

# California Department of Insurance

## *15-Hour Life Settlement Broker Outline*

### Topics to be included in the Life Settlement Broker License Training Courses

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#### **Overview**

The following outline is a listing of the topics that must be addressed as part of a 15-hour life settlement broker course designed to meet the requirements in Section 10113.2 of the California Insurance Code (Senate Bill (SB) 98, Calderon, Chapter 343, Statutes of 2009, Life insurance: contracts and viatical settlements).

Specifically, the new law adds California Insurance Code sections 10113.2 relating to life insurance and states that individuals acting as life settlement brokers shall complete an application, pay the appropriate fees and if the applicant is a life agent for less than one year or does not hold a life agent license, the applicant must complete 15 hours of continuing education related to life settlements and life settlement transactions prior to operating as a broker. The education requirement takes effect on July 1, 2010.

#### **Curriculum Objectives**

Each topic must be developed in its entirety and should explain (not merely recite) chaptered legislation and pertinent regulations. Each topic should ***include an explanation*** of why they are significant to the broker and client. The subjects do not need to be presented in this outline order. However, they do need to be developed in a clear and meaningful manner so that the student derives a clear understanding of the pertinent issues and implications. All statistical information and points of fact must be referenced to the original source data.

Examples are encouraged to illustrate points and concepts.

For contact courses, the topics need to be articulated in writing to the extent that the student can relate the words of the instructor to the course material in a meaningful way. For correspondence courses, each topic must be developed in full so that the student can get an understanding of the material as if he or she was attending a contact course.

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Disclaimer - The California Department of Insurance is released of responsibility for approved course materials that may have a copyright infringement. In addition, no course approved for either prelicensing or continuing education hours or any designation resulting from completion of such courses should be construed to be endorsed by the Commissioner.

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Discussion of topics must be handled in a neutral manner. Instructors and these courses may **NOT**:

- Use the opportunity to persuade, indoctrinate or enlighten brokers on a particular philosophy or a political or public policy position;
- Express or contain opinions about state or federal legislation or forecasting the success or failure of legislation;
- Insert or attach copyrighted material without proper references; and
- Contain attachments to the course material with information noted in the above bulleted items.

Absolutely no marketing information may be contained in these courses or distributed to course participants as part of the training.

Course providers are required to demonstrate the following:

- Provide a detailed understanding of all the topic areas with how the issues affect the policyholder;
- Show continuity of explanations in the course textbook, examples, references, and citations;
- Provide easy to read text. Rather than seemingly unrelated pieces of data, the text should have a narrative explanation of why/how parts fit together;
- Reach or state conclusions (i.e. why is this topic important and what does it mean for the policyholder); and
- Substantiate information contained in the material presented.

Courses should be focused on needs of consumers and the problems and solutions associated with viaticals and life settlements, especially as they affect policyholders.

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<sup>1</sup> Based on a 50-minute credit hour standard.

<sup>2</sup> Based on a standard text of approximately 1-credit hour per 10 pages of text with 44 lines per page and 12 or more words per line depending on the degree of difficulty of the material.

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#### **Background**

The Senate Banking, Finance and Insurance Committee held an informational hearing in February 2008 on the topic of life settlement contracts. A life settlement is a financial transaction in which an owner of a life insurance policy sells the policy to a third party for more than the cash value offered by the life insurance company. The purchaser becomes the new beneficiary of the policy at maturity and is responsible for all subsequent premium payments. Capital from hedge funds, investment banks, pension funds, and other sources in search of higher returns are flowing into the life settlement market.

Life settlements are a new market that is growing rapidly. These settlements have grown from a few billion dollars less than a decade ago to an estimated \$13 billion in 2006, and are expected to grow to an estimated \$150 billion in the next decade. However, life settlements are largely unregulated in California. There are no licensing requirements or standards for individuals acting as brokers or advising people in these complex transactions.

Senior citizens are the primary market for life settlements. This can include instances when seniors are planning to surrender their life insurance or let it lapse. According to marketing from the life settlement industry, other reasons for seniors to sell their policies include the use of the proceeds to purchase a new life insurance policy or a long-term care contract, collect immediate cash, make a gift to a family member, pay divorce costs, and obtain funds for other investments.

#### **Life Settlements**

The life settlement market has grown out of the viaticals market that developed in the 1980s in response to the crisis. Viatical settlements involved the sale of life insurance policies by persons facing a life expectancy of 24 months or less, for an amount less than the death benefit but more than the cash surrender value, to pay for end-of-life care. The desperate circumstances of the sellers raised the potential for abuse, and the Legislature in 1990 enacted legislation to regulate viatical sales. Anyone selling viatical settlements must be licensed and must provide disclosures to the seller, including possible alternatives to settlement, possible tax consequences, and issues relating to the confidentiality of medical information. The viatical market largely evaporated after medical advances dramatically altered the life expectancy of an AIDS diagnosis.

In 2001, a significant number of life settlement providers started purchasing policies for their investment portfolios using institutional capital. The arrival of well-funded corporate entities transformed the settlement concept into a wealth management tool, and began driving a rapid market expansion. Both the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators (NCOIL) have produced model acts to regulate life settlements. A primary difference between the two model acts is that in the NAIC act, an owner would wait for five years after purchasing a policy (with financed funds) before being able to enter into a life settlement, while under the NCOIL act, the policy owner may settle after two years. [*Reference: Senate Floor Bill Analysis, September 4, 2009*].

California has adopted comprehensive life settlement legislation based upon the NCOIL version. The law, SB 98, will regulate life settlement transactions effective July 1, 2010.

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#### **I. Introduction to Life Settlements**

- A. Basic overview of life insurance & purpose
  - 1. Reasons for buying life insurance
  - 2. Types of life insurance
    - a. Term
    - b. Permanent
  - 3. Insurable interest
- B. History and evolution of the life settlement industry
  - 1. Industry language v. statutory language
  - 2. Describe participants' roles to the settlement transaction
  - 3. Viatical settlements, life settlements, and stranger originated life insurance (STOLI) defined
  - 4. Size of industry marketplace/outlook/trends
- C. The impact of life settlements on the life insurance companies
  - 1. Profitability
    - a. Life settlements have a detrimental (negative) impact on product pricing. Life Insurance companies have designed products with a certain percentage lapsing (terminating without value) or being surrendered prior to payment of a death benefit. When a policy is sold to a third party, it is kept in force until a death benefit is paid out.
  - 2. Pricing
- D. California SB 98 (statutes and regulations pertaining to life settlements in California)
  - 1. Those brokering life settlements will need to be licensed
  - 2. Providers who contract directly with the policy owner for the purchase of a life insurance policy are required to be licensed, but not the financing entity supplying the capital
  - 3. There are required consumer disclosures at the time of application and at the time of execution of contract
  - 4. The life settlement broker outline is not an exhaustive review and familiarity with SB 98 and amended California Insurance Code Sections 10110.1(d) and (e), 10113.1, 10113.2, 10113.3, and 10113.25 is mandatory for all participants in the transaction.
- E. 15-Hour Life Settlement Broker Outline Definition of Terms
  - Attachment I

#### **II. Legal Considerations**

- A. Insurable interest
- B. Legal risk - Can a broker or agent (or anyone else) be sued by beneficiaries?
- C. Regulatory risk - Will further regulations impact a transaction?
- D. Other litigation risk - (from Issuing Life Insurance Company) - claim denial impact

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#### **III. Life Settlement Brokers**

- A. Who can broker life settlements in California?
  - 1. Life agents who have been licensed at least one year and who have complied with the California Department of Insurance's fee and notification requirements
  - 2. Licensed life settlement brokers
  - 3. Attorneys, CPAs and financial planners
- B. Responsibilities of life settlement broker
  - 1. Disclosures to policy owner
    - a. Disclosures at the time of application for a life settlement
    - b. Disclosures to be provided before a life settlement contract is executed
    - c. Special rules about commission disclosure (technically the provider's responsibility under SB 98)
    - d. Compensation disclosure by life settlement provider
    - e. Multiple life expectancy reports
  - 2. Brochure(s)
  - 3. Special duties to policy owner
    - a. Fiduciary
    - b. Principal/agent
    - c. Contract
  - 4. Disclosure of providers' offers
  - 5. Potential liabilities for the licensed life settlement broker agent
- C. Enforcement and Consequences
  - 1. Violations of the California Insurance Code
  - 2. Penalties

#### **IV. Suitability Considerations**

- A. Insurable interest
- B. Impact on future insurability
- C. Price/value risk
  - 1. Is this the best deal for the client? Would they do better to surrender the policy? This will require a full financial analysis (e.g. using present value and possible tax events (it is strongly recommended that all parties should seek professional tax advice)
  - 2. Were all alternatives explored?
- D. Discuss tax consequences of life settlements (Internal Revenue Service has issued Revenue Rulings for Income Tax only not changes to Tax Code) - Gift Tax & Estate Tax consequences
- E. Best practices
  - 1. Evaluation of personal needs and financial goals
  - 2. Advantages and disadvantages of life settlements

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3. Alternatives to life settlements
4. Cross selling
  - a. New sales
  - b. Replacement
- F. Personal considerations for the life settlor (periodic health status contacts of the named insured)

#### **V. Life Settlement for Transaction Process**

- A. Describing the typical process
  1. Application: An application must be submitted along with appropriate documentation such as policy information, medical records, etc.
  2. Review: The settlement broker and/or provider/funder review the information and request a life expectancy report by an independent life expectancy firm
  3. Analysis: After the life expectancy report is completed, and the other information reviewed, the provider/funder will determine a fair market value for the policy. Sometimes, there is no value, resulting in no offer
  4. Offer: The offer is presented to the policy owner (and advisor[s]). A life settlement broker has a fiduciary responsibility to obtain multiple offers, document responses and present all of them.
  5. Offer Acceptance: If an offer is accepted, a "closing package" including formal documentation is sent to the policy owner for review and signature. At this point, funds for the transaction are placed in an escrow account.
  6. Transfer of policy-ownership: Change of ownership forms are submitted to the insurance company.
  7. Funds Release: The escrow agent releases the funds to the seller (former policy owner) when the insurance company sends written confirmation of the change of ownership.
- B. Required Disclosures
  1. At time of application
  2. At time of policy execution
    - a. Provider disclosures
    - b. Life settlement broker disclosures
    - c. Life Agent Disclosure Requirements for Sales to Elders  
– Attachment II
- C. Privacy
  1. Disclosure of the insured's identity information that could be used to identify the insured or the insured's financial or medical condition is only permitted when:
    - a. Necessary to effect a life settlement contract and the owner and insured have provided prior written consent
    - b. Necessary to effectuate the sale of life settlement contracts as investments, provided such sale is conducted in compliance with the

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- applicable securities laws and that the owner and insured have provided prior written consent to disclosure
- c. Provided in response to an investigation/examination by the Commissioner
- d. A condition to the transfer of a policy by one provider to another provider, and the receiving provider agrees to comply with the Insurance Code's provisions pertaining to confidentiality (See Section 791 et seq of the California Insurance Code.), or
- e. Necessary to allow the provider or broker to make contact for purposes of determining health status of the insured

#### **VI. Fraud**

- A. Those that could be defrauded
  - 1. Company
  - 2. Owner
  - 3. Investors
    - a. Institutional
    - b. Private
- B. Defining Fraud
  - 1. Types of common law fraud
- C. Examples of life settlement industry types of fraud
  - 1. Clean sheeting
  - 2. Wet paper/Wet Ink (the sale of a newly-issued policy to a life settlement company “almost before the ink is dry”)
  - 3. Senior citizen fraud
  - 4. Churning
  - 5. Stranger Originated Life Insurance/Investor Owned Life Insurance (STOLI/IOLI)
    - a. Definition
    - b. Difference between STOLI/IOLI and other life settlements
    - c. Premium financing/free insurance schemes
    - d. Charitable institution involvement
    - e. STOLI/IOLI outlook – existing litigation and evolving regulations
    - f. Risk of not selling policy, problems with financing, etc.
    - g. Transfers to a Trust
  - 6. Bid-fixing
- D. Financial Crimes
  - 1. Financial Crimes Enforcement Network (FINCEN). Refer to the United States Department of the Treasury website for current information ([http://www.fincen.gov/financial\\_institutions/insurance/index.html](http://www.fincen.gov/financial_institutions/insurance/index.html))
  - 2. Anti-money laundering programs
  - 3. Money laundering schemes

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4. Red flags (e.g. spotting suspect investors)

#### **VII. Future Developments, the Securities and Exchange Commission (SEC), and the Financial Industry Regulatory Authority (FINRA) Impacts**

- A. Industry changes
- B. Federal role
  1. SEC
  2. FINRA
  3. Securitization

#### **VIII. Ethics**

- A. Be able to identify and apply the meaning of the following:
  1. Provide exemplary service to your clients;
  2. Use simple language; talk in layman's language when possible, avoid jargon;
  3. Ensure that the settlor understands the process and the impact to them of transacting in entering into a life settlement;
  4. Place the Life Settlor's interest first;
  5. Understand the process, stay informed and continue to educate yourself about the current industry and changes in the industry (vital due to the evolving nature of the industry);
  6. Identify the customer's needs and ensure that a life settlement is suitable and appropriate;
  7. Accurately and truthfully represent the life settlement process;
  8. Protect the privacy and confidentiality of all parties;
  9. Stay informed and obey all insurance laws and regulations;
  10. Avoid unfair or inaccurate remarks about different providers, brokers and other alternatives;
  11. Identify and avoid any conflicts of interests; and,
  12. Understand and refrain from any fraudulent, deceptive, or false marketing, advertising or promotions.

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Attachments

Attachment I	15-Hour Life Settlement Broker Outline Definition of Terms
Attachment II	Life Agent Disclosure Requirements for Sales to Elders