Addendum: for use with Michigan Variable Products online ExamFX course and study guide version 25718en, per exam content outline updates effective 10/18/2021.

*The following are **content additions** to supplement your existing text unless otherwise indicated:*

General Insurance

A. Concepts

1. Risk Management Key Terms

Exposure

Exposure is a unit of measure used to determine rates charged for insurance coverage. In life insurance, all of the following factors are considered in determining rates:

- The age of the insured;
- Medical history;
- Occupation; and
- Sex.

A large number of units having the same or similar exposure to loss is known as **homogeneous**. The basis of insurance is sharing risk among the members of a large homogeneous group with similar exposure to loss.

Peril

Perils are the causes of loss insured against in an insurance policy. Life insurance insures against the financial loss caused by the premature death of the insured; health insurance insures against the medical expenses and/or loss of income caused by the insured's sickness or accidental injury.

Methods of Handling Risk:

Avoidance

One of the methods of dealing with risk is **avoidance**, which means eliminating exposure to a loss. *For example*, if a person wanted to avoid the risk of being killed in an airplane crash, he/she might choose never to fly in an airplane. Risk avoidance is effective, but seldom practical.

Retention

Risk **retention** is the planned assumption of risk by an insured through the use of deductibles, co-payments, or self-insurance. It is also known as self-insurance when the insured accepts the responsibility for the loss before the insurance company pays. The purpose of retention is

- To reduce expenses and improve cash flow;
- To increase control of claim reserving and claims settlements; and
- To fund for losses that cannot be insured.

Sharing

Sharing is a method of dealing with risk for a group of individual persons or businesses with the same or similar exposure to loss to share the losses that occur within that group. A reciprocal insurance exchange is a formal risk-sharing arrangement.

Transfer

The most effective way to handle risk is to **transfer** it so that the loss is borne by another party. Insurance is the most common method of transferring risk from an individual or group to an insurance company. Though the purchasing of insurance will not eliminate the risk of death or illness, it relieves the insured of the financial losses these risks bring.

There are several ways to transfer risk, such as hold harmless agreements and other contractual agreements, but the safest and most common method is to purchase insurance coverage.

Adverse Selection

Insurance companies strive to protect themselves from **adverse selection**, the insuring of risks that are more prone to losses than the average risk. Poorer risks tend to seek insurance or file claims to a greater extent than better risks.

To protect themselves from adverse selection, insurance companies have an option to refuse or restrict coverage for bad risks, or charge them a higher rate for insurance coverage.

Adverse Selection can be described in terms of poorer or substandard risk individuals "lining up" first to purchase insurance. These individuals want to limit their personal exposure to the financial consequences of an unexpected loss, so they transfer this potential loss to the insurance companies. This causes the increase in the Adverse Selection for the insurer. It takes the collective efforts of all participants in the underwriting process to reduce adverse selection as much as possible.

Reinsurance

Reinsurance is a contract under which one insurance company (the reinsurer) indemnifies another insurance company for part or all of its liabilities. The purpose of reinsurance is to protect insurers against catastrophic losses. The originating company that procures insurance on itself from another insurer is called the *ceding insurer* (because it cedes, or gives, the risk to the reinsurer). The other insurer is called the *assuming insurer*, or reinsurer.

When reinsurance is purchased on a specific policy, it is classified as *facultative reinsurance*. When an insurer has an automatic reinsurance agreement between itself and the reinsurer in which the reinsurer is bound to accept all risks ceded to it, it is classified as a *reinsurance treaty*. Treaties are usually negotiated for a period of a year or longer.

D. Contracts

2. Distinct Characteristics of an Insurance Contract

Conditional Receipt

As the name implies, a **conditional contract** requires that certain conditions must be met by the policyowner and the company in order for the contract to be executed, and before each party fulfills its obligations. For example, the insured must pay the premium and provide proof of loss in order for the insurer to cover a claim.

3. Legal Interpretations Affecting Contracts

Ambiguities in a Contract of Adhesion

Because only the insurance company has the right to draw up a contract, and the insured has to adhere to the contract as issued, the courts have held that any ambiguity in the contract should be interpreted **in favor of the insured**.

Reasonable Expectations

It is not always practical or necessary to state every direct and indirect provision or coverage offered by an insurance policy. If an agent implies through advertising, sales literature or statements that these provisions exist, an insured could **reasonably expect coverage**.

Warranties

A **warranty** is an absolutely true statement upon which the validity of the insurance policy depends. Breach of warranties can be considered grounds for voiding the policy or a return of premium. Because of such a strict definition, statements made by applicants for life and health insurance policies, for example, are usually not considered warranties, except in cases of fraud.

Concealment

Concealment is the legal term for the intentional withholding of information of a material fact that is crucial in making a decision. In insurance, concealment is the withholding of information by the applicant that will result in an imprecise underwriting decision. Concealment may void a policy.

Fraud

Fraud is the intentional misrepresentation or intentional concealment of a material fact used to induce another party to make or refrain from making a contract, or to deceive or cheat a party. Fraud is grounds for voiding an insurance contract.

Waiver and Estoppel

Waiver is the voluntary act of relinquishing a legal right, claim or privilege. **Estoppel** is a legal process that can be used to prevent a party to a contract from re-asserting a right or privilege after that right or privilege has been waived. Estoppel is a legal consequence of a waiver.

Annuities

F. Uses of Annuities

Tax-Deferred Growth

Both qualified and nonqualified annuities grow **tax deferred**. Values that accumulate within an annuity contract are not subject to current income taxation. However, upon annuitization or surrender, values in excess of the owner's basis (contributions) are taxable as ordinary income.

During the annuitization period, part of each benefit payment is considered a return of principal (the investment) and part is considered earnings. Income taxes are owed on the earnings part of the payment. Dividing the total investment by the total amount that is expected to be paid out over the life of the contract equals the "exclusion ratio."

Federal Tax Considerations for Life Insurance and Annuities

D. Taxation of Individual Retirement Accounts

2. Roth IRAs

Distributions

Distributions from a Roth IRA are **not included in taxable income**; however, qualified distributions cannot be made prior to the fifth year of the account's existence. Qualified distributions include those made after 59½, those made to the estate or beneficiary at the owner's death, those made to a disabled owner, those made to a first-time homebuyer, or if paying qualified higher education expenses for the owner, owner's spouse, children or grandchildren. With qualified distributions, there is no 10% penalty for early withdrawals. Nonqualified distributions are subject to the same tax consequences as traditional IRAs.

Insurance Regulation

D. Unfair Trade Practices and Other Regulations

5. Illegal Inducement – *additions to the existing text*

Any person — an insurer, agent, or other person — who violates the Insurance Code statutes on rebating and illegal inducement is guilty of a **misdemeanor**.

If an insurer or an agent has made any **misrepresentation or incomplete comparison** of policies for the purpose of inducing someone to purchase or replace an insurance policy, upon conviction, the offender will be sentenced to pay a fine of up to **$2,000** per violation, or in the discretion of the course, to imprisonment in the county jail.

If a person has violated other statutes pertaining to rebates and illegal inducement, the person will be sentenced to pay a fine of up to $100 per violation, or in the discretion of the court, to imprisonment in the county jail. In addition, the person's license or certificate of authority will be revoked and cannot be reissued for 1 year from the date of revocation.

7. Defamation – *additions to the existing text*

Civil actions may be brought for libel or slander as acts of defamation. Libel is any written or printed untrue statement that injures a person's or company's reputation. Slander is any verbal untrue statement that injures a person's or company's reputation. An action for libel or slander may not be brought based upon a communication involving public officials unless the claim is sustained by clear proof that the defamatory falsehood was published with knowledge that it was false or with reckless disregard of whether or not it was false.

11. Consumer Privacy Regulation –*additions to the existing text:*

In addition, a licensee is not required to provide the notice and opt out requirements for nonpublic personal financial information if the licensee is an employee, agent, or other representative of a principal and all of the following conditions are met:

- The principal is another licensee;
- The principal otherwise complies with and provides the required notices; and
- The licensee does not disclose any nonpublic personal information to any person other than the principal or its affiliates.

Consumer means an individual, or the individual's legal representative, who seeks to obtain, obtains, or has obtained an insurance product or service from a licensee that is to be used primarily for personal, family, or household purposes. **Customer** means a consumer who has a customer relationship with a licensee.

Nonpublic personal financial information means personally identifiable financial information and any list, description, or other grouping of consumers and publicly available information pertaining to them that is derived using any personally identifiable financial information that is not publicly available. Nonpublic personal financial information does not include any of the following:

- Health and medical information otherwise protected by state or federal law;
- Publicly available information; or
- Any list, description, or other grouping of consumers and publicly available information pertaining to them that is derived without using any personally identifiable financial information that is not publicly available.

Personally identifiable financial information means any of the following information:

- Provided by a consumer to a licensee to obtain an insurance product;
- About a consumer resulting from any transaction involving an insurance product;
- Obtained by the licensee about a consumer in connection with providing an insurance product or service to that consumer.

The Michigan Administrative Code outlines the rules that establish the **standards for safeguarding customer financial information.** Each licensee is required to implement a **comprehensive written information security program** that includes administrative, technical, and physical safeguards for protecting the security, confidentiality, and integrity of customer information. The safeguards included in the program must be appropriate to the size and complexity of the licensee and the nature and scope of its activities.

A licensee information security program must be designed to do the following:

- Ensure the security and confidentiality of customer information;
- Protect against any anticipated threats or hazards to the security or integrity of the information; and
- Protect against unauthorized access to or use of the information that could result in substantial harm or inconvenience to any customer.

Any violation of this regulation is an unfair method of competition or an unfair or deceptive act and practice in the conduct of the business of insurance in this state.