that charges to join and pays mainly for recruiting.
- Forgetting that commissions may be shared only with persons licensed for the line — paying the unlicensed is a violation, not a courtesy.

Make it a game · Red Flag, Green Flag. Write fifteen slips, each one line from an imaginary agency pitch — "our commission schedule is attached as Exhibit A," "the $299 starter kit is required," "most of our agents begin by insuring themselves," "take the contract home to whoever you trust," "your split rises when your team hits ten recruits," "we verify every license, check ours too." A parent draws and reads each slip; you have five seconds to call RED FLAG or GREEN FLAG and one sentence of why. One point per correct call, a bonus point if your reason names the contract clause or the pyramid tell involved. Swap roles for round two; best score over fifteen slips wins.

Scripture. "The simple believeth every word: but the prudent man looketh well to his going." (Proverbs 14:15, KJV)

The verse does not praise suspicion; it praises looking. The prudent candidate verifies the license, reads the five clauses and asks for two weeks, not because all recruiters lie but because promises worth keeping survive inspection. Faith in God is never gullibility toward men — Scripture itself commands the testing.

10.3 An Honest Book of Business: Prospecting, Referrals and Service

OBJECTIVES

- Describe honest prospecting: the natural market served rather than ambushed, referrals earned by service, community presence and niche knowledge.
- State the marketing law every agent obeys: the National Do Not Call Registry, telemarketing calling hours, and CAN-SPAM's rules for commercial email.
- Explain the service cycle — annual reviews, claims advocacy and cross-serving real needs — and why retention is the profession's real asset.
- Compute what a retention rate does to a book of business over several years.
- Keep client records the way a professional keeps them: dated, complete and written as if the client will read them.

> **Warm-up.** In five minutes, write the names of up to fifteen households your family actually knows — neighbors, church, teams, work. Then put a star by each one you would feel comfortable serving honestly as their insurance agent someday, and an X by any you would feel you were ambushing. Keep the list; the lesson will give the stars and the X's their names.

WATCH

A day in the life of an insurance agent, agency owner

Mark W Flockhart · 5:56

https://www.youtube.com/watch?v=9Ck6Vu9cjWg

> **WHEN TO WATCH**
> Watch after the big idea and tally how the agent's hours actually divide — service, paperwork, prospecting — and notice how much of the day is keeping promises to existing clients rather than hunting new ones.

BACKUP VIDEO

National Do Not Call Registry (Avoid Telemarketers) | That Was History

That Was History · 2:23

https://www.youtube.com/watch?v=CK-84W6VuVA

A two-minute history of the registry every prospecting agent must obey; watch it before the practice set so the 2003 date and the registry's purpose are nailed down.

KEY TERMS

book of business

The clients and in-force policies an agent serves; its renewal commissions are the profession's compounding asset.

natural market

The people an agent already knows — family, friends, church, teams, trade — approached honestly as an offer of service, never as an ambush of a relationship.

prospecting

The ongoing work of finding people who may need what an agent sells — by referral, community presence, niche knowledge or permitted contact.

referral

An introduction a satisfied client makes to someone who may need the agent's help — earned by service and asked for plainly, never bought with anything of value that rebating rules forbid.

National Do Not Call Registry

The free federal registry, opened by the FTC in 2003, of phone numbers that telemarketers — including insurance prospectors — may not cold-call, with exceptions such as a consumer's written permission or an established business relationship.

telemarketing hours

The federal rule confining telemarketing calls to 8 a.m. through 9 p.m. in the called person's local time.

CAN-SPAM Act

The 2003 federal law governing commercial email: no false or misleading headers or subject lines, a truthful identification of the sender with a physical address, and a working opt-out honored promptly.

service cycle

The scheduled care of existing clients — annual reviews, claims advocacy, and updates at life changes — that earns retention and referrals.

annual review

A yearly sit-down comparing a client's coverage to his current life — new house, new driver, new business — so the policies still fit the risks.

retention rate

The percentage of a book's policies that renew each year rather than lapse or leave — the number that decides whether a book compounds or evaporates.

cross-serving

Offering an existing client coverage for another need he actually has — the auto client who also owns an uninsured rental, for example — as distinguished from selling for the sale's sake.

CORE IDEAS

The story. In 1896, local fire insurance agents from across the country organized a national association to defend their way of doing business — the hometown agency — against forces that thought insurance could be sold like flour, by mail and by price alone. The association survives today as the **Independent Insurance Agents &**

Brokers of America, and its long argument has never changed: insurance is not flour. A policy is a promise attached to a family, and promises are best kept by someone who knows the family — the agent whose office is on the square, who insured the hardware store and the pastor's car, who shows up at the fire. That small-town agent is not a nostalgia piece; he is a business model, and his asset has a name you learned last lesson: the **book of business.** This lesson is about how such a book is honestly built — and the first fact about it is arithmetic, not charm: books are built slowly, by service, because the only client worth winning is one worth keeping for twenty years.

How they figured it out. The industry learned, expensively, that there are two ways to grow: hunt new clients forever, or keep the ones you have. The second is wildly cheaper. A kept client renews — and renewal commissions arrive whether or not the agent sold anything that month. A kept client refers — and a **referral** arrives pre-trusted, because the recommendation of a friend outweighs any advertisement ever written. A kept client consolidates — the auto client brings the home, then the umbrella, then the small business, each a real need honestly served (**cross-serving**), not an upsell for the agent's sake. So the professionals built the **service cycle**: every client gets an **annual review** comparing coverage to his actual life; every claim gets the agent's advocacy, because the claim is the product finally delivered; every life change — marriage, teenager, new roof, new business — triggers a call. None of this is glamorous. All of it compounds.

The big idea. Honest prospecting starts where you already are. Your **natural market** — family, friends, church, teams, the trades you know — is not a list of targets; it is a set of relationships in which you may someday be genuinely useful, and the difference between serving and ambushing is the whole ethics of the profession. Serving sounds like: “I've become an insurance agent; if you ever want a second set of eyes on your coverage, I'd be honored.” Ambushing sounds like a friendship suddenly revealed to have been a sales funnel. Beyond the natural market, honest growth has three engines. *Community presence:* be visibly, actually useful — coach, volunteer, sponsor the team — and let the town learn your name attached to service. *Niche knowledge:* know one world deeply (farmers, contractors, restaurants) and become the agent who already understands the risk before the client explains it. *Earned referrals:* do excellent work, then ask plainly — “who else should I be taking

care of?" — remembering from Unit 9 that a thank-you may never become rebating: nothing of value for the sale that the state's rules forbid.

Now the law, because prospecting is regulated and the exam knows it. The **National Do Not Call Registry**, opened by the Federal Trade Commission in 2003, lists numbers that may not be cold-called for sales; an agent calls a registered number only with the consumer's prior written permission or an **established business relationship** — commonly from a purchase within 18 months or the consumer's own inquiry within 3 months, in the rule's terms. Telemarketing calls are confined to **8 a.m. to 9 p.m. in the called person's local time**, callers must identify themselves truthfully, and internal do-not-call requests must be honored even where the registry does not apply. Commercial email answers to the **CAN-SPAM Act** of 2003: no false headers or deceptive subject lines, a truthful sender with a physical mailing address, and a working opt-out honored promptly. Text messages are stricter still — automated marketing texts generally require the consumer's prior express consent, so the rule of thumb for a new agent is simple: no cold-text spam, ever. Scrub call lists against the registry, keep records of consent, and the law will never be the thing that ends your career.

Retention is where the ethics and the arithmetic shake hands. Suppose two agents each add 250 policies a year. One serves his book — reviews, claims advocacy, returned calls — and keeps 90% each year; the other hunts only, and keeps 80%. After three years the server's book holds about 678 policies and the hunter's about 610; run the same pattern a decade and the gap becomes a canyon, because every lost policy must be replaced just to stand still. Retention is also the honest agent's vindication: policies sold to people who needed them, at premiums they could afford, with coverage they understood, stay on the books. Policies sold by pressure lapse — and take a charge-back and the client's trust with them. The industry's blunt proverb is true: the first sale pays a commission; the twentieth year of renewals pays the mortgage. Your book's retention rate is your reputation, expressed as a percentage.

Last, the unglamorous habit that holds it all together: **records**. A professional's client file shows the date of every conversation, what was recommended and why, what the client declined and was told about the risk of declining, copies of applications and correspondence, and the consent trail for every call, email and text. Records protect the client, whose coverage can be reconstructed by a successor at need; they protect

the agent, because in any later dispute the contemporaneous note outweighs the confident memory; and they keep the service cycle honest, because the review you scheduled is the review you deliver, not the one you vaguely intend. Write every note as if the client — or the commissioner, from Unit 9 — will someday read it, because either may. A book of business is, literally, a book: the agent who keeps it well can hand a colleague any client's story in five minutes, and that is what “professional” means on an ordinary Tuesday.

On the exam today. State exams approach this lesson through the law and the ethics rather than the salesmanship. Know the marketing rules as facts: the Do Not Call Registry and its written-permission and established-business-relationship exceptions, the 8 a.m.–9 p.m. calling window in the consumer's time zone, CAN-SPAM's honest-header, physical-address and opt-out requirements. Expect crossover questions from Unit 9: a gift for a referral that violates the rebating rules, an advertisement that misrepresents a policy, a testimonial that implies guarantees. Watch the trap that confuses the registries: the Do Not Call list belongs to the FTC's telemarketing rules — it is not an insurance-department list, though the state's unfair trade practices law rides along whenever the call misrepresents. And remember the exam's quiet assumption, which happens to be true: a producer's records are evidence — the exam's scenarios about disputes and investigations are settled by what was documented, which is the examiner's way of telling you how to practice.

PICTURE STUDY



The Village Post Office, Frederick Goodall, 1849 · Oil on panel · Victoria and Albert Museum, London

Image: Wikimedia Commons, public domain

Frederick Goodall was barely twenty-seven when he painted this little panel of an English village's beating heart: the post office on the day the news and the letters come. Everyone is here — the readers and the read-to, the old soldier helping a young woman through her letter, the children underfoot who care for nothing but marbles — because this doorway is where the village's joys and troubles arrive. It opens this lesson because a book of business is exactly this crowd: one trusted point in a town where every family's news eventually lands, and where the professional who stands in the doorway had better be worthy of what he learns.

Look closely

- Find the POST sign over the door. One ordinary doorway serves the whole village — what does the crowd say about how much a town routes through a single trusted point?
- Watch the group bent over the news-sheet on the steps. News here is shared aloud, person to person — the original word-of-mouth that makes or unmakes a local reputation.
- Find the old man in the red coat reading over the young woman's shoulder. Someone's letter has become a neighbor's errand of help.

- Notice the children playing marbles, oblivious. The village's business goes on over their heads — until the day each of them has a letter of their own to receive.

Talk about it

1. Every letter in this picture is private news passing through trusted hands. An agent's files are the same: what does it mean to be worthy of a town's information — and what would one betrayal cost in a place like this?
2. The news-sheet crowd shows how fast word travels where everyone knows everyone. How is small-town word-of-mouth like a retention rate, and what behavior moves both?
3. The man in the red coat serves his neighbor by reading with her — unpaid, unasked, present. How does that kind of visible usefulness honestly build a professional's name, and where is the line where service would curdle into angling for the sale?

PROJECT

The Service Calendar and the Honest Market Map

You will build the two pages that turn this lesson's ethics into machinery: a map of a pretend agent's natural market sorted by service rather than by ambush, and a twelve-month service calendar showing when every client in a small pretend book gets reviewed, called and cared for — with the marketing law written across the top where the agent will see it every day.

You will need

- Two sheets of paper or a spreadsheet with two tabs
- Your warm-up list of fifteen households
- This lesson's key terms and the donotcall.gov consumer page from the kit

Steps

1. Page one, head it THE HONEST MARKET MAP. Using your warm-up list (or an invented one), sort the households into three rings: inner (would welcome an offer of service), middle (tell them the news once, then leave the door open), outer (relationships that should never be prospected — write why).
2. Under the map, write the two scripts from the lesson — the serving sentence and the ambushing sentence — and label which ring each belongs to (the ambush belongs to none).
3. Page two, head it THE SERVICE CALENDAR and rule twelve month-columns for a pretend book of 24 households (invent names and one fact each: new baby, teen driver, bakery owner, renter).
4. Place each household's annual review in a month, two per month, and mark four pretend claims through the year with a next-day follow-up call each.
5. Add the law banner across the top: registry scrubbed before any cold call — calls 8 a.m.–9 p.m. in THEIR time zone — truthful emails with a working opt-out — no cold texts.
6. Add a referral line to each month: one plain ask of one well-served household, and a note of what may never be given for one (Unit 9's rebating rules).

7. Write two sentences at the bottom on what this calendar costs the agent (hours, discipline) and what it buys (retention, referrals, a clean record), then date both pages for the Pathway File.

EXAM NOTEBOOK

1. Make flashcards for natural market, referral, Do Not Call Registry, telemarketing hours, CAN-SPAM, service cycle and retention rate, and add them to the box.
2. Draw the retention engine: a circle of arrows — honest sale → service and reviews → claim advocated → renewal kept → referral earned → honest sale — with the one number that measures the wheel (retention rate) in the hub.
3. Write a five-line trap list titled “Marketing law,” one line each for the registry and its two exceptions, the 8–9 clock in the consumer's time zone, CAN-SPAM's opt-out, the no-cold-texts rule, and rebating's shadow over referral gifts.

KEY FORMULAS

$$\text{Book next year} = \text{book now} \times \text{retention rate} + \text{new policies}$$

$$\text{Policies lost} = \text{book} \times (1 - \text{retention rate})$$

From history. The Do Not Call Registry's opening in the summer of 2003 was one of the most popular acts in regulatory history: millions of numbers were registered within days of the lines opening, and tens of millions by the first autumn. Originally numbers expired after five years; the rule was changed in 2007 so registrations stay until the number is dropped or the consumer removes it — a detail that still catches agents who assume old registrations have lapsed.

Example 1. Two agents each write 250 new policies a year. Agent A retains 90% of her book each year; Agent B retains 80%. Compute each book at the end of year 3, starting from zero.

Show solution

1. Year 1, both: 250 policies on the books.
2. Agent A — year 2: $250 \times 0.90 + 250 = 475$; year 3: $475 \times 0.90 + 250 = 677.5 \approx 678$.
3. Agent B — year 2: $250 \times 0.80 + 250 = 450$; year 3: $450 \times 0.80 + 250 = 610$.
4. Same selling, different serving: ten points of retention is 68 policies after three years — and the gap widens every year, because B must replace a fifth of his book annually just to stand still.

Answer: Agent A: about 678 policies; Agent B: 610. Retention — earned by reviews, claims advocacy and honest selling — is the compounding engine of a book.

Example 2. Exam style. An agent plans an evening of prospecting calls to numbers from a purchased lead list. Which call is PERMITTED under federal telemarketing rules?

A. A 9:30 p.m. call to a prospect in the agent's own time zone

B. A cold call to a number on the Do Not Call Registry

C. A call to a client who bought a policy from the agent eight months ago

D. A call using a false caller name to improve answer rates

Show solution

1. Test each against the rules: hours, the registry and its exceptions, truthful identification.
2. A fails the calling window if 9:30 p.m. is the called person's local time — calls run 8 a.m. to 9 p.m. where the consumer is.
3. B is the core prohibition; a purchased list does not scrub itself.
4. D violates the truthful-identification requirement and the state's misrepresentation rules besides.
5. C fits the established business relationship exception — a purchase within the rule's window permits the call, though any do-not-call request from the client must still be honored.

Answer: C. An existing client relationship permits the call; the registry blocks B, the clock blocks A, and honesty blocks D.

Example 3. The referral arithmetic, honestly. An agent serves 300 households. Each year she asks each household once, plainly, for an introduction; in this example 1 in 10 makes one, and 60% of those introductions become clients. How many new clients does service produce per year, and what would the same 300 households produce at a 95% retention rate in renewals kept versus a 85% rate?

Show solution

1. Referrals made: $300 \times 0.10 = 30$ introductions.
2. New clients: $30 \times 0.60 = 18$ — won without one cold call, pre-trusted by a friend's word.
3. Renewals kept at 95%: $300 \times 0.95 = 285$; at 85%: $300 \times 0.85 = 255$.
4. The served book gains 18 and keeps 285 — net 303. The unserved book gains few referrals and keeps 255. Service is not the soft side of the business; it is the arithmetic side.

Answer: About 18 referred clients a year, and a 30-policy renewal gap between 95% and 85% retention on the same book. The same behavior — service — drives both numbers.

PRACTICE

1. Easy What hours does federal law allow telemarketing calls, and in whose time zone?

   Show answer

   8 a.m. to 9 p.m. in the called person's local time — the consumer's clock, not the agent's.

2. Easy Name the three things the CAN-SPAM Act requires of a commercial email.

   Show answer

   Truthful, non-misleading headers and subject lines; honest identification of the sender including a physical mailing address; and a working opt-out honored promptly.

3. **Easy** What is a retention rate, and why does this lesson call it “your reputation, expressed as a percentage”?

Show answer

The share of a book's policies that renew each year. Policies sold honestly to people who needed them stay; policies sold by pressure lapse — so the rate measures how the selling was done.

4. **Medium** A book holds 400 policies and retains 88% this year while the agent writes 90 new ones. Compute next year's book and the number of policies lost.

Show answer

Lost: $400 \times 0.12 = 48$. Next year: $400 \times 0.88 + 90 = 442$. Almost half the new production merely replaced losses — the arithmetic case for service.

5. **Medium** Which prospecting call violates federal rules?

A. Calling a client who bought a policy six months ago
B. Calling a prospect at 8:30 p.m. his local time
C. Cold-calling a number listed on the Do Not Call Registry without permission
D. Calling a consumer who mailed in an inquiry last month

Show answer

C. The registry bars cold calls absent written permission or an established business relationship. A and D fit the exceptions (recent purchase; recent inquiry), and B is inside the 8 a.m.–9 p.m. window.

6. **Medium** Your warm-up list had stars and X's. State the difference between serving a natural market and ambushing it, in one sentence each.

Show answer

Serving tells the relationship the truth once — “this is my work now; I'm here if ever useful” — and leaves the friendship undisturbed. Ambushing converts the friendship into a sales funnel, spending trust that was given for another purpose.

7. Medium A delighted client asks how to thank her agent. The agent wants referrals. What may the agent ask for, and what may the agent not give in return?

Show answer

She may ask plainly for an introduction to someone else she could serve. She may not give anything of value for the sale or referral that her state's rebating and inducement rules forbid — gratitude is legal; purchased referrals generally are not.

8. Hard Why does this lesson call a claim "the product finally delivered," and what does an agent's claims advocacy earn?

Show answer

The policy is a promise; the claim is the day the promise is kept, and the only day the client learns what he really bought. An agent who shepherds the claim earns the renewal, the referral and the reputation — retention's three paychecks.

9. Hard An agent cold-calls from a purchased list without scrubbing it against the registry, reasoning that fines only follow complaints. Give the two-sentence professional answer.

Show answer

The violation exists at the dial tone, not at the complaint — and penalties per call can reach tens of thousands of dollars, so the strategy bets the agency on the hope that no one is annoyed. The deeper answer is Unit 9's: an agent who obeys the rules only when watched has already failed the license's real exam.

10. Hard Compute the five-year book for an agent adding 200 policies a year at 90% retention, starting from zero, and state what the sequence shows. (Round each year to the nearest policy.)

Show answer

Year 1: 200; year 2: $200 \times 0.9 + 200 = 380$; year 3: 542; year 4: 688; year 5: 819. Growth slows as losses grow with the book — a book compounds toward a ceiling set by retention, so raising retention lifts the ceiling itself.

11. **Challenge** At 90% retention an agent's book levels off near $200 \div 0.10 = 2{,}000$ policies; at 80% it levels near $200 \div 0.20 = 1{,}000$. Explain where these ceilings come from and what they imply about where an agent's effort belongs.

    Show answer

    The book stops growing when annual losses equal annual additions: book × (1 − retention) = new policies, so the ceiling is new ÷ (1 − retention). Ten points of retention doubles the lifetime size of the same selling effort — which is why the mature agent's hours shift from hunting to serving: the service IS the growth.

12. **Challenge** Proverbs 22:1 prefers a good name to great riches. Write three sentences showing how, in this profession, the two are not actually rivals — and what the verse still forbids even when they travel together.

    Show answer

    An agent's good name produces retention and referrals, which produce the renewals that build whatever riches the career yields — in insurance the good name is the business model. But the verse ranks them for the day they conflict: when a lie would win the sale or silence would keep the client, the name is to be chosen and the riches released. A reputation kept only while profitable was never a good name, merely good marketing.

COMMON MISTAKES

- Cold-calling from any list without scrubbing it against the Do Not Call Registry — purchased leads do not arrive pre-scrubbed, and the exceptions are written permission or an established business relationship, not the agent's optimism.
- Using the agent's own time zone for the 8 a.m.–9 p.m. window; the rule runs on the called person's clock.
- Treating CAN-SPAM as an anti-email law; it permits honest commercial email and forbids deceptive headers, hidden senders and ignored opt-outs.
- Rewarding referrals with gifts or payments that the state's rebating and inducement rules forbid — a thank-you note is safe; value-for-sale is not.
- Confusing cross-serving with upselling: offering coverage for a need the client actually has serves him; loading policies for commission's sake is Unit 9's suitability violation wearing a smile.

- Keeping records in memory — the contemporaneous, dated note is what protects client and agent alike when memories later disagree.

Make it a game · May I Make This Call?. Write twelve scenario slips: “8:45 p.m. call to a client two time zones east,” “cold call to a registry number,” “call to a man who mailed an inquiry last week,” “email with subject ‘Your policy is cancelled!’ that is really an ad,” “text blast to a purchased list,” “thank-you card to a referring client,” “$50 gift card per referral,” and five more of your own. A parent reads each; you have five seconds to call LEGAL, ILLEGAL, or LEGAL-BUT-UNWISE, plus the rule involved. One point per correct call, one more for naming the rule (registry, calling hours, CAN-SPAM, consent for texts, rebating). Best of twelve wins; then swap roles — writing the slips is the better drill.

Scripture. “A good name is rather to be chosen than great riches, and loving favour rather than silver and gold.” (Proverbs 22:1, KJV)

In most trades a good name decorates the business; in this one it is the business — the book of renewals is simply the town's opinion of the agent, collected annually. The verse's ranking still matters on the day the two diverge: the agent who would rather lose a commission than shade the truth is choosing exactly what Solomon said to choose.

10.4 The Agent's Income: Commissions, Renewals and the First Three Years

OBJECTIVES

- Compute first-year and renewal commissions for life insurance, and per-member-per-month and percentage compensation for health business.
- Explain property & casualty commissions — commonly about 10–15% on new business and renewals — and why a P&C book compounds.
- Compute a charge-back when an advanced commission outruns a lapsed policy.
- Build an honest first-three-years income model: production × premium × commission − charge-backs − expenses.
- Budget on commission income: taxes set aside, an emergency fund, and the licensing and E&O costs that arrive whether or not sales do.

> **Warm-up.** With pencil and paper: an agent sells a life policy with a $1,200 annual premium and earns 70% of the first year's premium, then 4% of each renewal premium for years two through ten. Compute the first-year commission and one renewal-year commission, and write one sentence on which number a hungry new agent cares about and which number a wise one does.

WATCH

How insurance agents get paid

Think Insurance · 9:42

https://www.youtube.com/watch?v=d2cab4NszMM

> **WHEN TO WATCH**
> Watch after the big idea with your notebook ruled into three columns — life, health, P&C — and record how each line pays its agents, noting every figure as that teacher's example rather than a promise.

BACKUP VIDEO

Insurance Agent Salary 2026: How Much Can You Earn? (Complete Guide)

Open Exam Prep · 3:44

https://www.youtube.com/watch?v=zNPaTynXEqk

A short, sober pass over agent pay ranges and what drives them; watch it after the project and check each figure it quotes against your own model's labeled examples.

KEY TERMS

first-year commission (FYC)

The commission on a life policy's first-year premium — commonly a large percentage, often 40% to 100% or more depending on product and contract, in example terms.

renewal commission

The much smaller percentage — commonly low single digits — paid on premiums in later policy years, often through year ten on life business.

per-member-per-month (PMPM)

A health-insurance compensation method paying the agent a flat dollar amount each month for each covered member, instead of a percentage of premium.

advance

Commission paid to the agent up front — often several months to a year of expected commission — before the client has actually paid the premiums that earn it.

as-earned

Commission paid only as each premium payment arrives — slower money, but money that can never be charged back.

charge-back

The repayment owed when a policy lapses or cancels before an advanced commission has been earned by premiums actually paid.

persistency

The insurance word for how long policies stay in force — the carrier's measure of an agent's book, and the hinge on which advances, bonuses and contracts turn.

renewal book

The accumulated in-force premium paying the agent renewal commissions every year — the asset that makes year ten of this career different from year one.

self-employment taxes

The Social Security and Medicare taxes an independent-contractor agent pays on his own earnings, which no employer withholds for him — set aside with income tax from every commission check.

median pay

The middle of all earners — half make more, half less; the Bureau of Labor Statistics reports a median of $60,370 for insurance sales agents as of May 2024.

CORE IDEAS

The story. In 1942 a thirty-year-old poultry-truck driver's son from East Liverpool, Ohio, named Ben Feldman took a job selling life insurance for New York Life — after an aptitude test suggested, the story goes, that he had little future in selling. He was not smooth. He was short, round and so soft-spoken that customers leaned in to hear him. What he did was work: he stayed in his little steel town instead of chasing a city, called on the same Main Street business owners for years, learned their balance sheets better than they did, and translated policies into problems solved — "the money to keep the shop open the week after the funeral." The lean years were lean. But renewals stacked on renewals, referrals on referrals, and by mid-career Feldman was, by wide repute, the most productive life insurance salesman in the world; over his career he placed on the order of a billion and a half dollars of coverage, nearly all of it within a short drive of home. Remember what the aptitude test could not measure: the income of this profession is not a salary attached to a talent — it is arithmetic attached to faithfulness, and this lesson is that arithmetic.

How they figured it out. Each line of the business pays its agents in the shape of its own economics. *Life insurance* pays a large **first-year commission** — commonly 40% to 100% or more of the first year's premium in example terms, because the carrier is buying the agent's hardest work, the needs analysis and placement — followed by small **renewal commissions**, commonly low single digits, often through year ten. *Health insurance* commonly pays a modest percentage of premium or a flat **per-member-per-month** amount — in this example $20 per member — reflecting business that must be re-served every year. *Property & casualty* pays the steadiest shape of all: commonly about 10–15% of premium on new business *and on every renewal*, which is why a P&C agent's book behaves like a savings account that service keeps filling. Every figure above varies by company, product, contract and state — your real numbers will live in a commission schedule like the one Lesson 10.2 taught you to read before signing.

The big idea. Now the sentence that explains the whole career curve: **first-year commissions buy groceries; renewals buy freedom.** A new life agent's income is almost all FYC — made this month, spent this month, and reset to zero on the first of next month. But every policy that stays in force quietly joins the **renewal book**, and the renewal book pays whether or not this month's prospecting went well. Run the shape: a life agent writing $8,000 of new annual premium a month at 70% FYC earns about $5,600 a month from new sales — year one and year five alike. But by year five, if his business has stayed on the books, renewals on four prior years of production are arriving on top, and the same selling month pays sharply more. P&C compounds even faster because renewals pay the full commission rate: the worked examples below put real numbers on it. This is why **persistency** — the carrier's word for policies that stay in force — is the number carriers print on an agent's scorecard, and why the honest selling of Lesson 10.3 is also the profitable kind.

The shadow side of commission income is the **charge-back.** Carriers often pay new agents **advances** — six, nine, twelve months of expected commission the day the policy is issued — because new agents need groceries before renewals exist. But an advance is a loan against premiums not yet paid: if the policy lapses in month three, the agent has earned only three months' worth, and the unearned remainder is charged back — deducted from his next checks or, if he has left, owed as a debt. In this example: a $100-monthly-premium policy at 75% FYC, advanced nine months, pays $0.75 \times \$100 \times 9 = \$675$ up front; a month-three lapse leaves $\$675 - \$225 = \$450$

to repay. Charge-backs are why pressure-selling destroys its own paycheck, why some veterans choose slower **as-earned** pay, and why a wise agent treats a fat advance as mostly not-yet-his.

Here is the honest first-three-years arithmetic, with every number an example. A new life & health agent sells 6 policies a month at an average $1,100 annual premium and 70% FYC: new commissions of about $6 \times \$1{,}100 \times 0.70 = \$4{,}620$ a month, roughly $55,000 in year one — before subtractions. Subtract charge-backs (a 15% first-year lapse rate in this example takes roughly $6,000), E&O ($600), licensing, CE and fees ($400), marketing, mileage and phone ($6,000), and the self-employment and income taxes set aside from every check (say a quarter of what remains), and year one's take-home is nearer $31,000 than the gross a recruiter might quote. Year two: the same production plus renewals on year one; year three: plus two years of renewals. The curve bends upward — but it starts low, which is why this course tells you now, not after a contract is signed: the first years are the price of the asset. Most who quit, quit in years one to three, usually because the arithmetic surprised them; the survivors knew the shape, kept their activity up (calls made, reviews held), served their books so renewals actually renewed, and lived on a budget while the book grew.

Which brings us to budgeting, the unglamorous key to surviving the curve. Commission income arrives jagged — $7,000 one month, $1,900 the next — and no employer withholds anything, so the agent is his own payroll department. The working rules: set aside a fixed share of every check for **self-employment and income taxes** the day it arrives (new agents commonly reserve a quarter to a third, in example terms, and pay the IRS quarterly); build an emergency fund of several months' expenses before upgrading anything, because a slow quarter is a certainty, not a risk; pay the non-negotiables first — E&O, license renewals, CE — since they guard the career itself; and live, deliberately, below the *average* month, never the best one. The Bureau of Labor Statistics (May 2024) reports **median pay of $60,370** for insurance sales agents, with about 47,000 openings a year and roughly 4% growth projected for 2024–34 — and because renewals compound, the right tail runs far above the median for agents who last. The whole game, therefore, is lasting.

On the exam today. State exams rarely ask your commission percentage — that is contract, not law — but they circle this lesson's edges constantly. Commissions may be paid only to producers licensed for the line, and sharing them with the

unlicensed is a violation; returning any part of a commission to the client is Unit 9's rebating. Some states cap what may be charged beyond premium, and fee disclosures are tested where they apply. Expect the vocabulary as straight definitions: advances versus as-earned, charge-backs, persistency. And watch the exam's favorite income-adjacent trap — the producer who, short on groceries in month two, “borrows” a client's premium on its way to the carrier: that is conversion of premium funds, a license-ending violation, and the fiduciary duty over premiums you learned in Unit 9 is the real reason this lesson taught you to budget. An agent whose own finances are in order is an agent no temptation finds at a weak moment.

PICTURE STUDY



The Sower, Jean-François Millet, 1850 · Oil on canvas · Museum of Fine Arts, Boston

Image: Wikimedia Commons, public domain

Jean-François Millet, the painter of French peasant labor, shocked the Paris Salon of 1850 with this figure — a sower made monumental, striding down a bare autumn field, throwing seed into ground that will show nothing for months. The critics argued about him; the farmers simply recognized him. He opens this lesson because the new agent's first years are this field: all scattering, no harvest, birds taking some of what is thrown. The sower keeps his stride anyway, because he knows something the single evening cannot show — the arithmetic of seasons. Renewals are a harvest, and harvests answer only to those who sowed and stayed.

Look closely

- Follow the sower's stride — he moves like a man who will cross this whole field tonight. Effort is the part of the harvest he controls.
- Find the scattered seed leaving his hand. At the moment of sowing it looks like loss; nothing in the picture yet proves it was not.
- Notice the birds circling in the distance — some seed will be taken. What does the sower's steady pace say about losses he has already priced in?
- Find the harrowing team on the far slope: another worker, another stage. The field is a system of faithful steps, not one dramatic act.

Talk about it

1. The sower works at dusk with no harvest in sight. Which parts of a new agent's first three years are pure sowing, and what tempts people to quit a field that is actually working?
2. The birds take some seed, as lapses take some policies. How do charge-backs teach an agent to sow good seed in good ground — suitable policies for real needs — rather than simply to sow more?
3. Paul writes that one sows, another waters, but God gives the increase. What does that leave in the agent's hands, and what does it take out of them?

PROJECT

The First Three Years: An Honest Income Model

You will build the spreadsheet a recruiter will never show you: a month-by-month model of a pretend new agent's first three years, with production, commissions, charge-backs, expenses and taxes all visible — and the renewal book growing quietly underneath. Every figure is a labeled example, and the finished model joins your Pathway File as the page that proves you entered this career with your eyes open.

You will need

- Free spreadsheet software (Google Sheets or LibreOffice Calc)
- This lesson's formulas and worked examples
- The BLS Occupational Outlook page for insurance sales agents, from the kit, for the honest benchmarks

Steps

1. Build the assumptions block and label it EXAMPLES: policies sold per month (6), average annual premium ($1,100), FYC (70%), renewal rate (4%, years 2–10), first-year lapse rate (15%), monthly expenses (E&O, fees, marketing, mileage — total $600), and a tax set-aside share (25%).
2. Rule 36 month-rows. For each month compute new-sale commissions: policies × premium × FYC.
3. Add a charge-back column: in this simple model, subtract the lapse rate's share of each month's new commissions three months later.
4. Add a renewals column that begins in month 13: 4% of all premium still in force from the first year's sales, growing again in month 25 — your in-force tracker from the formulas makes this one multiplication.
5. Compute each month's net: commissions + renewals − charge-backs − expenses − tax set-aside, and total each year.
6. Chart the 36 months as a line, and mark where the renewal book first pays more than one whole month's expenses.

7. Write the honest paragraph beneath the chart: what year one's net actually was, when the curve bent, what the model says to someone who quits in month nine — and compare year three's pace to the BLS median of $60,370 (May 2024), labeling every number an example.
8. Print or export the summary page, date it, and clip it into your Pathway File.

EXAM NOTEBOOK

1. Make flashcards for FYC, renewal commission, PMPM, advance, as-earned, charge-back and persistency, and add them to the box.
2. Draw the income curve of the first five years: a jagged low line (FYC) with a smooth wedge (renewals) growing beneath it, labeled where the wedge overtakes the jag — title it GROCERIES VS. FREEDOM.
3. Write a five-line trap list titled “Commission money,” covering: the advance is a loan; set taxes aside the day the check lands; E&O and license fees come before upgrades; premiums are never the agent's money; live below the average month.

KEY FORMULAS

$$\text{First-year commission} = \text{annual premium} \times \text{FYC rate}$$
$$\text{Renewal commission} = \text{renewal premium} \times \text{renewal rate}$$
$$\text{Charge-back} = \text{advance} - \text{commission earned before lapse}$$
$$\text{P\&C book income} = \text{in-force premium} \times \text{commission rate}$$
$$\text{Net income} = \text{commissions} - \text{charge-backs} - \text{expenses} - \text{taxes set aside}$$

From history. Feldman's method was homely and transferable: he carried simple one-page “idea cards” that turned a policy into a solved problem — the week-after-the-funeral payroll, the partner's buyout funded in advance — and he famously kept calling on one prospect for years until the man's problem and the policy finally met. New York Life honored his fiftieth anniversary in 1992 with a company-wide sales celebration in his name; Feldman, by then in his eightieth year, competed in it himself — and won it from a hospital room.

WORKED EXAMPLES

Example 1. A life policy carries a $1,200 annual premium. The contract pays 70% FYC and 4% renewals for years 2–10. Compute the first-year commission, one renewal year, and the policy's total commissions over ten years if it stays in force.

Show solution

1. First year: $\$1{,}200 \times 0.70 = \$840$.
2. Each renewal year: $\$1{,}200 \times 0.04 = \$48$.
3. Renewal years 2–10 are nine years: $9 \times \$48 = \$432$.
4. Ten-year total: $\$840 + \$432 = \$1{,}272$ — and a third of it arrives only if the policy persists, which is why honest, suitable selling is also the profitable kind.

Answer: FYC $840; renewals $48 a year; ten-year total $1,272, of which $432 depends entirely on the policy staying in force.

Example 2. A P&C agent writes $150,000 of new annual premium each year at a 12% commission on new business and renewals, and her book retains 90% each year. Compute her commission income in years 1, 2 and 3.

Show solution

1. Year 1 in-force: $150,000; commission $\$150{,}000 \times 0.12 = \$18{,}000$.
2. Year 2 in-force: $\$150{,}000 \times 0.90 + \$150{,}000 = \$285{,}000$; commission $\$285{,}000 \times 0.12 = \$34{,}200$.
3. Year 3 in-force: $\$285{,}000 \times 0.90 + \$150{,}000 = \$406{,}500$; commission $\$406{,}500 \times 0.12 = \$48{,}780$.
4. Identical selling all three years — but the renewal book nearly tripled the paycheck, because P&C renewals pay the full rate. This is the compounding the quitters never stay to collect.

Answer: Year 1: $18,000; year 2: $34,200; year 3: $48,780 — the same work, compounding.

Example 3. A carrier advances nine months of commission on a life policy with a $100 monthly premium at 75% FYC. The client stops paying after month 3. Compute the advance, the earned commission, and the charge-back.

Show solution

1. Advance: $0.75 \times \$100 \times 9 = \$675$ paid at issue.
2. Earned before lapse: $0.75 \times \$100 \times 3 = \$225$.
3. Charge-back: $\$675 - \$225 = \$450$, deducted from the agent's future checks.
4. If that advance was already spent, the agent now works a month to repay a sale that failed — the arithmetic that punishes pressure-selling and rewards suitable placement.

Answer: Advance $675; earned $225; charge-back $450. An advance is a loan against persistency, not a gift.

PRACTICE

1. Easy A life policy has a $900 annual premium and the contract pays 80% FYC. Compute the first-year commission.

   Show answer

   $\$900 \times 0.80 = \$720$ — earned once; the renewal years pay far less, which is why production must continue.

2. Easy What does per-member-per-month compensation mean, and which line commonly uses it?

   Show answer

   A flat dollar amount paid monthly for each covered member — common in health insurance. At $20 PMPM in this example, a 40-member book pays $40 \times \$20 = \$800$ a month.

3. Easy What is the difference between advanced and as-earned commissions?

   Show answer

   An advance pays expected commission up front, before the client's premiums arrive, and can be charged back if the policy lapses; as-earned pays only as each premium is paid — slower, but never owed back.

4. **Medium** A P&C agency book holds $600,000 of in-force premium at a 10% commission. What does the book pay this year before any new sale, and why does this lesson call a P&C book "a savings account that service keeps filling"?

Show answer

$600,000 \times 0.10 = $60,000 of renewal commissions. Because P&C renewals pay the full rate, retained policies keep paying every year — service (which drives retention) is literally the deposit.

5. **Medium** A carrier advances six months of commission on a policy with a $80 monthly premium at 60% FYC. The policy lapses after month 2. Compute the charge-back.

Show answer

Advance: $0.60 \times $80 \times 6 = 288. Earned: $0.60 \times $80 \times 2 = 96. Charge-back: $$288 - $96 = 192.

6. **Medium** What median pay does the BLS report for insurance sales agents (May 2024), and what do the words "median" and "right tail" each tell a student?

Show answer

$60,370: half of agents earn more, half less. The right tail runs high because renewals compound for agents who last — but a median is a fact about the whole field, not a promise to any entrant.

7. **Medium** Why do most agents who quit do so in years one to three, according to this lesson — and name two things the survivors did differently.

Show answer

Because income in those years is nearly all first-year commission minus charge-backs and expenses, and the arithmetic surprises those who expected the recruiter's gross. Survivors kept activity up (calls, reviews), served the book so renewals persisted, and budgeted below the average month while the renewal wedge grew.

8. Hard An agent's commission check is $4,000 and she reserves 28% for taxes the day it arrives. How much may she spend, and why must she do her own withholding?

Show answer

$4,000 \times 0.72 = $2,880. As an independent contractor no employer withholds for her — income and self-employment taxes are hers to set aside and pay quarterly, and spending the tax share is borrowing from a lender who always collects.

9. Hard A life agent writes 72 policies in year one, average annual premium $1,000, 70% FYC, 4% renewals. If 85% of those policies are still in force in year two, what do year-one sales pay him in year two while he sells nothing new from them?

Show answer

In-force premium: $72 \times $1,000 \times 0.85 = $61,200. Renewals: $61,200 \times 0.04 = $2,448 — small beside FYC, but it arrives for up to nine more years and stacks with every later year's book.

10. Hard Two agents gross the same $50,000 of FYC. Agent A's lapse rate charges back 8% of it; Agent B's pressure-sold book charges back 25%. Each pays $7,000 of expenses. Compare their pre-tax nets and state the lesson.

Show answer

A: $50,000 \times 0.92 - $7,000 = $39,000. B: $50,000 \times 0.75 - $7,000 = $30,500. Identical selling totals, $8,500 apart: suitability is not only Unit 9's law — it is the better-paying business model.

11. Challenge Using worked example 2's pattern ($150,000 new premium a year, 12% commission, 90% retention), compute year 5's in-force premium and commission, and the ceiling the book approaches if the pattern never changes.

Show answer

Year 4: $406,500 \times 0.9 + $150,000 = $515,850; year 5: $515,850 \times 0.9 + $150,000 = $614,265, paying $614,265 \times 0.12 \approx $73,712. The ceiling is new ÷ (1 − retention) = $150,000 \div 0.10 = $1,500,000 in force — about $180,000 a year — reached only by an agent whose service keeps retention at 90% while he keeps sowing.

12. **Challenge** Luke 14:28 asks who builds a tower without first counting the cost. Write three sentences applying the verse to a student deciding on this career — including what this lesson's honest model is for, and why counting the cost is an act of faith rather than of doubt.

Show answer

> The tower is the renewal book, and the cost is two or three lean, disciplined years that the income model counts in advance, month by month. The model exists so that the decision is made once, on paper, instead of nightly in discouragement — the builder who counted can keep laying bricks in month nine because month nine was already on the plan. Counting the cost is not doubting the tower; it is the obedience of a builder who intends to finish, which is exactly the kind Scripture commends.

COMMON MISTAKES

- Quoting the gross commission as the income — charge-backs, expenses and self-set-aside taxes stand between the FYC and the groceries, and the honest model subtracts all three.
- Treating an advance as earned money; it is a loan against persistency, and the lapse that triggers a charge-back does not ask whether the advance was already spent.
- Confusing the lines' shapes: life pays big-then-small (large FYC, small renewals), P&C pays steady (commonly about 10–15% on new and renewal) — reversing them fails questions and business plans alike.
- Forgetting that commissions may be paid or shared only with producers licensed for the line, and that returning commission to a client is rebating.
- Budgeting on the best month instead of below the average one — commission income is jagged, and the emergency fund is what makes the jag survivable.
- Even touching premium money on its way to the carrier — premiums are held in trust, and “borrowing” them is conversion, a license-ending violation no lean month excuses.

Make it a game · Commission Dice. Each player is an agent with a pretend book. Each round, roll two dice: the first die is policies sold this month, the second sets the annual premium (die × $200). Compute your FYC at 70% on paper — fastest correct answer steals a bonus $100. Then draw from a shuffled deck of six slips, two marked LAPSE: a lapse charges back half of this round's FYC (compute it aloud). Keep a running renewal line too: each round, add 4% of all premium you have kept so far. Play six rounds; highest total wins, and notice who wins — almost always the player whose renewal line grew, not the one with one lucky month.

Scripture. “For which of you, intending to build a tower, sitteth not down first, and counteth the cost, whether he have sufficient to finish it?” (Luke 14:28, KJV)

Christ assumes that wise building begins with honest arithmetic — sitting down first is not pessimism but intent to finish. This lesson's income model is that sitting down: the student who counts the lean years before signing anything can walk through them when they come, because nothing in them is a surprise.

10.5 The Capstone: Your Pathway File and the Practice Exam Plan

OBJECTIVES

- Assemble the complete Pathway File: state facts sheet, licensing checklist, contract and agency tools, service calendar, income model and ethics commitments.
- Name the profession's ladders beyond the license: the CLU, ChFC, CPCU and CIC designations, the adjuster, underwriter and agency-owner paths, added lines, and the securities licenses variable products require.
- Plan and sit the course final exactly like test day, and map the score honestly to readiness.
- State the license's ongoing duties: continuing education — commonly 24 hours per two-year renewal including about 3 hours of ethics — renewals, and a clean record.
- Say, in your own words, what the agent is for: the neighbor who shows up after the fire.

> **Warm-up.** In five minutes, write the table of contents for your Pathway File from memory — every artifact this unit and this course asked you to build and keep. Then open the file and check: list what you actually have, and circle anything missing. The capstone project begins wherever your circles are.

WATCH

7 Secrets To Passing Your Insurance Exam In 1 Week

Insurance Exam Prep by JustInsurance · 10:54

https://www.youtube.com/watch?v=vK9JlVgR-4g

> **WHEN TO WATCH**
> Watch before planning your practice final and collect the study tactics — pacing, elimination, trap words — into a checklist; ignore the title's one-week framing, since your plan has thirty-three weeks behind it.

BACKUP VIDEO

The Alphabet Soup of Insurance Designations - Hey #Insurance - Ep 112

Insurance Nerds · 9:16

https://www.youtube.com/watch?v=DgQKB7Nu2yU

Two industry veterans sort the designations cheerfully; watch it while finishing the profession map so CLU, CPCU and their cousins land as real career rungs rather than letters.

KEY TERMS

Pathway File

The portfolio this course has built since Unit 1 — the state facts sheet, checklists, comparisons, models and commitments a student carries from the course to the real licensing road.

practice final

This course's full-length, 150-question, two-and-a-half-hour exam, sat closed-book under a proctor exactly like a testing-center attempt.

readiness mapping

Translating a practice score into a next step: comfortably above the passing line means schedule, near it means drill the weak topics, below it means reteach before re-testing.

continuing education (CE)

The study a licensee must complete to renew — commonly 24 hours per two-year renewal period including about 3 hours of ethics, varying by state.

CLU

Chartered Life Underwriter — the life insurance profession's senior designation, awarded since 1927 through The American College.

ChFC

Chartered Financial Consultant — The American College's broader financial-planning designation, established in 1982.

CPCU

Chartered Property Casualty Underwriter — the property & casualty profession's senior designation, first awarded in 1943 and now conferred through The Institutes.

CIC

Certified Insurance Counselor — a practical agency-focused designation program begun in 1969 by the National Alliance.

claims adjuster

The licensed professional who investigates and settles claims — a career door the same insurance knowledge opens, usually with its own state license.

underwriter

The carrier-side professional who selects and prices risks — a salaried path for those who love the analysis more than the selling.

variable products registration

The FINRA securities registration — a Series 6 or 7 — required in addition to a state life license before an agent may sell variable life or variable annuities.

CORE IDEAS

The story. On the night of December 16–17, 1835, in weather so cold the rivers froze and the fire hoses with them, downtown New York burned: the Great Fire destroyed some six or seven hundred buildings around Wall Street, and with them most of the city's fire insurance companies — of the local insurers, the majority were bankrupted outright by the claims. Word reached Hartford, Connecticut, where Eliphalet Terry, president of the Hartford Fire Insurance Company, made the decision this course has been circling for thirty-three weeks. He pledged his own fortune to back the company's promises, hired a sleigh, and rode through the snow to New York. Standing in the smoking district, he announced that the Hartford

would pay every valid claim in full — and then, on the spot, began selling new policies to a city that had just watched insurance fail. The Hartford paid, and the company that kept its promise when keeping it was ruinous won the trust of a generation. Hold the picture: the ashes still warm, the neighbors ruined, and a man arriving — not fleeing — with a promise in his hands. That is the profession you have been studying. The license is the state's permission to make such promises; this capstone is about becoming the kind of person who keeps them.

How they figured it out. A license is a floor, and the profession long ago built ladders above it. The oldest is the **CLU** — Chartered Life Underwriter — created in 1927 under the leadership of Solomon Huebner, the Wharton professor whose human life value concept you met in Unit 3, and awarded through The American College; its sibling **ChFC** (Chartered Financial Consultant, 1982) widens into full financial planning. The property & casualty world answers with the **CPCU** — Chartered Property Casualty Underwriter, first awarded in 1943 and now conferred through The Institutes — and agencies prize the practical **CIC** (Certified Insurance Counselor, begun 1969). Each is years of study and examinations; each marks an agent who kept learning after the state stopped requiring it. The career also branches sideways: **claims adjusters** investigate and settle losses, **underwriters** select and price risk from the carrier's side, agency owners build and someday sell books of business, and licensees add lines — the life & health agent adding property & casualty, or either adding Medicare work. And one branch needs a second regulator: **variable life and variable annuities** are securities, so selling them requires FINRA registration — a Series 6 or 7 — on top of the state life license; the School Launch Series 65 course maps that securities world, including the adviser's exam this course's graduates sometimes take next.

The big idea. This week you assemble the **Pathway File** — and discover it is not a scrapbook but a machine with five working parts. *The facts:* your dated state facts sheet and the licensing checklist from Lesson 10.1, every figure sourced, the whole road from study rule to appointment in checkbox order. *The map:* the profession map of lines and careers, now finished with this lesson's ladders — designations, adjusting, underwriting, ownership, the securities door. *The guards:* the contract reader's checklist and agency scorecard from Lesson 10.2, standing between you and the counterfeit. *The disciplines:* the service calendar and honest market map from Lesson 10.3, and the income model from Lesson 10.4 with its budget rules. *The commitments:* a one-page code you will write in the capstone project — the ethics of

Units 2 and 9 in the first person: the truth on every application, no sale a client does not need, premiums held as a trust, the claim served as the whole point. A file like this does something subtle: on the day a recruiter, a lean month or a tempting shortcut finds you, you will not be deciding your standards then — you will be reading standards you set when your head was clear.

Now plan the **practice final** — the full-length, 150-question, two-and-a-half-hour practice licensing exam this course ends with — and sit it exactly like test day, because the rehearsal only works at full dress. The week before: review only your right-hand notebook pages (every corrected miss of the year) and the ten units' trap lists; cramming new material in the last days buys little and costs calm. The night before: sleep, and lay out the pencils and the timer. The day: one sitting, closed book, a parent proctoring, no pauses, phone in another room — and use the exam habits of thirty-three weeks: about a minute a question, last line of the stem first, strike two wrong answers, mark the unsure and return, answer everything. Scoring is the state's arithmetic: 70% — 105 of 150 — passes. Then comes the step most students skip: grading the misses by unit, because the final's real product is a map of your weaknesses while fixing them is still free.

Readiness mapping turns the score into a decision, honestly. Comfortably above the line — say 80% or better in this example — means the material is yours: keep a light weekly review, and when you are of age and ready, open your state's candidate handbook and schedule a real seat. Near the line — roughly 70–79% — means pass-but-fragile: drill the two weakest units' trap lists and practice sets for a few weeks, then re-sit a fresh timed final before scheduling anything. Below the line means the kindest possible news arrived at the cheapest possible moment: a real attempt would have cost a fee and a waiting period, while this one cost an afternoon — reteach the weak units from their lessons, not just their summaries, and test again in a month. There is no shame anywhere on this map; there is only information and the next step. And remember the license's own rhythm once it is real: renewal every two years in most states, **continuing education** of commonly 24 hours per period including about 3 hours of ethics, appointments kept current, and a record kept clean — the license is not a trophy but a subscription, paid in diligence.

Last, the commissioning. Strip away the vocabulary of thirty-three weeks — aleatory contracts, coinsurance clauses, incontestability, subrogation — and what remains is the oldest arrangement in this course: many hands agreeing to carry the one whose

house burns, with an agent standing where the many meet the one. You have seen what the work is: the application filled truthfully, the policy fitted to the need and not to the commission, the premium held as another's money, the claim answered the way Terry answered New York. The state will test whether you know the rules; your clients will test whether you are, in fact, their neighbor. Insurance remains what it was at Lloyd's coffee house and in Franklin's Philadelphia — organized neighborliness, a promise kept to people on the worst day of their lives — and the agent is the person the neighborhood sends to the fire. Bear ye one another's burdens: the industry runs on a verse it did not write, and an agent who means that verse has already passed the only exam with no retakes.

On the exam today. The capstone's testable content is the meta-skill, plus a short list of facts. The facts: variable products require FINRA registration (Series 6 or 7) in addition to the state life license; CE commonly runs 24 hours per two-year renewal with about 3 hours of ethics, varying by state; designations like CLU, ChFC, CPCU and CIC are earned credentials, never to be claimed or implied falsely — misusing a designation is misrepresentation under Unit 9's rules. The meta-skills are how every question of your real exam will be won: read the stem's last line first; respect the exam's favorite words — *first*, *most*, *best*, *except*, *not* — because they flip answers; eliminate two, choose between two; never leave a blank; and when a number looks state-specific, pick the answer that points at the state's rules rather than one that pretends a universal figure. Thirty-three weeks of trap lists have taught you the examiner's mind. Trust the preparation, sit up straight, and go be the neighbor.

PICTURE STUDY



The Good Samaritan (after Delacroix), Vincent van Gogh, 1890 · Oil on canvas · Kröller-Müller Museum, Otterlo, Netherlands

Image: Wikimedia Commons, public domain

In the spring of 1890, recovering in the asylum at Saint-Rémy, Vincent van Gogh painted his own version of Delacroix's Good Samaritan — the parable rendered in the heaving color that was his language. The thieves' emptied strongbox lies on the road; the two respectable men who crossed by are already small in the distance; and the whole painting is the effort of one man's back and arms lifting a stranger he owes nothing. It closes this course because the parable is the profession's true commission: the question is never who counts as my neighbor, but whether I will be one — and the agent's entire working life is arriving, prepared and solvent, at other people's worst days.

Look closely

- Watch the Samaritan's body — braced legs, straining back. Mercy in this picture is physical work, planned and paid for, not a feeling.
- Find the emptied chest on the road. The loss has already happened; nothing will undo it. What can still be done?
- Find the priest and the Levite walking away. The painter makes them tiny — distance is the picture's verdict on them.
- Notice that the Samaritan came equipped — a horse to carry the man, means to pay the innkeeper. Preparation is part of the mercy.

Talk about it

1. The Samaritan's mercy cost him oil, wine, money and a detour he had not planned. What does it cost an agent to be the one who shows up after the fire — and who pays it ahead of time?
2. The priest and Levite were not villains; they were busy. What are the respectable reasons an agent might walk past a hard claim or a small client, and what does this parable call that?
3. Christ ends the parable with a command: “Go, and do thou likewise.” You now hold a course's worth of knowledge about carrying other people's burdens. What, concretely, will you go and do with it?

PROJECT

The Pathway File, Assembled — and the Practice-Exam Plan

The capstone project is the course's deliverable: your complete Pathway File, assembled, ordered and gap-checked, with two new pages only this final week can produce — your personal ethics commitments, and the written plan for sitting the practice final like test day. When this project is done, a stranger could open the file and see exactly who prepared it and what road it maps.

You will need

- Every artifact the course has had you keep: the state facts sheet, licensing checklist, profession map, contract checklist and agency scorecard, market map and service calendar, income model, unit trap lists
- A binder or folder with dividers, and your exam notebook
- A calendar showing the coming month, and your proctor (a parent) for scheduling the final

Steps

1. Gather and order the file in five sections — Facts, Map, Guards, Disciplines, Commitments — using your warm-up gap list; rebuild anything missing before going on.
2. Finish the profession map with this lesson's ladders: the four designations with their fields (CLU and ChFC — life and planning; CPCU — property & casualty; CIC — agency practice), the adjuster, underwriter and owner paths, and the securities door (Series 6 or 7 for variable products, with a note pointing to the Series 65 course for the adviser's road).
3. Write the Commitments page in the first person and keep it to one page: truth on every application, suitability before commission, premiums held as a trust, claims served as the point of the promise, records kept as if read aloud — sign and date it.
4. Write the practice-exam plan: the date and start time of the final, the room, the proctor, the timer, the no-notes rule, and the review-week schedule before it (right-hand notebook pages and trap lists only).

5. Sit the final as planned — 150 questions, one sitting of two and a half hours — then score it as a state would: 105 of 150 passes.
6. Grade your misses by unit, write the readiness map verdict in one honest sentence (schedule, drill-and-re-sit, or reteach-and-re-test), and set the dated next step on the calendar.
7. Place the scored final, the miss-map and the verdict page at the front of the file, and show the finished Pathway File to your parent as the course's closing act.

EXAM NOTEBOOK

1. Make flashcards for CLU, ChFC, CPCU, CIC, the Series 6/7 rule for variable products, and the common CE rhythm (24 hours per two years, about 3 of ethics), and add them to the box — the deck should now hold the whole course.
2. Draw the career ladder: the state license as the ground floor, lines added as rooms, designations as upper stories, adjusting, underwriting and ownership as wings, and the securities door drawn to one side with its own FINRA key.
3. Write the final trap list of the course, titled “Exam-day words,” one line each for FIRST, MOST, BEST, EXCEPT and NOT — and beneath them the three rules: last line first, strike two, no blanks.

KEY FORMULAS

$$\text{Pace} = \frac{\text{minutes allowed}}{\text{questions}} \qquad \left(\frac{150}{150} = 1 \text{ minute per question}\right)$$

$$\text{Score} = \frac{\text{correct}}{\text{total}} \times 100\%$$

From history. Solomon Huebner, the Wharton professor behind the CLU, had argued since the 1910s that insurance selling should be a true profession with education, examinations and an ethical code like law or medicine — he called the idea “the institution of the American College,” and lived to see tens of thousands earn the designation. The CPCU followed the same blueprint for the property & casualty world; its first class of designees in 1943 numbered under a hundred, and its alumni society now spans the industry.

WORKED EXAMPLES

Example 1. Plan the clock. The practice final gives 150 minutes for 150 questions. A student answers 100 questions in her first 80 minutes. What pace does she have left for the remaining 50, and what should she do with any minutes left at the end?

Show solution

1. Overall pace: $150 \div 150 = 1$ minute per question.
2. Used: 80 minutes for 100 questions — 0.8 minutes each, ahead of pace.
3. Remaining: $150 - 80 = 70$ minutes for 50 questions — $70 \div 50 = 1.4$ minutes each, a comfortable margin for the harder, marked items.
4. Endgame: sweep for blanks first (a blank is a guaranteed zero; a guess is a 25% chance), then revisit marked questions — changing answers only for a reason, not a feeling.

Answer: She has 1.4 minutes per remaining question. Bank time on the easy ones, spend it on the marked ones, and finish with zero blanks.

Example 2. Map the score. On the 150-question practice final, one student scores 112 and another scores 92. Compute each percentage, state each student's position against the 70% line, and name each one's next step.

Show solution

1. Student one: $112 \div 150 \approx 74.7\%$ — passing, but inside the fragile band below 80%.
2. Her step: grade the misses by unit, drill the two weakest units' trap lists, re-sit a fresh timed final before any real scheduling.
3. Student two: $92 \div 150 \approx 61.3\%$ — below the line; a real attempt today would likely cost a fee and a retake wait.
4. His step: reteach the weakest units from their lessons, rebuild their flashcards, and re-test in about a month — the practice final just saved him real money.

Answer: 74.7% — pass-but-fragile: drill and re-sit. 61.3% — not yet: reteach and re-test. Both students got exactly what a practice final is for — the truth, cheap.

Example 3. Count the gap. A student needs 105 of 150 and scored 92. His miss-map shows 11 misses in Unit 6, 9 in Unit 4, and the rest scattered. If focused restudy could convert 60% of just those two units' misses, would he clear the line?

Show solution

1. Gap to the line: $105 - 92 = 13$ questions.
2. Targeted misses: $11 + 9 = 20$ in the two weak units.
3. Converted at 60%: $20 \times 0.60 = 12$ — one short of the gap by itself.
4. Add the scattered misses: even a modest pickup elsewhere closes the last question, but the margin is thin — so he re-tests only after the drilling, and schedules nothing until a fresh final clears 105 with room.

Answer: Almost — about 12 of the needed 13 from the two weak units alone. The miss-map turns "study more" into a plan with named chapters, which is the whole point of grading the final by unit.

PRACTICE

1. Easy What two credentials must an agent hold before selling a variable annuity?

   Show answer

   A state life insurance license and a FINRA securities registration — a Series 6 or 7 — because variable products are securities as well as insurance.

2. Easy Match the designation to its field: CLU, CPCU, CIC.

   Show answer

   CLU — life insurance (The American College, since 1927); CPCU — property & casualty (The Institutes, first awarded 1943); CIC — practical agency work (National Alliance, since 1969).

3. **Easy** What continuing education does a typical state require of a licensed producer?

Show answer

Commonly 24 hours per two-year renewal period, including about 3 hours of ethics — with the exact rule set by each state, which is why the state facts sheet stays in the Pathway File.

4. **Medium** A student scores 119 of 150 on the practice final. Compute the percentage and name the readiness verdict and next step.

Show answer

$119 \div 150 \approx 79.3\%$ — passing but just under the comfortable 80% band: drill the weakest units' trap lists and re-sit a fresh timed final before scheduling a real seat.

5. **Medium** Why does this course insist the practice final be proctored, timed, closed-book and taken in one sitting?

Show answer

Because the rehearsal predicts the performance only at full dress: the real exam's pressure is the clock, the silence and the no-notes rule, and a score earned under easier conditions maps to nothing.

6. **Medium** An agent's business card reads “Jane Doe, CPCU” though she has completed only one of the designation's exams. Which rule from this course does that break, and why does it matter?

Show answer

It is misrepresentation — claiming a credential not earned — an unfair trade practice under Unit 9's rules. Designations exist to signal verified mastery; a false one defrauds every client who relied on it.

7. **Medium** Name the five sections of the assembled Pathway File and one artifact that lives in each.

Show answer

Facts (state facts sheet, licensing checklist); Map (profession map with the ladders); Guards (contract checklist, agency scorecard); Disciplines (service calendar, income model); Commitments (the signed ethics page).

8. Hard On a four-choice exam with no guessing penalty, why is a blank strictly worse than a guess, in expected points?

Show answer

A blank scores 0 with certainty; a blind guess scores the question's points 25% of the time — and elimination of even one choice raises it further. Over a 150-question exam, habitually guessing instead of blanking is worth several questions.

9. Hard A student finishes 150 questions with 20 minutes left and has 12 questions marked as unsure. Describe the professional endgame, in order, with the one rule about changing answers.

Show answer

First sweep the whole exam for blanks and fill every one. Then revisit the 12 marked questions at well over a minute each ($20 \div 12 \approx 1.7$), rereading the stem's last line. Change an answer only for a reason — a misread word, a recalled fact — never for a feeling; first instincts beat nervous second-guessing.

10. Hard Why did Eliphalet Terry's 1835 decision make commercial sense as well as moral sense? Answer in two or three sentences.

Show answer

Insurance sells a promise, so the only advertisement that fully works is a promise kept when keeping it is expensive — Terry paid the claims and immediately found a burned city eager to buy from the one company proven good for it. The moral act and the franchise were the same act. The agent's small-scale version is the well-served claim, which Lesson 10.3 showed earns the renewals and referrals.

11. **Challenge** Design the retake plan: a student scores 96 of 150, with misses concentrated in Units 5 (12) and 7 (10). State the gap to 105, the conversion needed from those units if 60% of drilled misses convert, and a dated three-step plan.

    Show answer

    Gap: $105 - 96 = 9$. Targeted conversion: $(12 + 10) \times 0.60 = 13.2$ — clears the gap with margin. Plan: weeks 1–2, reteach Units 5 and 7 from the lessons and rebuild their flashcards; week 3, timed practice sets and both trap lists; week 4, a fresh proctored final, scheduling nothing real until it clears 105 comfortably.

12. **Challenge** Galatians 6:2 commands bearing one another's burdens. Write three or four sentences on how insurance organizes that command — and on the one thing the mechanism can never supply, which the agent must.

    Show answer

    Insurance is burden-bearing with arithmetic: many hands pay small, certain premiums so that no one family carries a crushing, uncertain loss alone, and the law of large numbers makes the sharing solvent. The mechanism distributes money, but money is not the whole burden. What the pooled premiums cannot supply is the neighbor — the person who shows up, explains, advocates and stays — and that is the agent's office. The license authorizes the work; only love of neighbor performs it.

COMMON MISTAKES

- Selling a variable product on a state life license alone — variable life and variable annuities also require FINRA registration (Series 6 or 7), and the exam loves this trap.
- Treating the license as permanent — it renews on a cycle, commonly every two years with about 24 CE hours including roughly 3 of ethics, and appointments and records must be kept current.
- Claiming or implying a designation not fully earned, which is misrepresentation under the unfair trade practices rules.
- Taking the practice final open-book or in pieces, then trusting the score — a rehearsal under easy conditions predicts nothing about test day.

- Reading a below-passing practice score as a verdict on the student instead of a map of the weak units — the final's product is the miss-map, and the fix is reteaching, not despair.
- Skipping the endgame sweep for blanks — on a no-penalty exam, every blank is a point handed back to the examiner.

Make it a game · The Gauntlet. The whole course in ten minutes. A parent takes your flashcard box — now roughly 400 cards — shuffles, and deals ten face-down stacks, one per unit's worth of material, mixed at random. You run the gauntlet: one card from each stack, ten seconds each, one point per correct answer, and any miss goes into a “rematch” pile. Clear all ten, then face the rematch pile at five seconds a card for double points. Family members can play as rival candidates with their own gauntlets. Play three rounds in the final week; the rematch pile on the last night is, conveniently, your last study list before the practice final.

Scripture. “Bear ye one another’s burdens, and so fulfil the law of Christ.” (Galatians 6:2, KJV)

The course ends where the industry began: at a command older than any policy form. Insurance is the verse built into machinery — many hands under one family's loss — but machinery cannot love, explain or show up in the snow. That part is the agent's, and it is the part Christ calls fulfilling His law.

UNIT 10

The Career and the Capstone

Nine units taught you the policies, the mathematics and the law; this one walks you down the road itself. You will stand a pretend candidate at the door of the **testing center** and walk every step — the line of authority chosen, the vendor scheduled, the fingerprints taken, the application filed through **NIPR** — and then cross the threshold that surprises most new licensees: the **appointment**, the carrier's filed authorization without which a licensed producer still cannot sell. There you will face the first real career decision, the honest trade between the **captive** agent's support and the **independent** agent's ownership, learn to read an agency contract before signing it, and learn to recognize — by pattern, coldly, arithmetically — the pay-to-join recruiting pyramid that circles this profession's doorway.

Then the career itself. You will learn how an honest **book of business** is built — a natural market served rather than ambushed, referrals earned, the marketing law obeyed — and do the income arithmetic recruiters skip: **first-year commissions**, renewals, charge-backs, and the lean first three years that precede the compounding. The capstone assembles everything this course has had you build into the **Pathway File**, maps the ladders beyond the license — CLU, ChFC, CPCU, the adjuster and underwriter paths, the securities door for variable products — and ends at full dress: a 150-question practice licensing exam, sat like test day and scored like a state. The unit's hero is the agent the whole course has aimed at: the neighbor who shows up after the fire.

PREREQUISITES

- Has completed Units 1–9, including the licensing law of Unit 9 and the state facts sheet kept current since Lesson 1.5
- Can compute percents and compound simple year-over-year growth (a book retained at 90% with new policies added)
- Can look up a producer license, a candidate handbook and a state insurance department page online and record what each says
- Has the course portfolio to date — profession map, trap lists, corrected practice sets — gathered and ready to assemble

MASTERY CHECKLIST

- ☐ I can walk the licensing pipeline in order — line, study rule, vendor, exam day, fingerprints, NIPR application — with the common fee ranges and the 2–8 week adult timeline, and say where the live figures are checked.
- ☐ I can describe a testing-center day and the instant pass/fail result, and state the common retake waits and what a fail actually costs.
- ☐ I can define appointment and explain why a licensed but unappointed producer may not sell a carrier's policies.
- ☐ I can contrast captive and independent agents by carriers, support, commission share and ownership of expirations — without calling either one better.
- ☐ I can name the five agency-contract clauses to read before signing, and recognize a pay-to-join recruiting pyramid by its pattern.
- ☐ I can state the prospecting law — the Do Not Call Registry and its exceptions, the 8 a.m.–9 p.m. window, CAN-SPAM — and compute what a retention rate does to a book over several years.
- ☐ I can compute first-year, renewal, PMPM and P&C commissions and a charge-back, and build an honest

first-three-years income model with taxes and expenses included.

- ☐ I can assemble the Pathway File, name the designations and careers beyond the license, sit a full-length practice exam under test conditions, and map the score honestly to a next step.

OPTIONAL BOOKS AND RESOURCES FOR THIS UNIT

- **NIPR: National Insurance Producer Registry**: Free to browse, official. The gateway through which real license applications flow to the states. Explore the licensing sections with Lesson 10.1 to see the actual forms and fees your checklist describes — but pay nothing; this course requires no purchase. Ages 15 and up.
- **NAIC: Directory of State Insurance Departments**: Free, official. The map to all fifty regulators. Use it in Lessons 10.1 and 10.2 to find your state's producer-licensing pages, candidate handbook link and public license lookup — the tool that verifies any agency's claims. Ages 14 and up.
- **BLS Occupational Outlook Handbook: Insurance Sales Agents**: Free, official. The federal government's sober data on the career — median pay, openings, outlook. Read it with Lesson 10.4 beside your income model as the reality check no recruiter provides. Ages 15 and up.
- **National Do Not Call Registry**: Free, official (FTC). The registry every prospecting call must respect. Visit it with Lesson 10.3 to see what consumers register and what sellers must honor — the law side of honest marketing. Ages 14 and up.
- **The Institutes: CPCU and Insurance Education**: Free to browse, official designation body. Skim the CPCU pages with Lesson 10.5 to see what the profession's upper ladder actually requires — years of study after the license, which is the point. For the life-side ladder, The American College's CLU pages serve the same purpose. Ages 15 and up.

Not required. Every project in this unit works without them. School Launch has no ties to these authors, publishers or companies.

LESSONS IN THIS UNIT

10.1 Exam Day: Enrollment, Fingerprints and the Testing Center

3 sessions of 50 minutes

10.2 Appointed: Carriers, Contracts and the Captive–Independent Choice

3 sessions of 50 minutes

10.3 An Honest Book of Business: Prospecting, Referrals and Service

3 sessions of 50 minutes

10.4 The Agent's Income: Commissions, Renewals and the First Three Years

3 sessions of 50 minutes

10.5 The Capstone: Your Pathway File and the Practice Exam Plan

3 sessions of 50 minutes

Unit 10 test

Closed book, closed notebook. Twenty four-choice questions, 5 points each, 100 points total. Time yourself at about one minute per question — set a timer for 25 minutes and finish inside it, exactly as you will at the testing center. Answer every question; an unanswered question is simply wrong. Where a question says "in this example" or "commonly," use the figures given, and remember that real fees, hours and waiting periods are your state's decision — the live numbers are at your state insurance department and in its candidate handbook. A licensing exam passes at 70% — 14 of 20 here — but you are one unit from the final: aim higher. Choose the one BEST answer.

1. **5 pts**

   Which of the following is required in nearly every state before a person may sit for a producer licensing exam?

   A. A sponsoring insurance company

   B. Being at least 18 years old

   C. An associate's or bachelor's degree

   D. Two years of related work experience

2. 5 pts

For most states, the insurance licensing exam is administered by:

A. The state legislature

B. The insurance company appointing the agent

C. A contracted testing vendor such as Pearson VUE, PSI or Prometric

D. The National Association of Insurance Commissioners

3. 5 pts

A candidate fails the licensing exam. What commonly follows?

A. She may retake it after a wait of anywhere from the next day to 30 days, paying another exam fee

B. She is barred from the profession for one year

C. She may retake it free within 90 days

D. Her pre-licensing education must be repeated before any retake

4. 5 pts

Federal law at 18 U.S.C. §1033 bars insurance work, without the regulator's written consent, by anyone convicted of:

A. Any misdemeanor whatsoever

B. Any traffic felony

C. Any offense committed after licensure only

D. A felony involving dishonesty or breach of trust

5. 5 pts

A newly licensed producer signs an agency agreement with a carrier but no appointment has been filed with the state. She may:

A. Sell the carrier's policies, since her license is valid

B. Not transact that carrier's business until it appoints her

C. Sell only renewals, not new business

D. Sell if a licensed coworker countersigns each application

6. 5 pts

Which statement correctly contrasts captive and independent agents?

A. The captive represents one carrier and typically does not own his book; the independent represents several and owns his expirations

B. The captive owns his expirations; the independent's book belongs to the carriers

C. The captive may not earn commissions; the independent may

D. The independent is always better paid than the captive

7. 5 pts

Which clause of an agency contract determines whether renewal commissions continue to a producer after she leaves the agency?

A. The commission schedule

B. The charge-back provision

C. The non-solicitation clause

D. The vesting provision

8. 5 pts

An organization charges new “agents” $400 to join, urges each to buy a policy on himself immediately, and pays rising overrides mainly for recruiting more members. The pattern is:

A. A legitimate captive agency system

B. An independent marketing cooperative

C. A pyramid-style recruiting scheme to walk away from

D. Acceptable if the insurance products are genuine

9. 5 pts

Under federal telemarketing rules, a prospecting call may be placed:

A. Any time before midnight in the agent's time zone

B. Between 8 a.m. and 9 p.m. in the called person's local time

C. Only between 9 a.m. and 5 p.m. on weekdays

D. At any hour, if the number is not on the Do Not Call Registry

10. 5 pts

An agent may lawfully cold-call which of the following numbers?

A. A consumer who bought a policy from him eight months ago

B. Any number on a lead list he paid for

C. A registry-listed number, if he keeps the call under two minutes

D. A registry-listed number, if he calls from his personal phone

11. 5 pts

The CAN-SPAM Act requires all of the following for commercial email EXCEPT:

A. Truthful, non-deceptive subject lines and headers

B. A physical mailing address identifying the sender

C. The recipient's written permission before any commercial email is sent

D. A working opt-out honored promptly

12. 5 pts

An agent's book of 500 policies retains 90% this year while she writes 120 new ones. Next year's book holds:

A. 620 policies

B. 500 policies

C. 450 policies

D. 570 policies

13. 5 pts

A life policy carries a $1,500 annual premium, with 70% first-year commission and 4% renewals. The first-year and each renewal-year commission are:

A. $1,050 and $60

B. $700 and $40

C. $1,050 and $420

D. $105 and $6

14. 5 pts

A carrier advances nine months of commission on a policy paying the agent $90 per month as earned. The policy lapses after month 4. The charge-back is:

A. $810

B. $450

C. $360

D. $90

15. 5 pts

Property & casualty commissions commonly differ from life commissions in that P&C:

A. Pays no commission on renewals

B. Pays commissions only to captive agents

C. Pays a much higher first-year percentage than life

D. Pays roughly the same rate — commonly about 10–15% — on new business and renewals

16. 5 pts

The Bureau of Labor Statistics (May 2024) reports the median pay of insurance sales agents as:

A. $29,500

B. $122,400

C. $60,370

D. $95,800

17. 5 pts

Before selling variable life insurance or variable annuities, a state-licensed life producer must also:

A. Register with FINRA by passing a securities exam such as the Series 6 or 7

B. Obtain a property & casualty license

C. Earn the CLU designation

D. Be appointed by at least three carriers

18. 5 pts

Continuing education for a licensed producer commonly requires:

A. 100 hours each year, all in ethics

B. Nothing, once the exam is passed

C. CE only for independent agents

D. About 24 hours per two-year renewal period, including roughly 3 hours of ethics

19. 5 pts

Which designation belongs to the property & casualty side of the profession?

A. CLU

B. ChFC

C. CPCU

D. Series 65

20. 5 pts

On the 150-question practice final, passing at the common state standard requires 105 correct. A student scores 96, with 20 of her misses concentrated in two units. The readiness map says:

A. Schedule a real exam immediately — 96 is close enough

B. Reteach and drill the two weak units, then re-sit a fresh timed final before scheduling anything

C. Abandon the career path

D. Retake the same final open-book to confirm the score

ANSWER KEY

1. B. The near-universal requirement is age 18. No state requires a college degree, a sponsor or prior experience for the entry license — the exam's favorite false requirements.
2. C. Most states contract with Pearson VUE, PSI or Prometric (Alabama tests through the University of Alabama, and Kentucky runs its own). Carriers appoint agents but never administer the state exam, and the NAIC coordinates regulators rather than testing candidates.
3. A. A fail costs another fee and a waiting period that runs, by state, from next-day to about 30 days — the candidate handbook states the rule. Nothing bars the career (B), the retake is never free (C), and education generally need not be repeated (D).
4. D. The statute turns on felonies of dishonesty or breach of trust, with written-consent relief available from the regulator. It does not reach every misdemeanor or traffic matter, and it applies whether the conviction came before or after licensure.
5. B. The license is the state's permission to transact insurance; the appointment is the carrier's filed authorization, and a producer must be appointed by each insurer whose policies he sells. No countersignature or renewals-only exception exists.
6. A. One carrier with support and (usually) a company-owned book versus several carriers, higher share and agent-owned expirations. B reverses the ownership, C is false, and D turns a trade-off into a ranking the facts — and the exam — refuse to make.
7. D. Vesting governs whether renewals survive departure, retirement or death. The schedule sets rates, charge-backs recover unearned advances, and non-solicitation limits whom a departing agent may contact.
8. C. Pay-to-join, pressured self-purchase and compensation driven by recruiting rather than by serving clients is the pyramid pattern, and its exponential arithmetic guarantees that late joiners — almost everyone — lose. Genuine products do not redeem the model (D), and no legitimate agency charges people for the right to work (A, B).
9. B. The window is 8 a.m. to 9 p.m. on the consumer's clock. Registry status (D) does not unlock the hours rule, and A uses the wrong time zone — the exam's favorite twist on this fact.

10. A. A recent purchase creates an established business relationship — an exception to the Do Not Call Registry. Paying for a list scrubs nothing (B), and neither brevity nor the phone used (C, D) excuses calling a registered number.
11. C. CAN-SPAM does not require advance permission for email — it requires honesty (A), identification (B) and a working opt-out (D). Prior express consent is the stricter rule for automated marketing texts, which is the distinction the exam likes to blur.
12. D. $500 \times 0.90 + 120 = 570$. A forgets the 50 lost to lapses, C forgets the new business — the formula is book × retention + new.
13. A. $\$1{,}500 \times 0.70 = \$1{,}050$ and $\$1{,}500 \times 0.04 = \$60$. C applies 4% to ten years at once, and D slips a decimal — the two classic arithmetic errors.
14. B. Advance $9 \times \$90 = \$810$; earned $4 \times \$90 = \$360$; charge-back $\$810 - \$360 = \$450$. A is the whole advance, C is the earned portion — the charge-back is the difference.
15. D. P&C's steady new-and-renewal rate is why a retained book compounds. Life is the big-then-small shape (large FYC, small renewals) — C reverses the comparison, and A describes neither line.
16. C. The median — half earn more, half less — is $60,370, with about 47,000 openings projected a year. The right tail runs high because renewals compound, but the median is the honest anchor this course quotes.
17. A. Variable products are securities, so FINRA registration rides on top of the state life license. Designations (C) are voluntary honors, and B and D invent requirements from the wrong shelves.
18. D. The common pattern — varying by state — is 24 hours per biennium with an ethics component. The license is a subscription renewed by diligence, not a one-time trophy (B), and CE binds captive and independent alike (C).
19. C. The Chartered Property Casualty Underwriter, first awarded in 1943, is the P&C profession's senior designation. CLU and ChFC are The American College's life and planning credentials, and the Series 65 is a securities exam, not an insurance designation.
20. B. Below the line means reteach, drill the concentrated weaknesses, and re-test under full conditions — the practice final just delivered the truth at zero cost. A pays a real fee to learn the same thing, C mistakes information for a verdict, and D's open book makes the score meaningless.

PORTFOLIO PIECE: THE PATHWAY FILE

Assemble the file this whole course has been building and this unit completed: the dated state facts sheet and the state-specific licensing checklist with its fee budget (Lesson 10.1); the contract reader's checklist and ten-question agency scorecard with its automatic walk-aways (Lesson 10.2); the honest market map and twelve-month service calendar with the marketing-law banner (Lesson 10.3); the 36-month income model with its chart and honest paragraph (Lesson 10.4); and the finished profession map with the career ladders, the signed one-page ethics commitments, and the scored 150-question practice final with its miss-map and readiness verdict (Lesson 10.5).

Order the file in its five sections — Facts, Map, Guards, Disciplines, Commitments — and place the scored final and verdict page at the front. A stranger opening this binder should be able to see what state it serves, what the road costs, what offers it will refuse, how its owner intends to treat clients, and exactly how ready its owner is — with the next step dated on a calendar.

LOOK FOR	WHAT IT MEANS
Licensing checklist and facts	The pipeline is complete and in order, every fee, wait and rule carries a real figure sourced from the state insurance department or candidate handbook, each is dated and marked verified, and the budget line includes a retake reserve.
Contract and agency tools	The five contract clauses are correctly explained with a question for each, the scorecard's ten items are present with its scoring rule, and the three pyramid-pattern questions are flagged as automatic walk-aways.
Service and marketing pages	The market map sorts its households defensibly into three rings, the service calendar schedules every pretend client's review and claim follow-ups, and the law banner states the registry, the calling window, CAN-SPAM and the no-cold-texts rule correctly.
Income model	The 36-month spreadsheet computes commissions, charge-backs, renewals, expenses and tax set-asides correctly from labeled example assumptions, the chart marks where renewals overtake expenses, and the closing paragraph is honest about year one.
Capstone and commitments	The profession map includes the designations, the adjuster, underwriter and owner paths and the Series 6/7 securities door;

LOOK FOR	WHAT IT MEANS
	the ethics page is first-person, one page, signed and dated.
Practice final and verdict	The final was sat in one proctored, closed-book, 150-minute sitting; it is scored as a state would score it (105 of 150 passes), the misses are mapped by unit, and the readiness verdict names a dated next step.

COURSE EXAM

Midterm Exam

Covers Units 1–5. Time: 120 minutes.

Closed book, in one two-hour sitting, with a parent or proctor present. Every question has four choices and one best answer. There is no penalty for guessing, so answer every question — a blank is a guaranteed zero. Budget about two minutes per question and keep moving; mark the ones you are unsure of and return to them. Your score is the number correct out of 60. The licensing-exam standard in most states is 70% — 42 correct here — but aim higher: a comfortable margin on practice is what makes the real testing center feel calm. Dollar figures, day-counts and limits described as examples ("in this example," "commonly") are illustrations, not current law; the live figures for your state are at your state insurance department.

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1. **1 pt** **Lesson 1.1**

   Eleanor is licensed and shops among four insurers to find coverage for her client, representing the buyer throughout the transaction. Marcus is licensed and appointed by one insurer, whose policies he sells. Eleanor and Marcus are, respectively:

   A. An independent agent and a captive agent

   B. A broker and an agent

   C. An agent and a broker

   D. A solicitor and an underwriter

2. **1 pt** **Lesson 1.2**

   In the decades after 1688, merchants gathered at Edward Lloyd's London coffee house to share shipping news, and men willing to accept a share of a voyage's risk signed their names beneath the risk described on a broker's slip. This marketplace became famous for insuring:

   A. Houses against fire

   B. Lives of clergymen's widows

   C. Ships and their cargoes

   D. Crops against hail

3. 1 pt **Lesson 1.3**

A warehouse owner stops repairing his sprinkler system, telling his manager, “Why spend the money? If the place burns, the insurance pays.” His attitude is best described as:

A. A moral hazard

B. A peril

C. Adverse selection

D. A morale hazard

4. 1 pt **Lesson 1.3**

Which of the following is an insurable risk?

A. A family’s chance that the father dies during his working years

B. A trader’s chance that a stock she bought falls in price

C. A gambler’s chance of losing a wager on a race

D. A merchant’s chance that a new product fails to sell

5. 1 pt **Lesson 2.4**

An insurer terminates an agent’s contract but never collects its application forms, rate books and signage. The ex-agent takes an application and a premium from a customer who had no way to know of the termination. The insurer may be held to the coverage under:

A. Apparent authority

B. Express authority

C. Implied authority

D. The entire contract doctrine

6. 1 pt **Lesson 1.4**

A company incorporated in Ontario, Canada, holds a certificate of authority to sell insurance in Oregon. From Oregon’s standpoint the company is:

A. A foreign insurer

B. An alien insurer

C. A domestic insurer

D. A non-admitted insurer

7. 1 pt **Lesson 1.4**

Which Supreme Court decision held that insurance transacted across state lines IS interstate commerce, subject to federal law?

A. United States v. South-Eastern Underwriters Association (1944)

B. Paul v. Virginia (1869)

C. SEC v. Capital Gains Research Bureau (1963)

D. Marbury v. Madison (1803)

8. 1 pt **Lesson 1.1**

A producer passes her state exam, receives her license, and signs an agency agreement with an insurer. Before she may lawfully sell that insurer's policies, one step remains:

A. A college transcript filed with the state

B. A surety bond posted with the NAIC

C. Sponsorship by a second licensed producer

D. The insurer's appointment of her, filed with the state

9. 1 pt **Lesson 1.2**

The first American property insurer, organized in 1752 with Benjamin Franklin among its founders, was:

A. The Philadelphia Contributionship

B. The Presbyterian Ministers' Fund

C. Lloyd's of London

D. The Hartford fire pool

10. 1 pt **Lesson 1.5**

A candidate wants her state's exact licensing exam fees, question counts and identification rules. The authoritative source is:

A. A national average published by the NAIC

B. The testing vendor's candidate handbook for her state

C. Any commercial study guide

D. The figures another state publishes, since all states match

11. (1 pt) **Lesson 2.1**

In exchange for the insurer's promise to pay, the applicant's consideration for a life insurance contract consists of:

A. The premium only

B. The statements in the application only

C. The premium plus the statements made in the application

D. The medical examination

12. (1 pt) **Lesson 3.2**

A couple owes 25 years on an amortizing mortgage and wants the cheapest coverage that tracks the shrinking balance. The classic recommendation is:

A. Decreasing term

B. Level term

C. Whole life

D. An annuity

13. (1 pt) **Lesson 2.2**

In June, Dale sold his pickup truck but let his old policy run to its expiration. In August the truck burned in the buyer's driveway. Dale's claim will be:

A. Paid, because his premiums were current

B. Denied, because he had no insurable interest at the time of loss

C. Paid, but only at actual cash value

D. Denied, because fire is excluded on autos

14. (1 pt) **Lesson 2.2**

A wife owns a life policy on her husband, purchased during the marriage. They later divorce, and she keeps paying the premiums. At his death the policy is:

A. Enforceable — insurable interest was required at application, not at death

B. Void, because the interest ended at the divorce

C. Enforceable only if the ex-husband consented annually

D. Payable to his estate instead of to her

15. 1 pt **Lesson 2.2**

Which statement correctly contrasts life insurance with property insurance?

A. Both are contracts of indemnity

B. Life insurance is an indemnity contract; property insurance is a valued contract

C. Both pay a stated amount regardless of measured loss

D. Life insurance is a valued contract paying its face amount; property insurance is an indemnity contract paying the measured loss

16. 1 pt **Lesson 2.3**

Statements an applicant makes on an insurance application are held to which standard of truth?

A. Strict, literal truth, like a warranty

B. Substantial truth to the applicant's knowledge and belief, as representations

C. No standard — applications are not part of the contract

D. Truth only as to questions about health

17. 1 pt **Lesson 2.3**

Eight months after issue, a life insured dies in a boating accident. The insurer discovers the application concealed a serious heart condition the insured knew about. The insurer rescinds. The rescission stands because:

A. Any error on an application voids the policy

B. The heart condition caused the death

C. The concealment was material to underwriting — the truth would have changed the decision — and the policy was still contestable

D. Boating accidents are excluded

18. 1 pt **Lesson 1.3**

An insurer covers 2,000 similar houses, each with a 1-in-100 annual chance of a $150,000 total loss, in this example. The pure premium per house — losses only, before expenses — is:

A. $750

B. $3,000

C. $1,500

D. $150

19. 1 pt **Lesson 2.4**

Nothing in an agent's written contract mentions collecting initial premiums, yet collecting them with applications is customary and necessary to the work the contract assigns. The agent's power to collect them is:

A. Apparent authority only

B. No authority at all

C. Implied authority — real, binding authority supplied by custom and necessity

D. Express authority

20. 1 pt **Lesson 2.4**

An agent carelessly fails to submit a client's completed application, and the client suffers an uninsured loss. An agent's errors and omissions policy would cover this claim, but E&O would NOT cover:

A. A missed deadline that left a client without coverage

B. Honest but negligent advice that chose the wrong policy form

C. A clerical error in a coverage amount

D. The agent's intentional misappropriation of a client's premium money

21. 1 pt **Lesson 2.5**

Premium accompanies a life application, and the agent gives the applicant a conditional receipt. Coverage under that receipt begins:

A. Immediately and unconditionally, until the insurer declines

B. As of the receipt (or exam) date, provided underwriting finds the applicant insurable as applied for

C. Only when the policy is delivered

D. Only when the first renewal premium is paid

22. 1 pt **Lesson 4.2**

A beneficiary leaves death proceeds with the insurer under an interest-only settlement option. The policy's spendthrift clause protects those proceeds from:

A. Federal income tax on the interest

B. The beneficiary's creditors, while the insurer still holds the money

C. The insured's funeral expenses

D. Claims by contingent beneficiaries

23. (1 pt) **Lesson 3.1**

Which fact belongs in a needs-approach calculation but NOT in a human life value calculation?

A. The breadwinner's annual earnings

B. The years remaining until retirement

C. The share of earnings the breadwinner spends on himself

D. The family's outstanding mortgage balance

24. (1 pt) **Lesson 3.1**

A beneficiary receives a $300,000 lump-sum death benefit and deposits it in a savings account, where it earns $9,000 of interest in the first year. For income tax purposes:

A. Both the $300,000 and the $9,000 are taxable

B. The $300,000 is taxable; the interest is not

C. The $300,000 is received income-tax-free; the $9,000 of interest is taxable

D. Neither amount is ever taxable

25. (1 pt) **Lesson 3.2**

In this example, 20-year level term costs $2.20 per $1,000 of face amount per year. The annual premium for a $250,000 policy is:

A. $2,200

B. $550

C. $220

D. $5,500

26. (1 pt) **Lesson 3.2**

A healthy 35-year-old buys 10-year renewable term. At 45 he renews without a medical exam. Which statement about his renewal is TRUE?

A. His premium stays at the age-35 rate

B. He must prove insurability to renew

C. His face amount is automatically reduced

D. He renews without evidence of insurability, at a higher premium based on his attained age

27. 1 pt **Lesson 2.1**

An applicant applies for a $500,000 policy at standard rates. The insurer issues the policy rated, at a higher premium. The issued policy is legally:

A. An acceptance of the applicant's offer

B. A binding contract the applicant must pay for

C. A voidable contract

D. A counteroffer, which the applicant may accept by paying the premium

28. 1 pt **Lesson 3.3**

A woman buys a paid-up-at-65 whole life policy at age 40. At 65 she stops paying premiums, as the contract provides. Her coverage:

A. Ends at 65 when premiums end

B. Converts automatically to term insurance

C. Continues for her whole life, fully paid up

D. Continues only if she proves insurability

29. 1 pt **Lesson 3.3**

A $300,000 whole life policy has a $20,000 policy loan and $800 of accrued loan interest outstanding when the insured dies. The beneficiary receives:

A. $300,000

B. $279,200

C. $280,000

D. $280,800

30. 1 pt **Lesson 4.5**

A life policy funded faster than the seven-pay test allows becomes a modified endowment contract. The consequence is that:

A. Loans and withdrawals are taxed gain-first (LIFO), with a 10% penalty on taxable amounts before age 59½ — though the death benefit stays income-tax-free

B. The death benefit becomes taxable

C. The policy is void

D. The policy loses its cash value

31. 1 pt **Lesson 3.4**

A universal life policy is written with death benefit Option A (level). As the cash value grows over the years, the insurer's net amount at risk:

A. Shrinks, because the death benefit stays level while the cash value inside it grows

B. Grows with the cash value

C. Stays exactly level

D. Equals the face amount plus the cash value

32. 1 pt **Lesson 3.4**

An indexed universal life policy credits interest with a 0% floor, a 10% cap and an 80% participation rate. In a year the index rises 20%, the interest credited is:

A. 20%

B. 16%

C. 10%

D. 0%

33. 1 pt **Lesson 3.5**

An employee leaves her job, where she was covered under the employer's group term life plan. Within 31 days she may convert that coverage to:

A. The same group term policy, kept individually at group rates

B. An individual permanent policy at attained-age rates, with no evidence of insurability

C. Any policy, but only after passing a medical exam

D. A new group plan of her own

34. 1 pt **Lesson 3.5**

An employer pays the entire premium for its group life plan, with no employee contribution. Under common group underwriting rules, the plan must cover:

A. At least 75% of eligible employees

B. Only the officers

C. At least half of eligible employees

D. 100% of eligible employees

35. 1 pt **Lesson 4.1**

An insured dies 12 days after missing the premium due date on her $250,000 policy; the overdue premium was $400 and the grace period is 31 days. The insurer pays:

A. $249,600

B. Nothing — the policy had lapsed

C. $250,000

D. A refund of all premiums ever paid

36. 1 pt **Lesson 4.1**

A whole life policy lapsed 14 months ago. To reinstate it, the owner must generally:

A. Simply resume paying the current month's premium

B. Buy a new policy at attained age

C. Prove insurability and pay all back premiums with interest

D. Pay a reinstatement fee only, with no health questions

37. 1 pt **Lesson 4.1**

An insured dies by suicide 14 months after policy issue; the policy's suicide clause runs 2 years. The beneficiary receives:

A. The full face amount

B. A refund of the premiums paid

C. Nothing at all

D. The policy's cash value only

38. 1 pt **Lesson 5.4**

Under the uniform mandatory provisions, an insured must give the insurer notice of claim within:

A. 20 days of the loss, or as soon as reasonably possible

B. 90 days of the loss

C. 60 days of the loss

D. 15 days of the loss

39. 1 pt **Lesson 4.2**

A beneficiary elects the fixed-AMOUNT settlement option at $2,000 a month. If the insurer credits more interest than it guaranteed, the result is:

A. Payments continue for a longer time

B. Each monthly payment grows larger

C. The excess is forfeited to the insurer

D. The option converts to a life income

40. 1 pt **Lesson 2.5**

In this example, a $200,000 life policy is priced from a mortality rate of $3.00 per $1,000, a $70 expense load, and a $90 credit for interest earnings. The annual premium is:

A. $580

B. $760

C. $600

D. $670

41. 1 pt **Lesson 4.3**

A whole life policyowner stops paying premiums and elects the nonforfeiture option that keeps the FULL original face amount in force. She has chosen:

A. Reduced paid-up insurance

B. The automatic premium loan

C. Cash surrender

D. Extended term insurance

42. 1 pt **Lesson 4.3**

The guaranteed insurability rider permits the insured to:

A. Convert term coverage to whole life at any time

B. Buy stated additional amounts of coverage at scheduled ages and life events, with no evidence of insurability

C. Increase coverage whenever he passes a new medical exam

D. Freeze his premium for life

43. 1 pt **Lesson 4.4**

An annuitant invested $50,000 in a nonqualified annuity; her expected return is $100,000, and she receives $500 a month, in this example. The portion of each payment excluded from tax is:

A. $250

B. $500

C. $100

D. Nothing — annuity payments are fully taxable

44. 1 pt **Lesson 4.4**

Which annuity payout option provides the LARGEST monthly check — and why?

A. Life with 20-year period certain, because of the guarantee

B. Joint and survivor, because two lives are covered

C. Pure life (straight life), because nothing is payable to anyone after the annuitant dies

D. Fixed period, because the insurer controls the calendar

45. 1 pt **Lesson 4.4**

An agent recommends that an 80-year-old widow move nearly all her savings — her only emergency fund — into a deferred annuity carrying a 12-year surrender charge schedule. The recommendation is best described as:

A. Suitable, because annuity growth is tax-deferred

B. Unsuitable, because it locks her liquid funds behind surrender charges she is likely to need to breach

C. Suitable, if the product was honestly described and all forms were signed

D. Prohibited only if the annuity is variable

46. 1 pt **Lesson 5.5**

An employee's wife has been covered under his employer's group health plan (60 employees). The couple divorces. Under COBRA, the ex-wife may continue the group coverage at her own cost for up to:

A. 18 months

B. 12 months

C. 36 months

D. 63 days

47. (1 pt) **Lesson 3.3**

A participating whole life policyowner elects to leave her dividends with the insurer to accumulate at interest. The tax consequence is:

A. The dividends themselves become taxable income each year

B. Both dividends and interest are tax-free

C. Both dividends and interest are taxable

D. The dividends remain an untaxed return of premium, but the interest they earn is taxable

48. (1 pt) **Lesson 5.1**

A major medical policy has a $1,000 calendar-year deductible, 80/20 coinsurance and a $6,000 out-of-pocket maximum. The insured, who has met nothing this year, incurs $21,000 of covered charges. She pays:

A. $4,200

B. $1,000

C. $5,000

D. $6,000

49. (1 pt) **Lesson 5.1**

Same policy — $2,000 deductible, 80/20 coinsurance, $7,000 out-of-pocket maximum — but the hospital bill is $102,000 of covered charges. The insured pays:

A. $22,000

B. $20,000

C. $2,000

D. $7,000

50. (1 pt) **Lesson 5.1**

A health plan requires no referrals and no primary care gatekeeper, but pays nothing for out-of-network care except emergencies. This design is:

A. A PPO

B. An EPO

C. An HMO

D. A POS plan

51. 1 pt **Lesson 5.2**

A disability policy defines total disability as the inability to perform ANY occupation for which the insured is reasonably suited by education, training or experience. A disabled carpenter who can still do light office work would:

A. Collect the full benefit while working the office job

B. Collect half the benefit

C. Not qualify as totally disabled under this definition

D. Collect only if he refuses the office work

52. 1 pt **Lesson 5.2**

A residual disability benefit is figured on a $4,000 total monthly benefit. Before disability the insured earned $8,000 a month; working part-time she now earns $6,000. Her residual benefit is:

A. $1,000

B. $2,000

C. $4,000

D. $3,000

53. 1 pt **Lesson 5.2**

An accountant buys her own disability income policy and pays the premiums with after-tax dollars. When she collects benefits, they are:

A. Taxable as ordinary income

B. Received income-tax-free

C. Taxable only above $50,000

D. Taxed as capital gains

54. 1 pt **Lesson 5.3**

Inpatient hospital care, skilled nursing facility care after a qualifying hospital stay, and hospice are covered under:

A. Medicare Part A

B. Medicare Part B

C. Medicare Part D

D. Medigap

55. 1 pt **Lesson 5.3**

A long-term care policy pays benefits when the insured cannot perform a stated number of the six activities of daily living — commonly two — OR when a second trigger is met. That second trigger is:

A. Reaching age 85

B. Severe cognitive impairment, such as advanced dementia

C. Exhausting Medicare benefits

D. Admission to any hospital

56. 1 pt **Lesson 4.2**

A policy leaves $300,000 “to my three children equally, per capita.” One child died years earlier, leaving two daughters of her own. At the insured’s death, the proceeds are divided:

A. $100,000 to each surviving child and $50,000 to each granddaughter

B. $100,000 to each of the three branches

C. Equally among the four survivors

D. $150,000 to each surviving child, with nothing to the granddaughters

57. 1 pt **Lesson 5.4**

A guaranteed renewable health policy differs from a noncancellable policy in that the guaranteed renewable insurer:

A. May refuse renewal for health reasons

B. May raise premiums, but only for an entire class of insureds

C. May cancel mid-term with notice

D. May never change the premium

58. 1 pt **Lesson 5.4**

An insurer receives a policyowner’s reinstatement application for a lapsed health policy and neither approves nor declines it. Under the uniform provisions, the policy is automatically reinstated after:

A. 10 days

B. 90 days

C. 31 days

D. 45 days

59. 1 pt **Lesson 4.5**

Which exchange qualifies for tax-free treatment under Section 1035?

A. An annuity exchanged for a life insurance policy

B. A life insurance policy surrendered for cash and reinvested within 60 days

C. A savings account exchanged for an annuity

D. A life insurance policy exchanged for an annuity

60. 1 pt **Lesson 5.5**

Which person is eligible to contribute to a health savings account?

A. A 65-year-old enrolled in Medicare

B. A 30-year-old claimed as a dependent on her parents' return

C. A 40-year-old covered by both an HDHP and his wife's traditional low-deductible plan

D. A 45-year-old whose only health coverage is a qualifying high-deductible health plan

ANSWER KEY

1. B. Representation decides the label: Eleanor represents the buyer, which makes her a broker; Marcus represents an insurer, which makes him an agent. Choice A is the trap — an independent agent shops several companies but still represents the insurers that appointed him, not the buyer.
2. C. Lloyd's grew up around shipping news, and marine insurance — hull and cargo — is the oldest branch of the business. Fire insurance grew from the Great Fire of London, and the clergy fund was Philadelphia's Ministers' Fund of 1759.
3. D. Indifference and carelessness bred by the existence of coverage is morale hazard. Moral hazard (A) is dishonesty — faking or causing a loss on purpose — and the exam offers that reversal every time this pair appears.
4. A. Insurance covers only pure risk — loss or no loss, with no possibility of gain. The stock, the wager and the product launch all carry a chance of profit, which makes them speculative and uninsurable.
5. A. Actual authority — express and implied — died with the contract, but the principal's own conduct, leaving the trappings of agency in the agent's hands, created a reasonable public appearance of authority. Apparent authority is built by the principal's conduct, never by the agent's own claims.
6. B. Incorporated in another country makes it alien; another state would make it foreign — the exam offers both every time. Its certificate of authority makes it admitted, so D fails.
7. A. SEUA (1944) reversed Paul v. Virginia's 1869 holding that insurance was not commerce; Congress answered a year later with McCarran-Ferguson, returning primary regulation to the states. Keep the three dates in order: 1869, 1944, 1945.
8. D. The license is the state's permission to transact insurance; the appointment is the insurer's filed authorization, and a producer needs one from each insurer she represents. No college degree or sponsor is required for an insurance license — the exam's favorite invented requirements.
9. A. The Contributionship (1752) insured Philadelphia houses against fire. The Ministers' Fund (1759) was the first American life insurer — property came first, a sequence the exam likes to reverse.
10. B. Fees, hours and question counts vary by state and year, and only the candidate handbook — the testing vendor's official booklet for that state — speaks with authority. Treating any other state's figures, or a study guide's examples, as law is the classic mistake.

11. C. The applicant's consideration is both the premium and the application's statements — which is why a material misstatement strikes at the contract itself. Premium-only is the tempting half answer.
12. A. Decreasing term's face amount declines on a schedule matched to the amortizing debt, at a level premium — the textbook mortgage-protection design. Level term fits income replacement, where the need does not shrink.
13. B. Property insurance requires insurable interest at the time of loss, and nothing of Dale's was lost — a paid-up premium cannot create a stake he no longer owns. Insurance is a personal contract; it did not follow the truck to the buyer.
14. A. Life insurance tests insurable interest once, when the policy is issued; a validly formed policy survives divorce. The time-of-loss rule belongs to property insurance — the exam swaps the two constantly.
15. D. No adjuster appraises a life: the life policy pays its stated face amount, while property insurance restores the measured loss up to the limit. Choice B states the exam's favorite reversal.
16. B. Application answers are representations, true to the applicant's honest knowledge and belief; the strict literal-truth standard belongs to warranties, which are written into the contract itself. The entire contract provision makes the attached application part of the agreement, so C is false.
17. C. Materiality is measured against the underwriting decision, not the cause of death — a concealed heart condition supports rescission even when the claim is a drowning, so long as the contestable period is still running. Choice A overstates the rule: immaterial errors change nothing.
18. C. Expected losses: 2,000 ÷ 100 = 20 losses, totaling 20 × $150,000 = $3,000,000; spread over 2,000 houses that is $1,500 each. Choice A halves it by misreading the odds; the pure premium carries no expense load.
19. C. Implied authority is written nowhere but is genuine, binding authority — the customary powers needed to carry out the express grant. Apparent authority (A) covers what the public reasonably believes; this power is actual.
20. D. E&O is professional liability for negligence — mistakes, oversights, bad advice honestly given. It never covers fraud, theft or other intentional dishonesty; stolen premium money is a crime, not an error.
21. B. The conditional receipt dates coverage back to the receipt or exam date if — and only if — the applicant proves insurable as applied for. Choice A describes the rarer binding receipt; the exam tests the difference between the two.

22. B. The spendthrift clause shields proceeds the insurer still holds under a settlement option from the beneficiary's creditors; once money is paid out, the protection ends. It has nothing to do with taxation — interest earned is still taxable.

23. D. The needs approach totals what survivors will actually face — debts, mortgage, income, education — then subtracts resources in place. Human life value ignores the bills and simply values the earnings stream: income kept for the family times working years remaining.

24. C. A lump-sum death benefit is generally income-tax-free to the beneficiary, but earnings on the money after it arrives are ordinary taxable interest. The exam tests exactly this line between the proceeds and what the proceeds earn.

25. B. The face amount is 250 thousands: 250 × $2.20 = $550. Choice A multiplies by 1,000 instead of dividing — watch the units on every rate-per-thousand problem.

26. D. Renewability waives evidence of insurability — never the price. The new premium is computed at attained age 45; a guaranteed old premium (A) is the too-good-to-be-true choice the exam loves to offer.

27. D. Issuing on different terms than applied for rejects the original offer and makes a new one; the applicant accepts the counteroffer by paying. Nothing binds the applicant to take a rated policy.

28. C. Limited-pay designs compress the paying period, not the protection: premiums stop at 65 and the policy is paid up for life. Confusing the end of premiums with the end of coverage is this lesson's most-tested trap.

29. B. The death benefit is reduced by the loan and its accrued interest: $300,000 − $20,000 − $800 = $279,200. Choice C forgets the interest — the exam almost always includes it.

30. A. MEC status strips away life insurance's FIFO advantage: gain comes out first on loans and withdrawals alike, penalized 10% before 59½ — and the status is permanent, surviving even a 1035 exchange. The death benefit's income-tax-free character survives, so B overreaches.

31. A. Under Option A the beneficiary receives the level face amount, so the insurer's true exposure — face minus cash value — shrinks as the account grows, and the monthly mortality charge is figured on that shrinking slice. Choice D describes Option B.

32. C. Apply participation first: 20% × 0.80 = 16%; then the cap cuts it to 10%. Choice B stops before the cap — the formula is the lesser of (gain × participation) and the cap, never below the floor.

33. B. The conversion right runs 31 days and leads to individual permanent coverage at attained-age rates, with no medical questions — and death during the window is covered by the group policy even if no conversion was filed. Conversion to term, or at the old group rate, is not offered.

34. D. A noncontributory plan commonly requires 100% participation; the 75% figure belongs to contributory plans, where employees share the premium. Both rules exist to smother adverse selection — a plan only the sick would join.

35. A. Death during the grace period is fully covered, but the insurer deducts the overdue premium: $250,000 − $400 = $249,600. The grace period exists precisely so a missed payment does not become a forfeited promise.

36. C. Reinstatement — commonly available for 3 years after lapse — costs proof of insurability plus the missed premiums with interest. Its reward is keeping the original issue-age premium, which is why it can beat buying new coverage at attained age (B).

37. B. Within the suicide period the insurer does not pay the face amount but must return the premiums paid; after the period expires, suicide is covered like any death. Both extreme answers — full face and nothing — are the standing traps.

38. A. The claims clock runs 20 days for notice of claim, 15 days for the insurer to send forms, 90 days for proof of loss, and 60 days to (commonly) 3 years for lawsuits. Choice B is the proof-of-loss number — the exam loves to shuffle the chain.

39. A. Under fixed amount the check is locked, so extra interest stretches the calendar; under fixed period the calendar is locked, so extra interest fattens the check. Swapping the two is the exam's standard play.

40. A. Mortality cost is 200 × $3.00 = $600; add $70 of expenses and subtract the $90 interest credit: $600 + $70 − $90 = $580. Interest earnings reduce the premium — adding them (B) is the classic error.

41. D. Extended term uses the cash value as a single premium to carry the full face amount for as long as the money lasts — full face, limited time. Reduced paid-up (A) is the mirror image: smaller face, permanent coverage.

42. B. The rider's whole value is the waiver of evidence: at the scheduled dates — and commonly at marriage or a child's birth — the insured may add coverage even if his health has collapsed. Choice C describes what anyone can already do without the rider.

43. A. The exclusion ratio is $50,000 ÷ $100,000 = 50%, so $250 of each $500 payment returns her own money untaxed; the other $250 is ordinary income. Annuity

gains are never capital gains — ordinary income, always.

44. C. With no residual promise to heirs, the insurer can pay the most per month; every added guarantee — a certain period, a refund, a second life — shrinks the check. The price of the big check is that payments stop at death, even after one month.

45. B. Locking a senior's emergency money behind a long surrender schedule is the exam's standard example of an unsuitable annuity sale. Honest description and signatures (C) do not cure a product that fails to fit the client's situation and liquidity needs.

46. C. Divorce is a dependent's qualifying event, carrying 36 months; the 18-month period belongs to the employee's own termination or reduced hours. She pays the full premium plus up to 2% — the employer's subsidy ends even though the plan continues.

47. D. Policy dividends are a return of overpaid premium — not guaranteed, and not income. But money the dividends earn while on deposit is ordinary taxable interest, the one taxable corner of the five dividend options.

48. C. Deductible first: $1,000; then 20% of the remaining $20,000 is $4,000 — total $5,000, which is under the $6,000 cap, so the cap does not bite. Choice A forgets the deductible comes off before the percentage is applied.

49. D. The uncapped share would be $2,000 + 20% of $100,000 = $22,000, but the out-of-pocket maximum caps the insured at $7,000 and the insurer pays the rest. Choice A is the number you get by forgetting the cap — always compute, then check against the maximum.

50. B. The EPO offers a PPO's freedom inside the network and an HMO's wall around it: no gatekeeper, no referrals, no out-of-network benefit except emergencies. The HMO adds the gatekeeper; the POS has a gatekeeper plus an out-of-network door.

51. C. Under the any-occupation standard, the ability to do suitable work — even different, lesser-paid work — defeats total disability. The own-occupation definition is the generous one, and the exam tests which definition a scenario quotes.

52. A. She has lost 25% of her income ($2,000 of $8,000), so she receives 25% of the $4,000 benefit — $1,000. Residual is proportional to income actually lost; the flat-percentage design (commonly 50%) is partial disability, a different provision.

53. B. Self-paid, after-tax premiums buy tax-free benefits; employer-paid premiums produce taxable benefits. The rule follows the premium dollars — whoever

deducted them going in, the IRS collects coming out.

54. A. Part A is the hospital insurance — inpatient care, skilled nursing after a qualifying stay, hospice and some home health — premium-free for most workers. Part B covers doctors and outpatient services; Part D covers prescription drugs.

55. B. Severe cognitive impairment qualifies on its own, even when all six ADLs — bathing, dressing, eating, toileting, transferring, continence — can still be performed. A person with advanced dementia may be physically able and still profoundly unsafe alone; the trigger exists for exactly that case.

56. D. Per capita divides among the living named class members only — the two surviving children — and a deceased child's branch takes nothing. Per stirpes (B and A's logic) is the designation that sends a share down the branch.

57. B. Both designs guarantee renewal, but only noncancellable freezes the premium at the rate stated in the policy; guaranteed renewable permits class-wide increases. Choice D describes noncancellable — the pair is the renewability ladder's most-tested rung.

58. D. Silence for 45 days works an automatic reinstatement. Once reinstated, accidents are covered immediately but new sickness only after 10 days — the asymmetry that keeps lapse-and-revive from becoming free coverage for a brewing illness.

59. D. The tax-free directions are life to life, life to annuity, and annuity to annuity — never annuity to life. Choice B is a taxable surrender followed by a purchase; 1035 requires a direct exchange, not a detour through cash.

60. D. HSA eligibility requires a qualifying HDHP and falls to three disqualifiers the exam rotates: Medicare enrollment (A), dependent status (B), and other non-HDHP coverage (C). The account is the HDHP's companion by federal design — triple tax-advantaged when the gate is passed.

COURSE EXAM

Final Exam: A Full-Length Practice Licensing Exam

Covers Units 1–10. Time: 150 minutes.

This is the dress rehearsal. Take it in one two-and-a-half-hour sitting: closed book, proctored by a parent, photo ID on the desk exactly as it would be at a real testing center, no phone in the room. Every question has four choices and one best answer. There is no penalty for guessing, so answer all 150 — pace yourself at about one minute per question, mark the doubtful ones, and sweep for blanks before time expires. Score it the way a state would: 105 correct out of 150 (70%) passes. The questions are mixed across all ten units, the way a real combined exam shuffles its outline. Figures labeled as examples ("in this example," "commonly," "as of 2026") are illustrations; the live numbers are in your state's candidate handbook and at your state insurance department. A pass earned under these honest conditions means you are ready to sit down with your parents and plan for a real seat.

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1. **1 pt** **Lesson 5.3**

   Medicare Part C — Medicare Advantage — is best described as:

   A. A federal long-term care program

   B. Private plans, commonly HMOs and PPOs, that contract with Medicare to deliver at least all Part A and Part B benefits

   C. A supplement that pays Original Medicare's deductibles

   D. The disability portion of Social Security

2. **1 pt** **Lesson 1.2**

   A mutual insurer differs from a stock insurer in that the mutual is owned by:

   A. Its stockholders, who receive guaranteed dividends

   B. The state insurance department

   C. The NAIC

   D. Its policyholders, who may receive non-guaranteed policy dividends

3. 1 pt **Lesson 7.3**

A covered auto worth $14,000 (actual cash value) sustains $5,000 of collision damage; the collision deductible is $1,000. The insurer pays:

A. $5,000

B. $13,000

C. $14,000

D. $4,000

4. 1 pt **Lesson 2.1**

In an insurance contract, only the insurer makes a promise that can be enforced at law; the insured may stop paying premiums without breaching anything. The contract is therefore:

A. Conditional

B. Unilateral

C. Aleatory

D. Void

5. 1 pt **Lesson 4.5**

An applicant did not pay the first premium with her application. When the agent later delivers the issued policy, he must collect the premium AND obtain:

A. A signed statement of continued good health

B. A new application

C. The beneficiary’s consent

D. A medical examiner’s certificate

6. 1 pt **Lesson 6.1**

A 6-year-old furnace is destroyed by a covered peril. A new one costs $8,000 installed, and furnaces last about 20 years. The actual cash value settlement, before any deductible, is:

A. $5,600

B. $8,000

C. $2,400

D. $6,000

7. 1 pt **Lesson 8.1**

Business income coverage pays for a manufacturer's lost net income and continuing expenses. It is triggered by:

A. Any drop in sales, whatever the cause

B. A competitor's grand opening

C. Suspension of operations caused by direct physical loss to the premises from a covered cause, commonly after a 72-hour waiting period

D. An employee strike

8. 1 pt **Lesson 7.3**

The insured's parked car is damaged by hail in April and struck by a falling tree limb in June. Under Part D, both losses fall under:

A. Collision coverage

B. Uninsured motorist coverage

C. Other-than-collision (comprehensive) coverage

D. Liability coverage

9. 1 pt **Lesson 4.2**

A policyowner named his business partner as irrevocable beneficiary. He now wants to borrow against the policy's cash value. He may do so:

A. Freely — loans are an ownership right

B. Only with the irrevocable beneficiary's written consent

C. Never, while the designation stands

D. Only by court order

10. 1 pt **Lesson 2.1**

A man sells his insured house. The buyer asks to simply take over the seller's homeowners policy. Without the insurer's consent, this transfer is not allowed because insurance is:

A. An aleatory contract

B. A conditional contract

C. A contract of adhesion

D. A personal contract

11. 1 pt **Lesson 5.5**

Which statement correctly contrasts a flexible spending account (FSA) with a health savings account (HSA)?

A. FSA funds are generally use-it-or-lose-it each year, while HSA funds belong to the individual, roll over, and move with her between jobs

B. The FSA requires an HDHP; the HSA does not

C. HSA funds expire annually; FSA funds roll over

D. Both accounts are owned by the employer

12. 1 pt **Lesson 6.3**

An insured's 10-year-old son and a visiting playmate both scrape their arms in a backyard fall. Coverage F — Medical Payments to Others will pay for:

A. Both children's medical bills

B. The son's bills only

C. Neither child's bills

D. The playmate's bills only — household members are never covered under Coverage F

13. 1 pt **Lesson 4.1**

Under the entire contract provision, the complete agreement between insurer and policyowner consists of:

A. The policy, the agent's sales presentation and the company's advertising

B. The policy alone

C. Whatever the home office files internally

D. The policy plus the attached copy of the application and any riders or endorsements

14. 1 pt **Lesson 8.3**

Which business is the classic candidate for a businessowners policy (BOP)?

A. A small Main Street gift shop within the program's size and sales limits

B. A regional bank

C. An automobile dealership

D. A heavy manufacturer

15. 1 pt **Lesson 4.4**

A fixed annuity differs from a variable annuity in that the fixed annuity's funds are held in:

A. The insurer's general account, with the insurer guaranteeing principal and a minimum interest rate

B. A separate account chosen by the owner

C. A stock brokerage account

D. The state treasury

16. 1 pt **Lesson 8.4**

A florist's employee uses her own car to make the shop's deliveries. For the shop's liability arising from that use, the car is a:

A. Hired auto

B. Covered auto under symbol 7

C. Non-owned auto

D. Mobile equipment

17. 1 pt **Lesson 2.1**

Courts construe ambiguous policy language against the insurer because an insurance policy is a contract of adhesion, meaning:

A. The insured drafted its terms

B. Both parties negotiated each clause

C. One party drafted it entirely and offered it take-it-or-leave-it

D. It binds only one party

18. 1 pt **Lesson 5.4**

Under the uniform provisions, the grace period for an individual health policy paying MONTHLY premiums is commonly:

A. 31 days

B. 7 days

C. 10 days

D. 45 days

19. 1 pt **Lesson 2.1**

A homeowner pays a $900 annual premium, in this example, and after a kitchen fire collects $48,000. This lawful exchange of unequal values, contingent on an uncertain event, shows that an insurance contract is:

A. Adhesive

B. Unilateral

C. Conditional

D. Aleatory

20. 1 pt **Lesson 5.5**

A policy that pays a flat $200 for each day the insured is hospitalized, regardless of actual charges, and covers nothing else, is properly sold as:

A. Major medical insurance

B. A Medicare supplement

C. A limited policy — hospital indemnity — with its limits disclosed on its face

D. Disability income insurance

21. 1 pt **Lesson 1.3**

People in poor health apply for life insurance more eagerly than the healthy, and keep their policies longer. This tilt is called:

A. The law of large numbers

B. Morale hazard

C. Pure risk

D. Adverse selection

22. 1 pt **Lesson 3.3**

A participating policyowner wants her dividends to increase her death benefit permanently, with each dividend buying its own small block of fully paid coverage. She should elect:

A. Dividends in cash

B. Reduction of premium

C. One-year term

D. Paid-up additions

23. 1 pt Lesson 2.5

Because the agent is the only company representative who actually sees the applicant, asks the questions and observes what a form cannot capture, the agent is called the:

A. Claims adjuster

B. Field underwriter

C. Actuary

D. Principal

24. 1 pt Lesson 7.4

An insured's umbrella covers libel and slander, which his homeowners policy does not cover at all. When a covered slander claim is brought, the umbrella:

A. Pays nothing until the homeowners limit is exhausted

B. Drops down and pays from the first dollar above the self-insured retention

C. Pays only defense costs

D. Requires the insured to pay half

25. 1 pt Lesson 1.2

After the Great Fire of 1666 destroyed some 13,200 London houses, early fire offices fastened metal badges to the buildings they insured. These fire marks told the companies' fire brigades:

A. The building's market value

B. Which insurer — and therefore whose brigade — protected the building

C. The owner's premium balance

D. The date the policy expired

26. 1 pt Lesson 9.5

A producer prints business cards reading "Certified Senior Retirement Advisor," a title he invented, and markets to clients over 65. Under the NAIC senior-specific designation rules, this is:

A. Lawful marketing creativity

B. Permissible with a disclaimer

C. Prohibited — using a title that falsely implies special training in advising seniors

D. Allowed if he completes CE

27. 1 pt Lesson 4.2

A beneficiary elects to receive $90,000 of proceeds in equal monthly payments over exactly five years, whether or not she survives the period. Ignoring interest, each payment is:

A. $2,500

B. $1,800

C. $900

D. $1,500

28. 1 pt Lesson 4.2

A policy names the insured's husband as primary beneficiary and her sister as contingent. The husband dies; a year later the insured dies, never having updated the policy. The proceeds go to:

A. The sister, as contingent beneficiary

B. The insured's estate

C. The husband's heirs

D. The state unclaimed property fund

29. 1 pt Lesson 5.2

A new disability income policy will not cover a disability from SICKNESS that begins during the first 20 days after issue, though injuries are covered immediately. This one-time period is the:

A. Probationary period

B. Elimination period

C. Grace period

D. Benefit period

30. 1 pt Lesson 5.2

Disability income policies commonly cap the monthly benefit at 60% to 70% of gross earnings rather than 100%. The underwriting reason is:

A. State law forbids larger policies

B. To keep premiums equal across occupations

C. Benefits are always taxable, so less is needed

D. To preserve the insured's financial incentive to recover and return to work

31. 1 pt **Lesson 9.4**

Two drivers deliberately stage a collision to collect on invented injuries. A third policyholder, after a genuine burglary, inflates the value of what was taken. These are, respectively:

A. Soft fraud and hard fraud

B. Hard fraud and soft fraud

C. Twisting and rebating

D. Misrepresentation and concealment

32. 1 pt **Lesson 7.2**

Which state law requires a driver to carry minimum liability insurance BEFORE a car may be registered or driven — rather than requiring proof of ability to pay only after an accident?

A. A compulsory insurance law

B. A financial responsibility law

C. The McCarran-Ferguson Act

D. A guest statute

33. 1 pt **Lesson 10.5**

A student takes the 150-question practice final under full exam conditions and scores 126 — comfortably above the 105 needed at the common 70% standard. The readiness map says:

A. Retake the practice final weekly for a year

B. Study the state's candidate handbook and schedule the real exam — she is ready

C. Discard the result as luck

D. Skip the state exam entirely

34. 1 pt **Lesson 10.3**

An agent's book holds 400 policies. This year she retains 85% of them and writes 90 new ones. Next year her book holds:

A. 490

B. 430

C. 340

D. 400

35. 1 pt **Lesson 10.2**

The clause of an agency contract that decides whether an agent keeps the client list and renewal relationships when he leaves the carrier is:

A. Ownership of expirations

B. The commission schedule

C. The charge-back provision

D. The errors and omissions requirement

36. 1 pt **Lesson 6.3**

A guest breaks his ankle on an insured's stairs and sues. The insurer spends $40,000 defending the insured and pays the full $100,000 Coverage E limit in damages. The defense costs:

A. Reduced the amount available for damages to $60,000

B. Were paid in addition to the limit — the insurer paid $140,000 in all

C. Were deducted from Coverage A

D. Were the insured's personal responsibility

37. 1 pt **Lesson 4.5**

An executive's employer pays for $130,000 of group term life coverage on her. Under federal tax law, she:

A. Is taxed on the full premium her employer pays

B. Receives the entire benefit tax-free while employed

C. Has imputed income on the cost of the $80,000 of coverage above the $50,000 threshold

D. Must refuse coverage above $50,000

38. 1 pt **Lesson 3.4**

An indexed universal life policy has a 0% floor, a 10% cap and a 50% participation rate. The index rises 4% this year. The interest credited is:

A. 4%

B. 10%

C. 0%

D. 2%

39. 1 pt Lesson 5.3

An 82-year-old widow of modest means has spent nearly all her savings on two years of custodial nursing home care. The program that commonly pays for such care once her income and assets fall within its limits is:

A. Medicaid

B. Medicare Part A

C. Medigap

D. Social Security retirement

40. 1 pt Lesson 4.1

A man stated his age as 42 when he was actually 46. He dies years later, after the contestable period. His premiums, at his true age, would have bought $88,000 of the $100,000 face, in this example. The insurer pays:

A. $88,000

B. Nothing — the policy is void

C. $100,000

D. A refund of premiums only

41. 1 pt Lesson 7.2

A neighbor borrows the insured's car with permission to pick up groceries and causes an accident. Under PAP Part A, the neighbor is:

A. Uninsured — only family members are covered

B. Covered only under his own policy

C. Personally liable with no coverage available

D. An insured, as a permissive user of the covered auto

42. 1 pt Lesson 7.1

A delivery company's driver negligently injures a pedestrian while making his assigned rounds. The injured pedestrian may hold the company liable under:

A. Vicarious liability — the employer answers for an employee's torts within the scope of employment

B. Strict liability

C. Contributory negligence

D. Assumption of risk

43. 1 pt **Lesson 2.3**

An insurer rescinds a policy for material misrepresentation during the contestable period. Rescission means the insurer:

A. Cancels the contract from its beginning and returns the premiums, as though it never existed

B. Raises the premium retroactively

C. Pays the claim but cancels future coverage

D. Reduces the face amount

44. 1 pt **Lesson 7.4**

An umbrella requires underlying auto liability of $250,000, but the insured quietly let his auto limit fall to $100,000. After a $500,000 judgment, the insured personally owes:

A. The $150,000 gap between his actual limit and the required underlying limit

B. Nothing — the umbrella absorbs the difference

C. The entire judgment

D. Only the self-insured retention

45. 1 pt **Lesson 9.3**

Which practice is CHURNING, as distinct from twisting?

A. A producer replacing policies within his own book at the same insurer, feeding on cash values chiefly to generate new commissions

B. Misrepresenting a competitor’s policy to move the client to a new company

C. Honest replacement with all required disclosures

D. Selling two policies to one family

46. 1 pt **Lesson 7.1**

A jury finds $100,000 of damages and assigns the claimant 25% of the fault in a pure comparative negligence state. The claimant recovers:

A. $100,000

B. $25,000

C. $75,000

D. Nothing

47. 1 pt Lesson 5.3

A long-term care policy pays $150 a day with a three-year benefit period. The policy's total benefit pool, in this example, is approximately:

A. $54,750

B. $164,250

C. $45,000

D. $150,000

48. 1 pt Lesson 8.4

In a storm, a ship's master deliberately jettisons one merchant's $40,000 of cargo, successfully saving the voyage. The remaining values saved are: hull $500,000, cargo $250,000, freight $50,000. Under general average, the hull's owner contributes:

A. $40,000

B. $12,500

C. $20,000

D. $25,000

49. 1 pt Lesson 1.5

A producer holds a life line of authority and wants to sell variable life insurance. In addition to her state license, she must obtain:

A. A property line of authority

B. FINRA securities registration — a Series 6 or 7

C. A second state residence

D. Nothing further

50. 1 pt Lesson 6.4

A tenant's apartment building burns through no fault of hers, destroying her furniture and forcing her into a hotel. Her landlord's insurance:

A. Covers her belongings and hotel bills

B. Covers neither — she needed her own HO-4 renters policy for personal property and loss of use

C. Covers her belongings but not the hotel

D. Covers her hotel but not the belongings

51. 1 pt **Lesson 2.4**

Which producer can commonly bind coverage so that it is effective immediately, before the policy is issued?

A. A property and casualty agent, by issuing a binder

B. A life agent, by issuing a binder

C. Any producer, by verbal promise

D. No producer — only underwriters bind coverage

52. 1 pt **Lesson 7.1**

A demolition contractor uses explosives with every modern precaution, yet the blast cracks a neighbor's foundation. The contractor's liability is:

A. Barred, because he was not negligent

B. Limited to half the damage

C. A matter for workers' compensation

D. Strict — blasting is an abnormally dangerous activity, and precautions are no defense

53. 1 pt **Lesson 6.4**

A landlord insures a rental house on a standard DP-3 dwelling policy. Which TWO exposures does the standard dwelling program famously leave out unless added by endorsement or separate policy?

A. Theft and liability

B. Fire and windstorm

C. Vandalism and smoke

D. Collapse and water damage

54. 1 pt **Lesson 4.4**

During the accumulation phase of a nonqualified deferred annuity, the earnings grow:

A. Tax-deferred, taxed as ordinary income when withdrawn

B. Tax-free forever

C. Taxed each year as earned

D. As capital gains

55. 1 pt **Lesson 7.4**

A $1,000,000 personal umbrella sits over an auto policy whose liability limit is $500,000. A court enters a $1,200,000 judgment against the insured for an auto accident. The umbrella pays:

A. $1,200,000

B. $1,000,000

C. $500,000

D. $700,000

56. 1 pt **Lesson 1.3**

Frayed wiring behind a workshop wall increases the chance that a fire will start. In insurance language, the frayed wiring is a:

A. Physical hazard

B. Peril

C. Morale hazard

D. Speculative risk

57. 1 pt **Lesson 4.5**

A policyowner surrenders a whole life policy for its $60,000 cash value. Over the years she paid $45,000 in premiums and received $5,000 in dividends. Her taxable gain is:

A. $15,000

B. $20,000

C. $60,000

D. Nothing — surrenders are tax-free

58. 1 pt **Lesson 9.3**

To win a reluctant prospect, a producer offers to hand back $300 of his commission if she buys the policy. This is:

A. A lawful discount

B. Permissible if put in writing

C. Rebating — giving value not specified in the policy to induce the sale — prohibited in nearly every state

D. Twisting

59. 1 pt Lesson 6.2

A lovingly maintained 1890 Victorian would cost far more to rebuild with period materials than it would ever sell for. The homeowners form designed for such older homes, commonly settling losses on a repair-cost basis using modern materials, is the:

A. HO-8 modified coverage form

B. HO-5 comprehensive form

C. HO-4 contents broad form

D. HO-6 unit-owners form

60. 1 pt Lesson 9.2

An insurer fires an agent for forging client signatures, terminating his appointment. The insurer must:

A. Keep the matter confidential to avoid defamation

B. Report only to the agent's next employer

C. Pay the agent's renewal commissions regardless

D. Report the termination for cause to the commissioner

61. 1 pt Lesson 2.4

An insurer accepts a late premium month after month without objection, then denies a claim for late payment. A court holds the insurer gave up its known right by its own conduct and may not now assert it. The doctrines at work are:

A. Waiver and estoppel

B. Subrogation and salvage

C. Indemnity and contribution

D. Rescission and reformation

62. 1 pt Lesson 5.4

Three years into an individual health policy, the insurer discovers an innocent material misstatement in the application. Under the time limit on certain defenses, the insurer:

A. May rescind within 90 days of discovery

B. May deny all future claims

C. May void the policy at any time

D. May no longer void the policy or deny a claim for that misstatement — though fraudulent misstatements commonly remain a defense

63. 1 pt **Lesson 3.3**

Among ordinary (straight) whole life, 20-pay whole life and single-premium whole life, the ordinary design has:

A. The fastest cash value growth

B. The lowest annual premium, paid for the whole of life

C. No cash value

D. The shortest premium-paying period

64. 1 pt **Lesson 6.1**

Under a NAMED-peril property form, when a loss occurs, the burden of proof falls on:

A. The insured, to show the loss was caused by a listed peril

B. The insurer, to show an exclusion applies

C. The adjuster, to remain neutral

D. The state insurance department

65. 1 pt **Lesson 3.2**

Why does term insurance provide the largest death benefit per premium dollar of any policy design?

A. Because the state subsidizes term rates

B. Because term policies never pay claims

C. Because insurers lose money on term

D. Because every premium dollar buys current protection only, with no cash value being funded

66. 1 pt **Lesson 9.1**

A market conduct examination reviews an insurer's:

A. Investment portfolio only

B. Reinsurance treaties

C. Treatment of the public — its sales, underwriting, advertising and claims practices

D. Building security

67. (1 pt) **Lesson 9.5**

A producer recommends a perfectly suitable annuity, honestly described — but makes and keeps no written record of the basis for the recommendation. Under the NAIC best-interest standard, he has:

A. Breached the documentation obligation, which is separately enforceable

B. Done nothing wrong, since the product fit

C. Breached the care obligation

D. Committed rebating

68. (1 pt) **Lesson 9.4**

Which pairing of federal privacy laws is CORRECT?

A. GLBA requires privacy notices and an opt-out of information sharing; FCRA governs consumer reports, with notice and adverse-action disclosure

B. GLBA governs consumer reports; FCRA requires privacy notices

C. Both acts regulate only banks

D. Both acts are NAIC model laws

69. (1 pt) **Lesson 6.2**

A homeowners policy is written with Coverage A of $300,000. Using the common HO-3 percentages, Coverage C — Personal Property is approximately:

A. $30,000

B. $90,000

C. $150,000

D. $300,000

70. (1 pt) **Lesson 4.4**

A 65-year-old retiree hands an insurer a single premium of $200,000, and his monthly income checks begin one month later. He has bought:

A. A flexible-premium deferred annuity

B. A single-premium immediate annuity

C. Universal life insurance

D. A variable deferred annuity

71. 1 pt Lesson 3.2

A 10-year level term policy with a reentry provision allows the insured, at the end of the term, to:

A. Convert to whole life at original age without back premiums

B. Keep the original premium automatically for another ten years

C. Prove good health and requalify for a lower select rate, instead of paying the guaranteed attained-age rate

D. Receive a refund of all premiums

72. 1 pt Lesson 6.5

After paying an insured's $25,000 fire loss caused by a negligent repairman, the insurer sues the repairman to recover what it paid. The insurer's right to stand in its insured's shoes is:

A. Salvage

B. Abandonment

C. Appraisal

D. Subrogation

73. 1 pt Lesson 1.4

Under the McCarran-Ferguson Act of 1945, insurance is primarily regulated by the states — with one standing exception. Federal law applies regardless of state regulation to:

A. Boycott, coercion and intimidation

B. Policy form approval

C. Agent licensing

D. Premium rate filings

74. 1 pt Lesson 5.4

A policyholder with an accident policy quits his accounting job to become a structural steelworker and is later injured on the beams. Under the optional change of occupation provision, the insurer will:

A. Void the policy for concealment

B. Reduce the benefit to what the premium paid would have purchased at the more hazardous occupation's rates

C. Pay the full benefit with no adjustment

D. Refund all premiums

75. 1 pt **Lesson 1.1**

A client asks who actually pays the agent who sold her the policy. The accurate answer is that the agent's commission is:

A. A separate fee the client pays at delivery

B. A percentage of the premium, paid by the insurer, often largest in the policy's first year

C. A flat salary from the state insurance department

D. Deducted from the death benefit

76. 1 pt **Lesson 6.2**

A college student's laptop is stolen from her dorm room. Her parents' homeowners policy:

A. Pays nothing — the laptop left the residence premises

B. Can cover it under Coverage C, which protects personal property anywhere in the world

C. Covers it only under Coverage B

D. Covers it only if the dorm is listed on the declarations

77. 1 pt **Lesson 8.2**

A customer sues a hardware store, claiming its radio advertisement defamed his competing business. Under the store's CGL, the claim falls under:

A. Coverage A — bodily injury and property damage

B. Coverage C — medical payments

C. The pollution exclusion

D. Coverage B — personal and advertising injury

78. 1 pt **Lesson 2.4**

An agent's written contract authorizes him to solicit applications, collect initial premiums and deliver policies. These enumerated powers are his:

A. Apparent authority

B. Implied authority

C. Fiduciary authority

D. Express authority

79. 1 pt **Lesson 3.5**

A borrower's credit life insurance policy is best described as:

A. Level term payable to his family

B. Decreasing term on the borrower's life, payable to the creditor, limited to the outstanding debt

C. Whole life assigned to the lender

D. A savings plan that retires the loan early

80. 1 pt **Lesson 5.2**

A benefit that pays a flat 50% of the total disability benefit while the insured works reduced hours during recovery — regardless of exactly how much income he lost — is:

A. Partial disability

B. Residual disability

C. Presumptive disability

D. Waiver of premium

81. 1 pt **Lesson 3.3**

The level premium of a whole life policy is possible because the policyowner:

A. Overpays the pure cost of protection in early years, building a reserve that supports later years when the true cost exceeds the premium

B. Pays interest to the insurer

C. Underpays in early years and makes it up later

D. Pays only for the current year's mortality

82. 1 pt **Lesson 3.1**

A 40-year-old breadwinner earns $60,000 a year, of which $45,000 supports the family, and plans to work 20 more years. Ignoring discounting, his human life value is approximately:

A. $1,200,000

B. $900,000

C. $300,000

D. $45,000

83. 1 pt Lesson 9.1

The state insurance commissioner may do all of the following EXCEPT:

A. Examine an insurer's market conduct

B. Issue a cease-and-desist order

C. Suspend or revoke a producer's license after notice and hearing

D. Sentence a fraudulent producer to prison

84. 1 pt Lesson 3.4

A universal life policyowner, short of money this year, skips several planned premium payments. The policy stays in force so long as:

A. The insurer waives the mortality charges

B. The cash value can carry the monthly mortality and expense charges

C. She repays the skipped premiums within 31 days

D. The face amount is reduced

85. 1 pt Lesson 4.2

An insured and his primary beneficiary die in the same crash, and the order of deaths cannot be determined. Under the common disaster provision, built on the Uniform Simultaneous Death Act, the proceeds are paid as if:

A. The beneficiary survived the insured

B. Both survived

C. The insured survived the beneficiary, sending the proceeds to the contingent beneficiary

D. Neither had insurance

86. 1 pt Lesson 5.1

A flat $30 the patient pays for each office visit, regardless of the visit's cost, is a:

A. Deductible

B. Copayment

C. Coinsurance percentage

D. Premium

87. 1 pt Lesson 2.2

A bank is owed $40,000 on a business loan and wants life insurance on the borrower. The bank's insurable interest supports coverage of approximately:

A. Any amount the borrower consents to

B. $40,000 — roughly the outstanding debt

C. Ten times the loan

D. Nothing — creditors may never insure debtors

88. 1 pt Lesson 8.3

A commercial package policy (CPP) is assembled from:

A. A single standardized form no one may alter

B. Common declarations and common conditions, plus two or more chosen coverage parts, each with its own declarations and forms

C. Personal lines forms endorsed for business use

D. Whatever the agent writes by hand

89. 1 pt Lesson 7.1

In a negligence case, the element requiring an unbroken chain of events between the careless act and the injury — without which the injury would not have occurred — is:

A. Duty of care

B. Breach of duty

C. Proximate cause

D. Actual damages

90. 1 pt Lesson 5.1

A PPO member sees a specialist outside the network, without any referral. The plan will commonly:

A. Pay nothing

B. Pay only after a gatekeeper approves

C. Cover the care, but at a lower benefit level than in-network care

D. Cancel her membership

91. 1 pt Lesson 8.2

A claims-made CGL policy differs from an occurrence form in that the claims-made policy covers:

A. Claims first made during the policy period, for injuries occurring after the retroactive date

B. Injuries occurring during the policy period, whenever the claim arrives

C. Only product liability

D. Claims the insured reports within 24 hours

92. 1 pt Lesson 2.3

An applicant answers every question truthfully but volunteers nothing about the chest pains that sent him to an emergency room last month, knowing no question asked. His silence about a known material fact the insurer could not discover is:

A. Misrepresentation

B. Concealment

C. Waiver

D. A warranty breach

93. 1 pt Lesson 2.3

A life insurer wants the right to void coverage for any application misstatement, however innocent or immaterial, forever. State law defeats this through:

A. The grace period

B. The incontestability clause, which bars contests after the policy has been in force a stated period — commonly two years

C. The free look

D. The consideration clause

94. 1 pt Lesson 6.5

An overwhelmed homeowner hires a licensed professional to prepare, present and negotiate her fire claim, for a percentage of the settlement. This professional — the only adjuster who represents the policyholder — is a:

A. Staff adjuster

B. Independent adjuster

C. Public adjuster

D. Field underwriter

95. 1 pt Lesson 5.2

A disability policy pays its full benefit, often without the usual ongoing proof, when the insured suffers the total loss of sight, hearing, speech, or the use of two limbs. This provision is called:

A. Residual disability

B. Presumptive disability

C. Partial disability

D. Recurrent disability

96. 1 pt Lesson 3.2

Under annually renewable term, the death benefit and the premium behave as follows:

A. Both increase each year

B. The face amount stays level while the premium rises each year with attained age

C. The premium stays level while the face amount shrinks

D. Both stay level for life

97. 1 pt Lesson 1.4

A nervous prospect asks what happens if the insurer fails. The producer replies, “Don’t worry — the state guaranty association covers it, so there’s zero risk.” The statement is:

A. Proper, because it is technically accurate

B. Proper, if made only to existing clients

C. A prohibited sales practice — the guaranty association may not be used to induce a sale

D. Required disclosure under state law

98. 1 pt Lesson 4.3

A totally disabled insured qualifies under his waiver of premium rider after the six-month waiting period. While the waiver operates:

A. The insurer pays the premiums; cash value and dividends continue as if he were paying

B. The policy continues but cash value stops growing

C. The face amount reduces each year

D. The policy converts to term

99. 1 pt Lesson 6.3

A family in a riverside town closes on a house next week and wants flood coverage through the NFIP. Which statement is TRUE?

A. Their homeowners policy already covers rising water

B. Flood coverage takes effect the moment the application is signed

C. NFIP coverage commonly carries a 30-day waiting period — but the wait is waived for coverage purchased in connection with a loan closing

D. Only renters may buy NFIP coverage

100. 1 pt Lesson 2.3

What distinguishes fraud from an innocent misrepresentation?

A. Fraud involves larger dollar amounts

B. Fraud occurs only on claims, never on applications

C. Fraud is an intentional deception, made to be relied upon

D. There is no legal difference

101. 1 pt Lesson 1.1

Which trait belongs to the INDEPENDENT agent rather than the captive agent?

A. Represents a single insurer or insurer group

B. Receives the company's brand, training and leads in exchange for exclusivity

C. Holds appointments from several competing insurers and typically owns his book of business

D. Represents the insurance buyer in the transaction

102. 1 pt Lesson 8.5

A city requires a contractor to post a performance bond before building its new bridge. If the contractor defaults, the surety pays the city — and then:

A. Absorbs the loss as insurers do

B. Bills the city for costs

C. Recovers from the contractor, under its right of indemnity against its principal

D. Cancels all its other bonds

103. (1 pt) **Lesson 7.2**

Under Part A of the personal auto policy, the insurer's supplementary payments — up to $250 for a bail bond, premiums on appeal bonds, loss of earnings for attending trial — are paid:

A. Out of the liability limit

B. In addition to the limit of liability

C. Only if the insured is found not at fault

D. By the state

104. (1 pt) **Lesson 8.5**

A surgeon's slip injures a patient; an accountant's error costs a client a tax refund; a corporate board's decision is challenged by shareholders. The three claims belong, respectively, to:

A. Malpractice, errors and omissions, and directors and officers liability

B. CGL, BOP and umbrella

C. E&O, D&O and malpractice

D. Workers' compensation, crime and surety

105. (1 pt) **Lesson 3.1**

A needs analysis totals $800,000 of survivor needs. The family already has $150,000 of group life through work and $50,000 of earmarked savings. The amount of new coverage to recommend is:

A. $800,000

B. $1,000,000

C. $600,000

D. $650,000

106. (1 pt) **Lesson 3.4**

In variable life insurance, the policy values are invested in subaccounts of the insurer's separate account. The investment risk is borne by:

A. The policyowner

B. The insurer's general account

C. The state guaranty association

D. FINRA

107. 1 pt Lesson 6.5

A $60,000 covered loss is insured under two overlapping policies: $100,000 with Insurer A and $300,000 with Insurer B. Under pro-rata other-insurance clauses, Insurer A pays:

A. $30,000

B. $15,000

C. $45,000

D. $60,000

108. 1 pt Lesson 1.1

Under modern state licensing codes, the umbrella term for any person licensed to sell, solicit or negotiate insurance is:

A. Actuary

B. Underwriter

C. Adjuster

D. Producer

109. 1 pt Lesson 6.4

A condominium association's master policy is written "bare walls." A unit owner choosing her HO-6 Coverage A limit should size it to cover:

A. Nothing — the master policy handles all real property

B. The full rebuilding cost of the entire building

C. Everything from the bare walls in — her cabinets, fixtures, flooring and interior finishes

D. Only her furniture

110. 1 pt Lesson 2.2

A healthy woman applies for a $750,000 policy on her own life and names her favorite charity as beneficiary. The application should be:

A. Declined — charities lack insurable interest

B. Approved only if the charity proves financial dependence

C. Approved only for a smaller amount

D. Processed normally — a person has unlimited insurable interest in her own life and may name anyone

111. 1 pt **Lesson 6.2**

The HO-3 special form homeowners policy covers:

A. The dwelling and personal property both on an open-peril basis

B. The dwelling and personal property both on a named-peril basis

C. The dwelling on named perils and contents on open perils

D. The dwelling and other structures on an open-peril basis, and personal property on named (broad-form) perils

112. 1 pt **Lesson 1.3**

The law of large numbers benefits an insurer because, as the number of similar, independent exposure units grows:

A. Each insured becomes less likely to suffer a loss

B. Premiums can be eliminated for good risks

C. The group's actual total losses become ever more predictable

D. Adverse selection disappears

113. 1 pt **Lesson 4.4**

An annuitant chooses a life income with 10-year period certain. He dies in year 4. The insurer:

A. Stops all payments at his death

B. Pays his estate a lump-sum refund of the full premium

C. Recalculates payments for his spouse's life

D. Continues payments to his designated beneficiary for the remaining 6 years of the certain period

114. 1 pt **Lesson 9.3**

Hoping to win a client away from a competitor, a producer falsely tells her that the rival insurer is "about to go under." This false statement about an insurer's financial condition is:

A. Permissible sales talk

B. Defamation under the unfair trade practices act — even in a private conversation

C. Lawful if the client never relies on it

D. Coercion

115. 1 pt Lesson 9.2

A licensed producer dies suddenly, leaving an agency full of clients. So that the business can continue while a successor qualifies, the state may issue his widow a:

A. Temporary license, commonly for up to 180 days, without examination

B. Permanent license by inheritance

C. Non-resident license

D. Certificate of authority

116. 1 pt Lesson 7.5

A covered worker earning an average weekly wage of $900 is temporarily and totally disabled. In a state paying two-thirds of AWW, within its minimum and maximum, her weekly benefit in this example is:

A. $300

B. $450

C. $900

D. $600

117. 1 pt Lesson 5.5

A laid-off employee elects COBRA. Her share of the group premium had been $150 a month while her employer paid the remaining $550. Her maximum COBRA premium, in this example, is:

A. $150

B. $550

C. $153

D. $714

118. 1 pt Lesson 9.4

One insurer fights a single disputed claim hard, in good faith. Another routinely denies claims without any investigation, across hundreds of files. Under the unfair claims settlement practices act:

A. Both insurers are equally liable

B. Neither can be sanctioned

C. The first must pay its claim at once

D. The second violates the act — most listed practices require knowing conduct or a general business practice, which routine denial shows

119. 1 pt **Lesson 2.5**

A property owner needs coverage in force today, before the policy can be issued. Her P&C agent provides temporary evidence of coverage, effective immediately, which may even be oral. This is a:

A. Conditional receipt

B. Warranty

C. Certificate of authority

D. Binder

120. 1 pt **Lesson 5.4**

Under the legal actions provision, an insured who disputes a claim denial may sue the insurer:

A. No sooner than 60 days after filing proof of loss, and no later than a stated period — commonly 3 years

B. Immediately upon denial, with no outer limit

C. Only with the commissioner's permission

D. Within 20 days of the loss

121. 1 pt **Lesson 3.5**

Business partners want a policy that pays at the FIRST death between them, funding the survivor's buyout of the deceased partner's share. The fitting design is:

A. Survivorship (second-to-die) life

B. An annuity

C. Joint (first-to-die) life

D. Credit life

122. 1 pt **Lesson 5.5**

An insured with a $100,000 AD&D policy dies of pneumonia. The policy pays:

A. $100,000

B. Nothing — AD&D responds only to accidents

C. $50,000

D. The capital sum

123. 1 pt **Lesson 10.4**

A life policy carries a $2,000 annual premium with a 55% first-year commission and 4% renewals, in this example. The agent earns, in the first year and in each renewal year respectively:

A. $1,100 and $80

B. $800 and $110

C. $1,100 and $8

D. $2,000 and $80

124. 1 pt **Lesson 4.1**

Three days after her new policy is delivered, a buyer has second thoughts and returns it under the 10-day free look provision. She is entitled to:

A. A refund minus the agent's commission

B. A full refund of the premium paid

C. The policy's cash value

D. Nothing — delivery completes the sale

125. 1 pt **Lesson 3.5**

In an employer group life plan, the employer holds the master policy. Each covered employee receives:

A. A certificate of insurance as evidence of coverage

B. A copy of the master policy with full contract rights

C. An individual whole life policy

D. Nothing in writing

126. 1 pt **Lesson 6.1**

Fire sweeps a home's kitchen. Smoke blackens rooms the flames never touched, and the fire department's water soaks the floors. Under the policy, the smoke and water damage are:

A. Indirect losses, covered only under loss of use

B. Excluded as secondary damage

C. Direct losses — part of the covered peril's unbroken chain

D. Covered only by endorsement

127. 1 pt **Lesson 2.2**

Investors approach a healthy 72-year-old stranger, pay him to apply for a large life policy, cover the premiums, and arrange to receive the death benefit. This arrangement is:

A. A lawful viatical settlement

B. A valued contract

C. Stranger-originated life insurance (STOLI), prohibited for lack of insurable interest at inception

D. Permissible if disclosed to the insurer

128. 1 pt **Lesson 3.1**

A grandmother buys a life policy on her adult son's life and names her granddaughter to receive the proceeds. In this arrangement the grandmother, the son and the granddaughter are, respectively:

A. Insurer, insured and annuitant

B. Insured, policyowner and beneficiary

C. Beneficiary, insured and policyowner

D. Policyowner, insured and beneficiary

129. 1 pt **Lesson 3.2**

The conversion privilege in a term policy allows its owner to exchange the coverage:

A. For permanent insurance, without evidence of insurability

B. For a larger term policy at select rates

C. For permanent insurance, after passing a new exam

D. For an annuity, tax-free

130. 1 pt **Lesson 3.3**

A whole life policy issued under the 2001 CSO mortality table reaches maturity when the insured turns:

A. 100

B. 85

C. 121

D. 65

131. 1 pt **Lesson 2.5**

Which statement about the Medical Information Bureau is TRUE?

A. It is a government agency that approves applications

B. Insurers may decline an applicant on an MIB code alone

C. It is a member-owned bureau through which insurers exchange coded underwriting information, with the applicant's authorization and rights of notice and correction

D. It collects credit scores

132. 1 pt **Lesson 5.1**

A major medical policy carries a $500 deductible and 80/20 coinsurance. The insured, having met nothing this year, incurs $10,500 of covered charges, well under the out-of-pocket maximum. The INSURER pays:

A. $2,500

B. $10,000

C. $8,400

D. $8,000

133. 1 pt **Lesson 1.5**

Under 18 U.S.C. §1033, a person convicted of a felony involving dishonesty or breach of trust may work in the business of insurance only:

A. After ten years have passed

B. In a clerical position

C. In a state without fingerprinting

D. With the written consent of the insurance regulator

134. 1 pt **Lesson 8.1**

A tenant bakery installs $40,000 of ovens, counters and finishes in its rented storefront. Under the building and personal property coverage form, these improvements and betterments are insured as:

A. Part of the landlord's building

B. The tenant's business personal property

C. Personal property of others

D. Uninsurable fixtures

135. (1 pt) **Lesson 4.1**

A policyowner transfers ALL rights in her policy — permanently — to her adult son, who becomes the new owner. This is:

A. A collateral assignment

B. A beneficiary change

C. An absolute assignment

D. A 1035 exchange

136. (1 pt) **Lesson 5.1**

A high-deductible health plan (HDHP) is designed by federal law to work together with:

A. Medicare Part D

B. A flexible spending account

C. COBRA continuation

D. A health savings account

137. (1 pt) **Lesson 7.5**

An employee is injured in a car accident during his ordinary morning drive from home to the workplace. His workers' compensation claim will commonly be:

A. Paid in full

B. Denied — under the going-and-coming rule, the ordinary commute does not arise out of and in the course of employment

C. Paid at half benefits

D. Denied, unless he was speeding

138. (1 pt) **Lesson 2.2**

The principle of indemnity exists so that property insurance will:

A. Restore the insured to approximately his pre-loss financial condition, never better

B. Pay a profit sufficient to reward careful insureds

C. Pay the policy limit on every claim

D. Replace used property with better property

139. (1 pt) **Lesson 4.3**

A terminally ill insured with a $200,000 policy receives a $100,000 accelerated death benefit. At his death a month later, his beneficiary receives:

A. $200,000

B. $300,000

C. $100,000 — the benefit was an advance, not an addition

D. Nothing

140. (1 pt) **Lesson 7.3**

An insured is seriously injured when a driver with no insurance runs a red light and hits her. Her own uninsured motorist coverage pays:

A. What she is legally entitled to recover from the at-fault uninsured driver, up to her UM limit

B. Any amount she requests

C. Only her car repairs

D. Nothing until she sues the other driver to judgment

141. (1 pt) **Lesson 6.1**

A building worth $400,000 at the time of loss carries an 80% coinsurance clause and a $240,000 policy with a $500 deductible. A kitchen fire causes $80,000 of covered damage. The insurer pays:

A. $80,000

B. $59,500

C. $60,000

D. $64,000

142. (1 pt) **Lesson 10.1**

A candidate passes her licensing exam on Tuesday. The wise next step is to:

A. Wait until she finds an employer before applying

B. Retake the exam for a higher score

C. Wait for the state to contact her

D. Complete fingerprinting and file her license application through NIPR promptly — passing scores commonly expire, often within 90 days to a year

143. 1 pt **Lesson 9.2**

A producer moves to a new home across town. Under the common pattern, she must report the address change to the insurance department within:

A. One year

B. 30 days

C. 24 hours

D. Only at renewal

144. 1 pt **Lesson 7.5**

Under the workers' compensation "great bargain," in exchange for guaranteed no-fault statutory benefits, the covered employee gave up:

A. His wages during disability

B. His medical coverage

C. The right to sue his employer for negligence — statutory benefits are the exclusive remedy

D. His right to change jobs

145. 1 pt **Lesson 7.3**

In a no-fault state, an injured driver's own medical bills and lost wages after an accident are first paid — regardless of who caused the crash — by:

A. The at-fault driver's liability insurer

B. Her own policy's personal injury protection (PIP)

C. The state fund

D. Workers' compensation

146. 1 pt **Lesson 4.3**

An insured with a $100,000 policy and an accidental death (double indemnity) rider dies of a heart attack at his desk. The rider pays:

A. $200,000

B. Nothing — the base policy pays its $100,000, but the rider responds only to accidental death

C. $100,000 in addition to the face

D. $50,000

147. 1 pt **Lesson 9.1**

Before revoking a producer's license, the commissioner must generally provide:

A. A criminal conviction

B. Ninety days of probation

C. The NAIC's approval

D. Written notice stating the time, place and charges, followed by a hearing — with the order appealable to the courts

148. 1 pt **Lesson 10.4**

A carrier advances an agent six months of commission at $120 a month. The policy lapses after the client pays only two monthly premiums. The agent's charge-back is:

A. $720

B. $240

C. $480

D. Nothing — advances are earned when paid

149. 1 pt **Lesson 5.3**

Prescription drug coverage under Medicare is provided by:

A. Part A

B. Part B

C. Part D plans sold by private companies, with a late-enrollment penalty for those who delay without other creditable coverage

D. Medigap policies only

150. 1 pt **Lesson 7.2**

An insured carries split limits of 25/50/10. Her at-fault accident injures three people, with bodily injury claims of $30,000, $20,000 and $10,000, and causes $15,000 of damage to the other car. The policy pays, in total:

A. $65,000 — all claims in full

B. $50,000 for bodily injury and $15,000 for property damage

C. $50,000 for bodily injury and $10,000 for property damage

D. $55,000 for bodily injury and $10,000 for property damage

ANSWER KEY

1. B. Part C bundles Medicare through private plans that must cover at least everything A and B cover, often adding extras within a network. Choice C describes Medigap — and Medigap pairs only with Original Medicare, never with Advantage.
2. D. Policyholders own a mutual; stockholders own a stock company — the exam offers both reversals. Policy dividends from a mutual are a non-guaranteed return of divisible surplus, never a promise.
3. D. Part D pays the lesser of repair cost or ACV, minus the deductible: $5,000 − $1,000 = $4,000. The total-loss arithmetic (ACV minus deductible) applies only when repairs would exceed the car's value.
4. B. One enforceable promise — the insurer's — makes the contract unilateral. The conditional characteristic (A) is the separate point that the promise pays only if conditions like premium payment and proof of loss are met.
5. A. With no premium at application, no coverage has begun — so at delivery the agent collects the premium and a signed statement of good health before the promise takes effect. Skipping it is a classic E&O claim in the making.
6. A. Depreciation is 6/20 × $8,000 = $2,400; ACV = replacement cost minus depreciation = $5,600. Choice C stops at the depreciation figure — the exam lists every intermediate number as a choice.
7. C. The income coverage needs a covered physical loss at the premises — and its deductible is measured in time, commonly 72 hours, not dollars. Lost sales without physical damage, from weather or competition, trigger nothing.
8. C. Hail, falling objects, fire, theft, flood, vandalism and animal contact are the named other-than-collision perils. Collision is impact with a vehicle or object, or upset — and "comprehensive" is simply this coverage's older name.
9. B. An irrevocable designation vests an interest in the beneficiary, so loans, surrenders, assignments and beneficiary changes all need that beneficiary's written consent. Ownership rights survive (C overstates), but they no longer operate unilaterally.
10. D. Property insurance covers a person's interest in property, not the property itself, so the policy does not follow the house to a stranger the underwriter never evaluated. Assignment of a property policy requires the insurer's consent.
11. A. The FSA is the employer's annual, forfeitable arrangement; the HSA is the worker's own portable property, HDHP-gated and rolling over indefinitely.

Choices B and C each swap the two — the exam's standard move on account questions.

12. D. Medical payments to OTHERS is the operative word: it pays small no-fault bills for guests, never for insureds or residents of the household. The family's own injuries are what health insurance covers.
13. D. The whole contract travels with the policy: the form, the attached application, the riders. Nothing may be incorporated by reference — which protects the owner from terms he was never handed.
14. A. The BOP packages property, business income and liability for small, predictable Main Street risks. Banks, auto businesses, bars and large manufacturers commonly fail the eligibility gate and need a commercial package policy instead.
15. A. Fixed annuities ride the general account and the insurer bears the investment risk; variable annuities ride separate-account subaccounts and the owner bears it — which is what makes the variable contract a security. The indexed annuity sits on the fixed side, with a guaranteed floor.
16. C. An employee's personal car used in the business is the classic non-owned auto (symbol 9); a hired auto (A) is one the business itself rents, leases or borrows, such as a rented box truck. The border between the two is what the exam tests.
17. C. The insurer wrote every word, so doubt is resolved against the drafter. Choice D describes the unilateral characteristic — a different word on the same list, and the exam grades the vocabulary precisely.
18. C. The ladder is 7 days for weekly-premium policies, 10 for monthly, and 31 for all other modes; 45 days belongs to automatic reinstatement, a different clock entirely. The exam rotates the modes to see who memorized the ladder.
19. D. Aleatory describes the unequal exchange hinging on chance — small premium, possibly large recovery, possibly nothing. Unilateral is about who makes an enforceable promise; conditional is about duties that must be met first.
20. C. Per-day fixed benefits are hospital indemnity — lawful and useful as a supplement, but a limited policy that must announce itself as one. Presenting it as medical expense coverage is misrepresentation.
21. D. Adverse selection is the tendency of the worst risks to seek and keep coverage most eagerly; underwriting is its named cure. It is a specific tilt in who buys — not a synonym for bad luck.

22. D. Paid-up additions convert each dividend into a miniature single-premium policy — permanent additional face amount with its own cash value. One-year term (C) also buys coverage, but only temporary coverage that vanishes annually.
23. B. The agent is the field underwriter — the first screen against adverse selection, obliged to record answers accurately and report what he observes. The home-office underwriter classifies and prices; the agent sees.
24. B. When no underlying policy covers the claim, the umbrella drops down, and the self-insured retention — not an underlying limit — is all the insured keeps. The SIR applies only to these drop-down claims, never on top of an underlying insurer's payment.
25. B. The fire mark announced which company insured the house, and in the early days which brigade would fight the blaze. It is the course's standing picture of insurance made visible — the promise nailed to the wall.
26. C. The senior-designation model (2008) bars certifications and titles that falsely imply expertise in advising older clients — invented credentials aimed at the retirement market are its exact target. Claiming an unearned designation is misrepresentation besides.
27. D. Fixed period: $90,000 ÷ 60 months = $1,500, plus whatever interest the insurer credits. If she dies mid-period, the remaining payments continue to her own beneficiary — the period, not a life, is the measure.
28. A. With no primary alive at the insured's death, the contingent class takes. Proceeds fall to the estate — with probate and creditors waiting — only when every named class has failed; the contingent designation exists to prevent exactly that.
29. A. The probationary period runs once, right after issue, and screens out sickness already brewing at purchase. The elimination period (B) is different: it runs at every claim, for all causes — a deductible measured in time.
30. D. Replacing every dollar would make disability pay as well as work — a moral hazard underwriters refuse to build. The cap keeps recovery worth something; with self-paid premiums the tax-free benefit narrows the gap honestly.
31. B. Inventing or causing a loss is hard fraud; padding a real one is soft fraud — and both are crimes, with the claim form's fraud warning making the falsehood knowing. Treating soft fraud as "not really fraud" is the attitude the statute exists to correct.

32. A. Compulsory laws demand coverage up front, before registration — Massachusetts pioneered the design. Financial responsibility laws (B) act after the accident or violation, demanding proof of ability to pay; the exam tests the before/after line.
33. B. Comfortably above the passing line under honest conditions means schedule; near the line means drill the weak units and re-test; below it means reteach. The practice final's product is the decision — and the miss-map that comes with it.
34. B. Book next year = book × retention + new business: 400 × 0.85 + 90 = 430. Choice A forgets the 60 policies lost to lapses — retention, not new sales alone, is what compounds a book.
35. A. Ownership of expirations is the independent agent's hallmark — the book of business belongs to the agent, not the carrier. The commission schedule sets rates and charge-backs recover unearned advances; neither decides who keeps the clients.
36. B. Defense is paid in addition to the limits under the homeowners liability section; only damages erode Coverage E. Choice A states the trap the exam sets on every defense-cost question.
37. C. Employer-paid group term is tax-free only up to $50,000 of coverage; the IRS table cost of the excess is imputed income on her W-2. The death benefit itself, whenever paid, remains income-tax-free to the beneficiary.
38. D. Participation applies first: 4% × 0.50 = 2%, well under the cap. The index only sets the crediting formula — the cash value is never invested in the market, and charges still reduce the account in lean years.
39. A. Medicaid is the needs-based program — state-run with federal funds — and it is the nation's largest payer of long-term custodial care, reached after assets are spent down. Medicare never pays for long-term custodial care; its skilled benefit is brief and follows a qualifying hospital stay.
40. A. Misstatement of age never voids a policy and is not barred by incontestability; the benefit is simply adjusted to what the premiums would have purchased at the true age. The two extreme answers are both traps.
41. D. Anyone using the covered auto with a reasonable belief of permission is an insured for liability. Family members are insureds for any auto; strangers are insureds only while using the covered auto — the two circles the exam keeps drawing.
42. A. The employee's negligence is imputed to the employer when it occurs within the scope of the work — respondeat superior. Strict liability (B) needs no

negligence at all and belongs to abnormally dangerous activities.

43. A. Rescission unwinds the contract to day one — coverage gone, premiums back. It is the remedy for material misrepresentation, concealment and fraud, and it is only available while the contract remains contestable.

44. A. The umbrella pays as if the required underlying limits were maintained — attaching at $250,000 — so the $100,000-to-$250,000 gap belongs to the insured who created it. Maintaining underlying limits is the umbrella's standing condition.

45. A. Churning is the same-insurer, commission-harvest version, typically mining the producer's own clients; twisting (B) uses misrepresentation to move business between companies. Honest, documented replacement (C) is legal — the sin is in the deception or the motive, not the exchange itself.

46. C. Comparative negligence reduces the award by the claimant's share: $100,000 × 0.75 = $75,000. Recovering nothing (D) is the old contributory rule — or a modified-comparative result once fault crosses the state's 50% or 51% bar.

47. B. Pool = daily benefit × benefit period in days: $150 × 1,095 = $164,250. Choice A computes a single year — read the benefit period before multiplying.

48. D. Each saved interest contributes in proportion to the value saved: the hull is $500,000 of the $800,000 total, so 5/8 × $40,000 = $25,000. General average requires a voluntary, necessary and successful sacrifice — cargo merely washed overboard is particular average, lying where it falls.

49. B. Variable products are both insurance and securities: state life license plus FINRA registration, always. This is among the most repeated facts on state exams — and in this course.

50. B. The landlord's policy insures the landlord's interest — the building — and never the tenant's property. The HO-4 exists exactly for her: contents on broad-form perils, loss of use, and personal liability, with no building coverage she does not need.

51. A. Binding authority is a property and casualty power: the P&C agent's binder, written or oral, puts coverage in force until the policy issues. Life agents cannot bind the insurer — the closest life instrument is the conditional receipt, which is not a binder.

52. D. Strict liability attaches to abnormally dangerous activities regardless of care taken; "he took every precaution" is the trap answer, because precautions are legally irrelevant here. The law lets him blast — and makes him pay for what the blasting does.

53. A. The dwelling program's two standing omissions are theft coverage and liability coverage — both must be added. Fire and windstorm are the program's core perils on every form in the ladder.

54. A. Deferral is the annuity's tax engine: nothing is taxed until money comes out, and the taxable slice is always ordinary income — never capital gains, the exam's recurring wrong choice.

55. D. The auto policy pays its $500,000 first; the umbrella pays the $700,000 excess, well within its $1,000,000 limit. Excess coverage attaches only after the underlying limit is exhausted.

56. A. The peril is the cause of loss — the fire itself; the wiring is a condition that makes the peril more likely, which is a physical hazard. Moral and morale hazards are about character and carelessness, not wiring.

57. B. Cost basis is premiums minus dividends: $45,000 − $5,000 = $40,000; gain is $60,000 − $40,000 = $20,000, taxed as ordinary income. Choice A forgets that dividends — an untaxed return of premium — reduce basis.

58. C. Anything of value outside the policy's own terms — commission shares, premium refunds, gifts beyond the state's small promotional cap — is rebating, however small, however kindly meant, and even if the client proposed it. Twisting (D) is a different sin: misrepresentation inducing replacement.

59. A. The HO-8 exists for homes whose replacement cost far outruns market value, paying to repair with common modern materials rather than museum-grade restoration. HO-4 is the renters form and HO-6 the condominium form.

60. D. Termination for cause is reportable to the regulator — a required report, protected from defamation claims when made in good faith. Silence between carriers is how dishonest producers once moved from company to company.

61. A. Waiver is the voluntary surrender of a known right; estoppel bars asserting it after conduct induced reliance. Together they keep an insurer from quietly tolerating a condition and springing it at claim time.

62. D. After two years in force, innocent misstatements are beyond the insurer's reach; the common exception, in individual health policies, is fraud. It is the health policy's cousin of the life incontestability clause — with the fraud carve-out the life version lacks.

63. B. Stretching premiums across the entire lifetime makes each year's payment the smallest — and the cash value grows slowest. Compressing the paying period (20-pay, single premium) raises the premium and speeds the cash value; the coverage in all three lasts for life.

64. A. Named-peril coverage pays only listed causes, so the insured proves the cause was on the list; open-peril coverage reverses the burden, making the insurer prove an exclusion. The burden of proof is the real difference between the two designs.

65. D. Term is pure protection: nothing is set aside as a living value, so the whole premium prices the current year's death risk. That is also why a term policy that expires unclaimed wasted nothing — each premium bought that year's real coverage.

66. C. Market conduct is the public-facing half of examination; financial examination watches solvency. Both are core commissioner powers, exercised on a regular cycle and for cause.

67. A. The four obligations — care, disclosure, conflict of interest, documentation — stand independently: a good recommendation with no written basis still breaches the fourth. The file is what proves, years later, that the fit was real.

68. A. Keep the layers straight: Gramm-Leach-Bliley (1999) is privacy notices and sharing opt-outs; the Fair Credit Reporting Act (1970) is consumer-report notice, consent for investigative reports, and adverse-action disclosure. Swapping them is the exam's standard play — and neither is an NAIC model.

69. C. Coverage C commonly runs 50% of Coverage A — $150,000 here — with B at 10% and D at 30%, all as additional amounts of insurance, not carve-outs. Hedge these percentages with "commonly," as the forms themselves vary.

70. B. Payments beginning within one payment interval make it immediate — and an immediate annuity is always single premium, since there is no time to pay any other way. Deferred annuities grow first and pay later.

71. C. Reentry rewards demonstrated health with select pricing at renewal; those who cannot requalify still renew at the guaranteed (higher) attained-age rate. Choice B promises the one thing renewal never guarantees — the old price.

72. D. Subrogation moves the claim against the wrongdoer to the insurer that paid — which is why an insured who signs a private release with the at-fault party can forfeit coverage. Salvage is the insurer's right to the damaged property itself.

73. A. McCarran-Ferguson left the states in charge on condition they regulate, but boycott, coercion and intimidation remain federally punishable no matter how thorough the state's code. Forms, rates and licensing are the states' daily work.

74. B. The provision adjusts, never voids: a riskier trade brings a benefit scaled to what the old premium buys at the new rates — and a safer trade earns a

premium refund going the other way. It is the occupational cousin of the misstatement-of-age formula.

75. B. The insurer pays the commission as a percentage of premium — commonly front-loaded on life products. The client pays no separate fee to an agent; charging one, or sharing the commission with the client, raises the rebating problems of Unit 9.

76. B. Coverage C is worldwide — belongings in a dorm, hotel or rental car are still the family's personal property. Coverage B (C) is for detached structures at the residence, a different letter entirely.

77. D. Libel, slander, false arrest and misappropriated advertising ideas are Coverage B offenses, requiring no bodily injury or property damage at all. Filing them under Coverage A is the classic CGL sorting error.

78. D. Express authority is what the agency contract spells out in writing. Implied authority fills in the customary, necessary powers the writing omits; apparent authority is what the principal's conduct leads the public to believe.

79. B. Credit life tracks the shrinking loan and makes the lender whole — never more than the balance, never payable to the family. It insures the debt, not the household.

80. A. Partial disability is the flat-percentage design; residual (B) is the proportional one, measuring the share of income actually lost. The pair is this lesson's most reliable exam question.

81. A. The level premium front-loads the cost: early overpayments build the reserve and cash value that carry the promise through the expensive later years. Choice D describes annually renewable term — the opposite design.

82. B. Human life value multiplies earnings kept for the family by working years remaining: $45,000 × 20 = $900,000. Choice A uses gross salary — forgetting the breadwinner's own maintenance is the standard slip.

83. D. The commissioner fines, orders, examines, suspends and revokes — and refers crimes for prosecution — but courts alone imprison and award damages. Administrative power ends where criminal punishment begins.

84. B. UL unbundles the contract: premiums feed a cash value account, and the account pays the monthly charges — flexible premiums are the design's signature. But flexibility cuts both ways: an underfunded UL quietly spends itself toward lapse.

85. C. The law presumes the insured outlived the primary beneficiary, so the proceeds skip the dead beneficiary's estate and pass to the contingent class —

avoiding a pointless probate detour. Many policies add a short survivorship period to the same effect.

86. B. A copayment is a fixed dollar amount per service; coinsurance is a percentage share, and the deductible is the annual amount paid before the plan begins. Each is cost sharing — but the exam grades the vocabulary separately.

87. B. A creditor's insurable interest is capped at roughly the outstanding balance; consent is necessary but cannot enlarge an interest the law limits. A creditor insuring a debtor for multiples of the debt would be betting on his death, which is what insurable interest exists to prevent.

88. B. The CPP is modular: shared declarations and conditions up front, with property, general liability, crime, inland marine and other coverage parts snapped on as the risk requires. It is the custom-built alternative for risks outside the BOP's fence.

89. C. Proximate cause is the unbroken causal chain linking breach to harm. All four elements — duty, breach, proximate cause, actual damages — must be present, or there is no negligence claim at all.

90. C. The PPO's bargain is freedom with a price signal: no gatekeeper, no referrals, any provider — but out-of-network care costs the member more. Paying nothing out-of-network is the EPO's rule, not the PPO's.

91. A. The claims-made trigger asks when the claim was made, gated by the retroactive date; the occurrence trigger asks when the injury happened — even if the claim arrives years later. The extended reporting period (tail) exists to catch late claims when a claims-made policy ends.

92. B. Concealment is the failure to disclose a known material fact; misrepresentation is an affirmative false statement. Utmost good faith obliges the applicant to speak about what only he can know.

93. B. The incontestability clause gives the insurer a window — commonly two years — to investigate, after which the promise becomes secure against application misstatements. It repairs the imbalance between a family at claim time and a company with a file.

94. C. The public adjuster works for the insured. The independent adjuster, despite the name, is a contractor hired by insurers — the exam counts on that name misleading you.

95. B. Certain catastrophic losses are presumed totally disabling — the insured qualifies even if he manages to work. Residual and partial pay reduced benefits for reduced capacity; presumptive pays in full.

96. B. ART renews every year without evidence of insurability, repriced at attained-age mortality — rising price, level protection. Choice C describes decreasing term; the exam tests which element moves in each design.

97. C. Nearly every state forbids advertising or invoking the guaranty association in selling, even truthfully, because it erases the buyer's reason to weigh insurer strength. The honest answer points to the insurer's financial ratings, not the safety net.

98. A. Waiver of premium keeps the whole contract whole: the insurer pays, and values grow exactly as if the owner were paying — premiums paid during the waiting period are commonly refunded. Nothing shrinks; that is the rider's promise.

99. C. The NFIP's 30-day wait blocks buying coverage as the river rises, and the loan-closing exception exists precisely for situations like this family's. Homeowners forms exclude flood — that gap is the program's whole reason for being.

100. C. Intent is the hinge: fraud is deliberate deception intended to induce reliance, while an innocent misrepresentation is a false statement honestly believed. The difference matters at claim time — fraud commonly remains a defense even after the contestable period closes.

101. C. Independence means multiple appointments and ownership of the expirations. Choice D is the broker's trait — shopping several companies does not make an independent agent the buyer's representative; he still represents the insurers that appointed him.

102. C. Suretyship is lent credit, not pooled risk: the surety underwrites to zero expected loss and holds indemnity rights against the principal whose performance it guaranteed. The obligee — the city — is the protected party; answers that protect the principal are traps.

103. B. Supplementary payments, like defense costs, ride on top of the stated limits. Deducting them from the limit is the recurring wrong answer on every PAP liability question.

104. A. Sort professional claims by the harm: bodily injury goes to malpractice, financial loss to E&O, management decisions to D&O. All three are excluded from the CGL — professional liability is always a separate purchase.

105. C. The last step of the needs approach subtracts resources in place: $800,000 − $150,000 − $50,000 = $600,000. Recommending the gross figure (A) ignores what the family already owns — and overselling is a suitability problem, not a rounding error.

106. A. The separate account's performance — up or down — belongs to the policyowner, which is precisely why variable products are securities requiring a prospectus and FINRA registration to sell. The general account backs fixed products, where the insurer bears the investment risk.

107. B. Shares follow limits over total limits: A carries $100,000 of the $400,000 total, so A pays 25% of $60,000 — $15,000 — and B pays $45,000. Computing shares from premiums or from who was first is the standing error.

108. D. "Producer" covers agents and brokers alike in the model licensing law. The underwriter selects and prices risk at the carrier, the adjuster settles claims, and the actuary computes the rates — four different chairs at the same table.

109. C. Bare-walls master coverage stops at the structural shell, leaving the interior build-out to the unit owner's walls-in Coverage A. The condo documents — not habit — set where the master policy stops, so reading them is the first step of sizing an HO-6.

110. D. When a person insures her own life, her unlimited interest in herself satisfies the requirement; the beneficiary needs no insurable interest at all. Testing the beneficiary is the exam's standard misdirection on owner-applicant questions.

111. D. The HO-3's signature split: open peril on the buildings, named peril on the belongings. All-open-peril is the HO-5 (A), and all-named-peril is the HO-2 (B) — the forms ladder in exactly those steps.

112. C. Large numbers make the pool's results predictable; they change no individual's odds (A) and do nothing by themselves against adverse selection (D) — underwriting exists for that. Predictability is what lets a premium be calculated at all.

113. D. The period certain guarantees a floor: payments run at least 10 years, to the annuitant if living, to the beneficiary if not. Choice A describes pure life — the option with no floor and the biggest check.

114. B. Maliciously false statements about an insurer's financial condition are defamation under the act, and a private conversation is enough. If the lie also induced a replacement, twisting rides along with it.

115. A. The temporary license is the succession tool — no exam, commonly 180 days, sponsored for winding up or transferring a book. It is not a career shortcut, and a certificate of authority (D) belongs to companies, not people.

116. D. Two-thirds of $900 is $600. Full replacement (C) exists in no state formula — the benefit is deliberately partial; her medical care, by contrast, is unlimited and carries no deductible.

117. D. COBRA continues the plan, not the subsidy: she pays the full $700 group premium plus up to 2% — $714. Expecting to keep paying only the old employee share is the provision's painful surprise.

118. D. The act reaches patterns: acts committed knowingly or so frequently as to show the company's way of doing business. One honestly contested claim is a contract dispute; a habit of denying without investigation is a violation.

119. D. The binder is temporary property or casualty coverage in force until the policy issues or the binder is canceled. The conditional receipt (A) is the life insurance instrument, and its coverage is conditioned on insurability — the two are a classic swap pair.

120. A. The provision imposes a cooling-off floor — 60 days after proof of loss — and an outer limit, commonly 3 years. The 20-day figure is the notice-of-claim deadline; keep the claims clock's numbers in their places.

121. C. Joint life pays at the first death — the buy-sell trigger. Survivorship life pays at the second death, fitting estate settlement costs; swapping the two is the exam's favorite play on this pair.

122. B. Accidental death and dismemberment pays the principal sum for accidental death and scheduled sums for dismemberments; death by illness, however tragic, is outside the promise entirely. AD&D is a limited policy and must be sold as one.

123. A. First year: $2,000 × 0.55 = $1,100; renewals: $2,000 × 0.04 = $80. Life compensation is big-then-small; property and casualty pays a steadier rate on new business and renewals alike.

124. B. The free look — commonly 10 days from delivery — allows return for a complete refund, no questions asked. It is the one period when walking away costs nothing.

125. A. The sponsor is the policyholder; employees are certificate holders who name their own beneficiaries but hold no contract. Calling the certificate "his policy" is the standing exam error.

126. C. Smoke and hose water flow from the fire in an unbroken chain, making them direct loss from the covered peril. The classic indirect loss is loss of use — the hotel bills while the kitchen is rebuilt.

127. C. STOLI manufactures a policy for strangers who are betting on a death — a wagering contract dressed as insurance, void for lack of insurable interest at the start. An owner's honest later sale of a policy he truly bought is a different, lawful transaction.

128. D. The policyowner holds the contract rights, the insured is the covered life, the beneficiary collects at death — three roles that one person may double up but the exam keeps distinct. The owner, not the insured or the beneficiary, names and changes beneficiaries.

129. A. Conversion runs one way — term into permanent — and its entire value is the waiver of evidence; the premium is set at attained age (or bought back by an original-age conversion). Requiring a new exam (C) would make the privilege worthless to the person who needs it most.

130. C. Policies under the 2001 table endow at 121, when cash value equals face amount and the insurer pays the living policyowner; older contracts matured at 100. Read the question's table reference — the exam uses both numbers.

131. C. The MIB is the insurers' own cooperative against fraud and omission: coded data, authorization required, correction rights honored — and never the sole basis for declining. It is not governmental, and credit reports travel under the FCRA instead.

132. D. The insured pays the $500 deductible plus 20% of the remaining $10,000 ($2,000) — $2,500 in all; the insurer pays the other $8,000. Choice C applies the percentage to the whole bill instead of to what remains after the deductible.

133. D. The federal bar turns on felonies of dishonesty or breach of trust, and its one door is the regulator's written consent — not the passage of time (A), and not a smaller job title (B); the statute reaches the whole business.

134. B. The tenant cannot insure a building he does not own, so the form folds his installed improvements into his business personal property. Classifying them as the building (A) is the exam's standing trap on BPP questions.

135. C. Absolute assignment transfers every ownership right, forever; collateral assignment is the lender's temporary, debt-limited claim. Neither requires the insurer's permission — only written notice.

136. D. The HDHP trades a higher deductible for a lower premium, and federal law pairs it with the HSA — the tax-favored account that helps fund that deductible. Only HDHP coverage opens HSA eligibility.

137. B. The compensability test is "arising out of and in the course of employment," and the ordinary commute fails it. Travel BETWEEN job sites during the workday, or errands run for the employer, are the classic exceptions that pass.

138. A. Indemnity restores, and only restores — profiting from a loss would turn insurance into a wager and invite arranged losses. That is why settlements measure the loss rather than paying the limit automatically.

139. C. The accelerated (living) benefit advances part of the death benefit to the dying insured; it reduces the beneficiary's payment dollar for dollar. It is mercy moved earlier, not extra money.

140. A. UM steps in as the absent insurer, paying what the insured could legally recover — fault still matters, so an uninsured driver who was NOT at fault triggers nothing. Basic UM is bodily injury coverage; the car's damage needs UMPD in some states, or her own collision coverage.

141. B. Required: 0.80 × $400,000 = $320,000; carried over required = 240/320 = 75%; 75% of $80,000 = $60,000, minus the $500 deductible = $59,500. Choice C is the undeducted figure — the deductible comes off last, after the formula.

142. D. The pass has a shelf life: fingerprints and the application should follow within days, not months. States do not call candidates, and no employer is required to apply for the license.

143. B. The 30-day family of reports covers address changes, criminal prosecutions and administrative actions taken by other states or regulators. The license is a relationship with the regulator, and the regulator must know where its licensee lives.

144. C. The bargain traded lawsuits for certainty: defined benefits without proving fault, and in return the negligence suit against the employer is barred. The old defenses — fellow servant, assumption of risk, contributory negligence — died in the same trade.

145. B. No-fault systems route each driver's medical and wage losses through his own PIP coverage, with lawsuits reserved for injuries crossing the state's threshold. The at-fault driver's liability coverage is exactly what no-fault bypasses for first-dollar losses.

146. B. Double indemnity multiplies the benefit only when death results from an accident, typically within a stated period (commonly 90 days) of the injury. Illness is not an accident; the base face amount is all that is payable.

147. D. License actions run on due process: notice (commonly 10 to 30 days ahead), hearing, order, appeal. No criminal conviction is required for administrative action — the two tracks are separate.

148. C. The advance was $720; only $240 was earned before lapse, so $480 must be repaid. An advance is a loan against persistency — and the charge-back does not ask whether the money was already spent.

149. C. Part D is the drug benefit, delivered through private plans — and delaying enrollment without creditable coverage buys a permanent late penalty. Parts A

and B are hospital and medical; Medigap fills Original Medicare's gaps but is not the drug program.

150. C. Cap each person first — $25,000, $20,000, $10,000 — totaling $55,000, then the $50,000 per-accident limit cuts it to $50,000. Property damage has its own $10,000 pool, which cannot borrow from unused bodily injury dollars.