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Variable Life Insurance Training

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for
CALIFORNIA INSURANCE LICENSEES

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Effective January 1, 2025, California life insurance agents and brokers who sell variable life insurance must complete a special two-hour training course as part of their continuing education requirement.

I've already completed a continuing education course in order to keep selling annuities. Will that satisfy the two-hour training requirement for variable life insurance?

No. The two-hour training on variable life insurance is a separate requirement.

Does this new requirement change the amount of continuing education that must be completed for my license renewal?

No. Agents and brokers in California still generally need 24 hours of continuing education in order to renew their license. The two-hour training on variable life insurance is now part of the 24-hour requirement.

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Yes. Bookmark Education is approved by the California Department of Insurance (Provider #284588). Course approval numbers are provided on each course's copyright page.

Do I need to enroll in a course before I can take the open-book exam?

Yes. Quick and easy enrollment is available at BookmarkEducation.com. You may also call us or enroll via fax or mail by using the form in this book.

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Students are permitted six months from the date of enrollment to complete a course.

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Yes. We will report successful completions within two business days of receiving your completed exam(s). The completion date will be the date when you successfully completed your course exam. We will also provide a certificate for your records.

What is the passing score required to earn credit for each of the courses in this book?

California requires a score of at least 70% for each exam. You will have four attempts to pass the exam.

Will I need to pay any fees in addition to course tuition?

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If I've completed a course in the past, can I take it again?

If you've taken a course <u>and renewed your license since then</u>, you may retake the same course again. You cannot repeat the same course twice during the same renewal period.

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VARIABLE LIFE INSURANCE TRAINING

California Approved Course License Number 391190

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All inquiries should be addressed to:

Bookmark Education
(800) 716-4113
BookmarkEducation.com

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OVERVIEW OF INDIVIDUAL VARIABLE LIFE INSURANCE

Variable life insurance can provide benefits to survivors after a death and also be used as a tangible financial asset to the policy's owner while the insured person is still alive.

Variable Life Insurance and Death Benefits

The amount that will be given to a beneficiary after the insured person's death is the "death benefit." All forms of life insurance are designed to provide a death benefit. However, whereas most other types of coverage keep that benefit unchanged and unaffected by market conditions, variable life insurance can make the death benefit rise or fall, depending on investment choices made by the owner. Despite possible fluctuations, variable life insurance will contain a guarantee that the death benefit will never be lower than when the policy was initially purchased.

Variable Life Insurance and Cash Value

In life insurance, the amount that might be used as an asset while the insured person is still alive is known generally as "cash value." Cash value is comparable to having equity in the policy, and it's expected to grow over many years. At the owner's option, the cash value might eventually be accessed in any of the following ways:

- Received as either cash or part of a loan to fund other expenses.
- Used to offset the cost of future premiums.
- Used to purchase additional insurance that increases the policy's death benefit.

Like the death benefit, the cash value of a variable life insurance policy is exposed to volatility in the financial markets. Unlike the death benefit, the cash value of a variable life insurance policy generally doesn't include a minimum guarantee.

Although many other types of life insurance have cash value, variable life insurance is the only major type that doesn't promise stability or growth of that amount. Instead of guaranteeing cash value and requiring that insurers invest all of the consumer's premiums in dependable ways, variable life insurance takes the amounts intended for the cash value and lets the consumer choose how to invest those funds As a result, a strong economy and smart investment choices by the consumer can help the cash value grow more quickly than in other insurance products, but a weak economy and bad investment choices can also make the cash value decline. Although somewhat uncommon, it's even possible for the cash value in variable life insurance to drop to zero.

Although the lack of guarantees of cash value can seem scary to some prospects, it's important to note that variable life insurance can help buyers achieve financial goals quicker than other types of coverage. If someone wants to grow cash value swiftly, variable life insurance at least makes that a possibility. If someone is generally concerned about cash value keeping up with inflation, variable life insurance is often a suitable option.

Variable Whole Life Insurance vs. Variable Universal Life Insurance

There are generally two types of variable life insurance:

- Variable whole life insurance.
- Variable universal life insurance.

This course will focus on those two types within the context of insurance that is bought by an individual person. Insurance intended for members of a group (such as insurance offered to employees through an employer) are beyond the scope of this training and might have different features/requirements.

Key Characteristics of Variable Whole Life Insurance

Compared to variable universal life insurance, variable whole life insurance is the more basic option. It’s intended to insure someone for the rest of a lifetime and will have a fixed premium that must be paid on a set schedule for the duration of the contract. The owner generally won’t be allowed to skip any premium payments but also won’t be charged a new and higher amount as the insured person ages.

Variable whole life insurance must have a death benefit with a minimum guarantee. Although the value of the eventual death benefit can increase or decrease at various points based on market conditions, it can never be lower than the amount that was originally purchased.

Unlike the death benefit, the cash value in variable whole life insurance might not have any guarantees attached to it. However, some insurers offer minimum guarantees in exchange for an additional cost and an agreement by the owner to invest part of the premium in a specific, low-risk fashion.

Product Design

Given that variable life insurance contains a combination of guarantees and non-guarantees, let’s identify how that mix is possible.

General vs. Separate Accounts

When consumers buy variable life insurance, the money needed to fund the guaranteed death benefit (plus insurer expenses) will go into the insurer’s “general account.” Money in the insurer’s general account is considered relatively safe because, by law, it can only be invested in low-risk parts of the economy and will be subjected to periodic audits by regulators.

Money intended for any of the policy’s non-guaranteed components (such as the cash value or the non-guaranteed portion of a death benefit) will go into a “separate account” with significantly fewer restrictions. Each separate account is similar to a mutual fund, and the value of the separate account will fluctuate based on the stock market, the bond market and other economic influences.

The insurer will likely offer several different types of separate accounts, and policyholders will need to choose the option that best suits their objectives and risk tolerances. Smart choices and/or good luck can result in high returns for what's invested in a separate account, whereas uninformed choices and/or bad luck and result in losses.

Changes in Investment Objectives

Each separate account will have rules and objectives that must be disclosed to the policyholder in advance. Those rules and objectives will specify any applicable fees and the types of investments that will be made on behalf of policyholders.

Before the insurer can change its policy regarding how to invest or operate its separate accounts, the change must be approved by the insurer's home state. If the insurer is domiciled outside of California, the California Department of Insurance will at least need to receive a copy of the home state's approval of the change.

Impact of Assumed Interest Rates and Actual Net Investment Rates

For a variable life insurance policy to remain stable, the cash value must earn at least an amount set by the insurance company. This amount is known as the "assumed interest rate" (AIR) or "target rate."

Regardless of the assumed interest rate, the amount that is actually earned is the "actual net investment rate" (ANIR).

When the ANIR is greater than the AIR, the cash value will grow. If the cash value grows beyond a certain point, some of it will be used to increase the policy's death benefit.

Although growth beyond the AIR can ultimately result in a bigger death benefit than what was originally purchased, the new, larger benefit might only be maintainable if investment returns remain strong. If returns on investment subsequently drop by too much for too long, the larger benefit can decrease or might no longer be available unless the owner increases the premium.

Even if increases in the death benefit might not be permanent, the policy's original death benefit will stay in force as a minimum guarantee.

Single-Premium and Level-Premium Additions

Increases in the policy's death benefit are possible via either a single-premium addition or level-premium addition.

A single-premium addition is usually intended to increase the amount of "paid-up" insurance and enlarge the death benefit on a permanent basis. However, although single-premium additions are meant to only require a one-time payment to the insurer, some complex policies may still rely on expected and continued growth of the contract's cash value to keep the additional insurance in force. In those cases, investment shortfalls can cause the cash value to decrease, and even an increase in cash value may not always be excessive enough to keep the additional coverage in force. In other words, it may be technically possible for the additional coverage to lapse without excess investment returns continuing at the same rate in the future.

A level-premium addition increases the policy's death benefit in exchange for an extra and unchanging amount of premium that is paid on a regular basis (rather than in a lump sum). However, in some cases, the policyholder may be relying on investment performance in order to fund this extra premium. Unless the person is willing to contribute more premium out of pocket, a drop in investment performance can cause the amount of additional death benefits to decrease rapidly.

Account Fees and Expenses

Owners can move money across an insurer's separate accounts and generally won't be taxed as long as they don't access the funds. However, the insurer can charge fees for managing the separate accounts, which might be applied as a flat dollar amount or an annual percentage of the account's value.

Insurance vs. Securities Product Regulation

Due to having no guarantee of cash value and only a limited guarantee of the death benefit, variable life insurance is BOTH an insurance product and a securities product.

In addition to being regulated by their state's insurance department, sellers of variable life insurance must comply with requirements imposed by federal law, the Securities and Exchange Commission and a national self-regulatory body called the Financial Industry Regulatory Authority (FINRA).

Based on this mix of regulation, someone who wants to sell variable life insurance in California must have ALL of the following credentials:

- A life insurance license.
- A securities license.
- A "variable contracts" license (Often added to a life insurance license after a securities license has been obtained).

Approval of Insurers

Insurance companies that want to sell variable life insurance in California must apply for and receive written qualification from the state's insurance commissioner.

In accordance with Section 10506(h) of the California Insurance Code, the state must believe that an insurer offering variable life insurance won't operate in ways that are hazardous to the public. As part of evaluating an insurer for approval, the insurance commissioner will consider the following factors (in accordance with Section 1506[h]):

- The insurer’s history.
- The insurer’s record of compliance with insurance laws, rules and requirements.
- The character, responsibility, reputation, expertise and general fitness of the insurer’s directors and officers.
- The insurer’s ability to manage investments adequately.
- The company’s arrangements for supervising its marketing of insurance contracts.

The company’s financial strength will be another major factor, and the commissioner will want to see that the insurer has adequate assets that are both liquid and quantifiable. Specifically, Section 1506(h) requires that the insurer maintain a combined capital and surplus of at least $10 million.

In general, the insurer must be capable of converting most of its assets to cash within one business day. The insurer must own enough of these assets outright and can’t be engaging in excessive borrowing.

The insurer must file several documents with the commissioner in advance of selling variable life insurance, such as:

- Annual financial statements.
- Sample copies of policies intended for sale.
- A plan for selling and distributing those policies to the public (including the names of people and/or companies—such as insurance agencies or brokerage firms—who will distribute or sell policies on the insurer’s behalf).
- An explanation of the investment objectives of any separate account that will be available to the public (for example, a prospectus that details the account’s current makeup and performance history).
- A description of any investment advisory services that might be used to manage or influence any separate account.
- Actuarial reports that depict the estimated cost of providing death benefits vs. the estimated cost of the insurer’s administrative expenses. (In general, the cost of providing the death benefit is the “morality cost” and will increase as policyholders age. By contrast, administrative expenses—such as agent commissions and health exams—are often more significant near the start of the policy.)
- For an insurer domiciled outside of California, the laws and regulations for variable life insurance in the insurer’s home state.
- Biographical information about officers, directors and anyone else who’ll be managing a separate account for the insurer.
- A five-year projection of the insurer’s expected capital and surplus.

Investigations into the insurer's finances are usually intended to confirm the company's solvency. When an insurer is "solvent," its assets exceed its liabilities, and it is able to pay all valid claims. Although rare, financial mismanagement that goes unchecked can cause insolvency and leave the public uncompensated for insured losses.

State guaranty funds exist as a safeguard against insolvency, but they typically don't compensate policyholders for any non-guaranteed portions of insurance products. For example, a guarantee fund might pay the minimum guaranteed death benefit if death occurs during an insolvency, but it might not compensate the owner for any lost cash value or anything kept in the insurer's separate account.

Free-Look Periods

A "free-look period" gives the buyer a set number of days after purchase to review the policy and return it for a refund of premium.

For policyholders under the age of 60, the free-look period for life insurance sold in California must be at least 10 days. For policyholders who are 60 or older, it must be increased to 30 days. If variable life insurance is intended to replace someone's existing coverage, the free-look period is 30 days regardless of age.

If a consumer returns a variable life insurance policy within the free-look period, the size of the refund will depend on whether the consumer had already chosen to invest any of the premium in the insurer's separate accounts. If the consumer returns the policy without already having invested the premium in the insurer's separate accounts, the insurer must return the full premium and any fees. If the consumer already invested some of the premium in a separate account, the insurer will need to return the person's current account value plus any fees. Someone who already directed assets into a separate account might receive a larger return due to market growth or a smaller return due to a market downturn.

Regardless of the amount, consumers who return a policy within the free-look period are required to receive their refund within 30 days.

Guarantees in Products

As mentioned previously, variable life insurance will at least include a guaranteed minimum death benefit. Increases in the death benefit or the cash value often aren't guaranteed by default, but they can sometimes be secured for a higher premium and/or an agreement to invest in nonvolatile "fixed" accounts according to the insurer's specifications.

Crediting Methods and Frequency

A variable life insurance policy needs to specify how the interest earned by separate accounts will be applied to the death benefit and cash value. It's common for cash values to be adjusted monthly, whereas death benefits may be adjusted annually.

Specific schedules for reconciling an insurer's separate accounts (and applying interest to relevant insurance policies) can be found in Bulletin 87-3, published by the California Department of Insurance.

Incontestability Clause

Statements made on applications for variable life insurance must become incontestable after two years. Ultimately, this gives the insurance company no more than two years from the policy's issue date to investigate possible misrepresentations on the application and take action against the owner.

While this part of the policy should serve as a warning to consumers that they can lose their insurance within the first two years by lying, it also forces the insurer to perform its due diligence regarding a suspicious statement in a timely manner. If a material fact was misrepresented on an application but isn't discovered within the policy's first two years, the insurer generally can't penalize the owner.

Note, however, that the two-year contestability period can restart if the owner requests additional insurance at a later date and is required to medically qualify for it. In this case, the policy would become incontestable two years after the requested increase goes into effect.

The two-year limit on contestability generally doesn't apply if the insurer learns that an impostor applied for the coverage. In that case, the policy will be rescinded, and all parties will be treated as if the policy had never existed.

Contestability of Age or Gender

A variable life insurance policy must explain what will happen to benefits if the insured person's age or gender, as stated on the application, is ultimately incorrect. In general, information about age or gender will be subjected to different rules than what is stated in the aforementioned incontestability clause.

Although age and gender are significant underwriting factors in life insurance, a misstatement about them typically can't result in the insurer rescinding or cancelling the insurance. Instead, benefits will be adjusted on the basis of:

- The person's true age or gender.
- How much the owner has already paid in premium.

For instance, pretend that a 40-year-old prospect claimed to be 40 years old and paid $20,000 for insurance. Now pretend the person was actually 50 and that the misstatement is ultimately caught by the insurer. In this case, the insurer would essentially determine how much insurance could've been bought by a 50-year old with $20,000 and adjust the death benefit downward.

Note that there is usually no time limit for catching and resolving a misstatement of age or gender. Errors pertaining to those issues can be identified and corrected at any point, even beyond two years after purchase.

Nonforfeiture Benefits

Nonforfeiture benefits are provided to the policyholder even if the insurance is surrendered long before a death. They essentially convert the policy's cash value into money or prepaid insurance. The size of these benefits will often be small or nonexistent if a policy is surrendered during its early years but will be larger if surrender happens much later.

Depending on the policy, nonforfeiture benefits can convert the remaining cash value into:

- Cash given to the owner.
- Temporary insurance with the same death benefit as the lapsed or surrendered policy. (This is known as "extended term insurance" and will usually only last for a few years, but it doesn't require any additional payment from the owner.)
- Permanent "paid-up" insurance with a lower death benefit than the lapsed or surrendered policy. (This insurance will last until death and doesn't require any additional payment from the owner.)

A policy with barely any cash value might not entitle the owner to any nonforfeiture benefits. Otherwise, once cash value has reached a certain point set by the insurer, nonforfeiture benefits need to equal the policy's "cash surrender value." (In general, the cash surrender value is the cash value minus any overdue premiums. It can also be reduced by the value of any outstanding loan that the owner obtained from the insurer).

Key Characteristics of Individual Variable Universal Life Insurance

By now, you should understand some major features of variable whole life insurance. A second type of variable life insurance is "variable universal life insurance."

Rather than needing to pay an agreed-upon premium for permanent coverage, someone with universal variable life insurance has some control over the size and even the frequency of premiums. Adjustments to the size and frequency of premiums can be made at the owner's option on either a short-term or long-term basis.

Premiums for variable universal life are credited to an account. From that account, the insurance company deducts an amount intended to cover the risk of the insured person dying (known as the "mortality cost"). The insurer will also deduct various expenses for maintaining the account. Meanwhile, the outcome of the policyholder's investment decisions (such as a positive return) will be credited to the account as well.

The premiums for variable universal life are flexible but are subject to maximum limits and minimum limits. Paying less than the minimum can cause the coverage to lapse. Conversely, paying more than the maximum can result in tax consequences unless enough of the premium is used to increase the death benefit.

Here are some scenarios in which the owner might decide to adjust the premium temporarily after the policy has been issued:

- The owner may decide to pay a higher premium than usual in an effort to grow the cash value
- The owner may decide to pay a lower premium than usual if the cash value is less of a concern.
- The owner may decide to skip premium payments during financial emergencies.

Again, these options can have consequences if they're exercised for too long. If a buyer overpays in order to increase the cash value, it's possible for the value to grow too quickly and for the policy to lose its positive tax status. (This concern can usually be addressed by using some of the cash value to increase the death benefit.) Conversely, if premiums are skipped too frequently, the coverage can lapse.

Since premiums don't need to be paid in a consistent amount on a firmly set schedule, universal variable life insurance is sometimes called "flexible premium variable life insurance."

Mortality Costs in Universal Variable Life Insurance

Universal variable life insurance premiums are often disclosed in a divided manner, showing how much of each payment ultimately goes toward the death benefit and how much goes toward the cash value. The portion that goes toward the death benefit is known as the "mortality cost." For the policy's death benefit to remain guaranteed, premiums paid by the policyholder must be at least as much as the mortality cost.

If a policyholder wants to skip a premium payment, the amount that should have been paid might be taken out of the cash value. However, if the cash value is insufficient to cover the mortality cost, the policy can lapse.

Upon realizing that cash value will be inadequate to cover the mortality cost, an insurer must send various notices to California policyholders.

Variable and Adjustable Death Benefits in Variable Universal Life Insurance

Depending on how the owner opts to structure the policy, variable universal life insurance can have a death benefit that is even more unpredictable than variable whole life insurance. The death benefit in variable universal life insurance can be variable (fluctuating on the basis of market performance) and/or adjustable (increasing or decreasing based on the owner's changing needs and preferences).

Level Death Benefit Option vs. Increasing Death Benefit Option

Regarding the death benefit, the owner can choose between a level death benefit option (called "Option A" or "Option 1") or an increasing death benefit option (called "Option B" or "Option 2"):

- The level death benefit option (Option A or Option 1) has a death benefit that will usually remain unchanged regardless of positive investment performance. However, even as the death benefit remains the same, positive investment performance will still be credited to the cash value. (Note that tax laws might still require an eventual increase in death benefits during the policy's later years.)
- The increasing death benefit option (Option B or Option 2) can result in BOTH an increase in the cash value and a proportional increase in the death benefit if positive investment returns occur. Unlike the level death benefit option, the increases in the death benefit can occur much more frequently and much sooner. Due to these more frequent increases, this option is often available for a higher premium.

Fluctuation and Non-Guarantee of Cash Value

In a manner similar to variable whole life insurance, cash value in variable universal life insurance generally won't be guaranteed and can fluctuate on the basis of investment performance. There is no guaranteed minimum rate of return, and even the principal can drop due to market performance. Although rare, it is possible for the cash value to drop to zero.

Fees and Expenses in Universal Variable Life Insurance

In a manner similar to variable whole life insurance, fees for variable universal life insurance may be deducted by the insurer on a flat or percentage basis for management of the insurer's separate accounts.

SELECTED INDIVIDUAL VARIABLE LIFE POLICY REQUIREMENTS

Variable life insurance policies sold in California need to include various disclosures. Some of the most important mandatory disclosures will be summarized next.

Mandatory Cover Page Disclosures

Explanations of the following features generally must be included on a policy's cover page:

- The variable nature of the death benefit.
- The variable nature of the cash value.
- The minimum death benefit.

- The manner in which the death benefit will be calculated.
- The free-look period (also known as a “right to examine”).
- Surrender charges (penalties imposed if the owner cancels the insurance).

Let’s summarize those items now.

Prominent Statement of Death Benefit Amount/Duration

In accordance with Section 3(c)(1)(A) of Company Bulletin 87-3, the policy’s cover page must include a prominent statement about the death benefit amount and its duration. The statement must indicate that the amount or duration may change (or remain fixed under specified conditions). This information must be displayed prominently, either in bold-face type or in a contrasting color.

Prominent Statement of Increase/Decrease in Cash Value

In accordance with Section 3(c)(1)(B) of Company Bulletin 87-3, the policy’s cover page must include a prominent statement about the policy’s cash value and how it will increase or decrease based on the performance of the insurer’s separate accounts (unless the policy includes guarantees of cash value). Like the information about the potentially changing death benefit, this information must be in bold-face type or a contrasting color.

In general, recalculations of the cash value need to be done at least monthly.

Guaranteed Minimum Death Benefit Disclosure

The cover page must indicate the guaranteed minimum death benefit, which will remain guaranteed unless premiums aren’t paid.

Although the value of the eventual death benefit can increase or decrease at various points based on market conditions, it can never be lower than the amount of coverage that was originally purchased. This assumes, though, that the owner makes all scheduled payments.

Death Benefit Calculation Disclosure

The cover page must explain how death benefits will ultimately be calculated by the insurer. As an alternative, the cover page may list the section of the policy where this information can be found.

The policy must adjust in value based on the performance of the insurer’s separate accounts (as selected by the policyholder). If the chosen separate account experiences growth, the policy needs to be adjusted in a correspondingly positive way. If the chosen separate account experiences a decline, the policy may need to be adjusted negatively. Ultimately, the benefits associated with the policy must be based on sound actuarial principles.

If variable life insurance will have a death benefit that can change due to economic factors (including the ability to increase), changes to that benefit must be applied at least every year.

Right To Examine

The cover page must include a captioned section that explains the policy's free-look period. The free-look period gives the buyer several days to review a purchased policy, return it based on any second thoughts, and receive a refund of premium.

More details about required free-look periods can be found in an earlier section of this course. As a reminder, the basic requirements are:

- Free-look periods must be at least 10 days if a policy is sold to someone under age 60.
- Free-look periods must be at least 30 days if a policy is sold to a "senior" (age 60 or older at the time of purchase).
- Regardless of age, free-look periods must be at least 30 days when a policy is intended to replace another policy.

When variable life insurance is sold in California to someone who is 60 or older, the following wording must appear on the policy jacket or cover page:

> *IMPORTANT!*
>
> *You have purchased a [variable life insurance policy], [variable annuity contract], referred to below as a "policy." Carefully review it for limitations.*
>
> *This policy may be returned within 30 days from the date you received it. During that 30-day period, your money will be placed in a fixed account or money-market fund, unless you direct that the premium be invested in a stock or bond portfolio underlying the policy during the 30-day period. If you do not direct that the premium be invested in a stock or bond portfolio, and if you return the policy within the 30-day period, you will be entitled to a refund of the premium and any policy fee paid. If you direct that the premium be invested in a stock or bond portfolio during the 30-day period, and if you return the policy during that period, you will be entitled to a refund of the policy's account value on the day the policy is received by the insurance company or agent who sold you this policy, which could be less than the premium you paid for the policy, plus any policy fee paid. A return of the policy after 30 days may result in a substantial penalty, known as a surrender charge.*

Surrender Charges

Consumers might forfeit a portion of their cash value if they cancel a variable life insurance policy too soon after purchase. These surrender charges tend to be higher during a policy's early years.

A special disclaimer about these charges (including their amount and duration) must appear on the policy's cover page if the insurance is for a senior citizen. In general, the California Insurance Code defines “senior” as someone who is at least 60 years old.

Grace Period

If the premium isn’t paid on time, variable life insurance needs to provide a grace period. During the grace period, the policy will remain in force without any impact on its value.

If death occurs during the grace period, the death benefit that was in place immediately before the grace period must be paid. However, the insurer can deduct the amount of overdue premium from that amount.

Consumers with variable whole life insurance are generally entitled to a 60-day grace period.

Grace Periods for Variable Universal Life Insurance

For variable universal life insurance, a slightly different grace period is necessary. Keep in mind that variable universal life insurance lets the owner skip premium payments occasionally, as long as there’s enough cash value to cover the mortality cost and the insurer’s expenses. However, if too many payments are missed, the cash value can be depleted.

If the cash value is too low to cover the unpaid premium, the insurer must send the policyholder a notice and abide by a slightly longer grace period (61 days from the mailing of the notice).

Description of Benefit Base

A variable life insurance policy needs to include a full description of the “benefit base.” The benefit base is usually the amount that will have interest credited to it by the insurer (based on economic performance). The policy must explain how applying interest to the benefit base will impact the person’s coverage and the policy’s value.

Deferral of Variable Death Benefit Payment

The policy must disclose the insurer’s ability to defer payment of death benefits, including but not limited to cases in which the financial markets have been closed due to emergency.

The insurer’s ability to defer death benefits only applies to the variable portion of the death benefit. Death benefits up to the policy’s minimum guaranteed amount must be provided promptly.

Mandatory Description of Cash Value and Surrender Value

Cash value (and the ability for it to grow) is one of the most attractive elements of variable life insurance. Therefore, the policy needs to include an explanation of how it will be calculated.

Similarly, the policy needs to mention how the "cash surrender value" will be determined. The cash surrender value is essentially the cash value minus any additional fees that the owner would incur for ending the contract prematurely.

Separate Accounts

The policy must contain a description of the insurer's separate accounts that will be associated with the non-guaranteed portions of the product. The policy must explain the difference between separate accounts and the insurer's "general" account. Assets within separate accounts are intended to be used solely to fund non-guaranteed benefits (such as cash value and any non-guaranteed death benefits). By contrast, assets within the insurer's general account will be used to fund the policy's guarantees.

The policy must state the schedule for reconciling and recalculating assets within the insurer's separate account(s). The value of a separate account must be calculated at least as often as the variable components of the insurer's life insurance policies.

Separate accounts must be diversified, typically with no more than 10 percent of its assets invested in the same source. This limit might not apply to securities that are issued or guaranteed by the U.S. government. It can also be waived by the state's insurance commissioner on a case-by-case basis if exceeding that amount is unlikely to harm the public.

Separate Accounts and Annual Statements

Owners of variable life insurance are obligated to receive an annual financial statement about the insurer's separate account(s). This statement needs to include:

- The net investment return for the account over the past year.
- A comparison of net investment return for the past year vs. the previous year.
- A comparison of net investment return for the past year vs. other prior years (up to the past five years).
- A list of investments held by the separate account.
- Charges, taxes and brokerage fees imposed on the separate account for the past year (expressed as percentages and dollar amounts).
- The portfolio turnover rate for the past year (indicating how quickly assets are bought and then sold by the account's managers, rather than bought and kept for an extended time).

- Any changes in the separate account's investment objectives.
- The name of brokers or dealers who handle transactions related to the separate account
- The compensation paid to brokers or dealers who handle transactions related to the separate account.
- The names and occupations of the insurer's executive directors and officers.
- The names of the insurer's parent companies (if any) and any person who owns more than 10 percent of the insurer.

Qualifications of Agents to Sell Variable Life Insurance

No one can sell variable life insurance in California without the appropriate licenses. In general, salespeople must have a valid life insurance license and the appropriate securities license.

Sellers of variable life insurance are required to report disciplinary actions against themselves to the California Department of Insurance. This includes but is not limited to:

- Any revocation or suspension of an insurance license by another state.
- Any revocation, suspension or removal from membership by any securities exchange or securities regulator.
- Any judgment or injunction against them as a result of deceit, fraud, misrepresentation or violation of any insurance laws, insurance regulations, securities laws or securities regulations.

California's insurance commissioner has the authority to revoke, suspend or refuse to renew a license to sell variable life insurance. The rules for any disciplinary proceedings, such as the right to any hearings, are generally the same as for other types of insurance sold in the state.

Two-Hour Variable Life Insurance Training

In California, agents who sell variable life insurance must complete a special two-hour training course as part of their 24-hour continuing education requirement every two years. The training requirement is intended to improve agents' understanding of these complex contracts and emphasize the importance of only recommending suitable products.

The course you are taking now is intended to satisfy the two-hour variable life insurance training requirement. It includes summaries of regulatory bulletins from the California Department Insurance and relevant sections of the California Code of Regulations. However, it isn't meant to explain all of a seller's obligations in detail and isn't a substitute for competent legal counsel.

APPROPRIATENESS OF THE POLICY FOR THE CONSUMER

Each insurer needs to establish written standards of suitability. The standards must be used to determine whether variable life insurance would be an appropriate product for a consumer. In general, the standards must consider:

- The consumer's insurance and investment objectives.
- The consumer's financial situation.
- Other information known to the insurer or the insurer's agent.

A recommendation to purchase variable life insurance generally can't be made if it would be inconsistent with the suitability standards.

When creating a set of suitability standards, the insurer is expected to consider the following factors (among others):

- Age.
- Income.
- Debts and other obligations.
- Financial experience.
- Insurance needs.
- Financial objectives.
- Financial time horizon.
- Existing assets.
- Liquidity needs.
- Liquid net worth.
- Risk tolerance.
- Tax status.

Questions on the application must be designed to determine the suitability of the product for that particular person. If answers to questions suggest that variable life insurance isn't appropriate for the applicant, a salesperson can't recommend it.

Regulation Best Interest

In June 2019, the Securities and Exchange Commission finalized "Reg BI," which established new federal requirements for some professionals who sell variable annuities and variable life insurance. The goal of Reg BI was to ensure that recommended products are not only "suitable" for the buyer but are sold with the purchaser's "best interest" in mind. Among other things, compliance with Reg BI may require various types of disclosure and the avoidance of certain conflicts of interest by the salesperson.

Reg BI requires that sellers of securities (including variable life insurance policies) not put their own interests above those of a consumer. To comply with Reg BI, sellers must honor four broad requirements:

- A "disclosure" requirement.
- A "care" requirement.

- A “conflict-of-interest” requirement.

Disclosure Requirement

As part of the disclosure requirement, all material facts about the scope and terms of the seller’s relationship with the consumer must be disclosed (either prior to or at the time of a recommendation). In general, this requires disclosure of:

- Fees and costs that the consumer will incur.
- All services that will be provided by the seller.
- Conflicts of interest that could reasonably impact the seller’s recommendation, such as compensation arrangements with third parties and (if applicable) the fact that the seller is recommending a proprietary product that is only sold by his/her own company.

Care Requirement

As part of the care requirement, the seller must exercise reasonable diligence, care, and skill when making a recommendation. A recommendation needs to consider the risks, rewards and costs that may result for the buyer and how those factors fit into the person’s financial objectives. Before making a recommendation, the seller must consider reasonable alternatives and believe that the recommendation is truly in the consumer’s best interest.

Conflict-of-Interest Requirement

As part of the conflict-of-interest requirement, sellers must establish, maintain, and enforce written policies and procedures that address conflicts of interest in their recommendations. Some conflicts are illegal under Reg BI (such as contests based on selling particular types of securities within a limited time). Others might not be prohibited by Reg BI but require proper disclosure.

Some examples of conflicts that might be allowed but would still need to be disclosed are:

- Being required to recommend products from a particular company.
- Being compensated on the basis of overall sales volume (rather than only for selling a particular product or a particular product type).

Reg BI vs. Fiduciary Standards

Note that although Reg BI imposes some high standards, it doesn’t specifically impose a “fiduciary” standard on all sellers. Fiduciary relationships often forbid all conflicts of interest and—in many contexts—can create a long-term obligation to keep advising the person on financial matters.

Reg BI, by contrast, might allow certain conflicts if they are disclosed properly and aren’t detrimental to the buyer. Meanwhile, recommendations under Reg BI must be appropriate when they are made, but they don’t necessarily need to be reevaluated for their appropriateness years later.

The existence of fiduciary duties (or lack thereof) may depend largely on the specific role being played by the seller. Whereas someone who claims to act as a financial or investment advisor likely has fiduciary duties to clients, someone who is acting solely as an insurance salesperson typically doesn't have those duties.

Other Considerations

When determining whether a variable life insurance policy is appropriate for a consumer, producers in California should consider:

- The product's risks and lack of guarantees. (Even if the policy is deemed appropriate, the risks and non-guarantees must be disclosed.)
- The product design. (Even if the policy is deemed appropriate, the role and impact of the separate account must be explained. Prospects who are intimidated by the product's complexities are likely not suitable candidates.)
- The person's risk tolerance. (Prospects who generally prefer "safe" low-risk/low-return investments are likely not suitable candidates.)
- Tax situation. (In general, life insurance death benefits are tax-free to beneficiaries, and growth of the policy's cash value is tax-deferred until it's accessed. However, the particulars of the situation can create some exceptions to those rules. Be aware that a license to sell insurance doesn't grant a person the right to dispense tax advice. Prospects should always be advised to seek counsel from certified tax professionals or other experts if they have specific tax concerns.)
- Annual income. (Although variable life insurance can be beneficial, it tends to cost more than simpler types of coverage.)
- Net worth and liquid net worth. (Surrendering a variable life insurance policy for its cash value can result in fees. Someone who has other liquid assets will be less likely to need the cash value in an emergency.)
- Age and time horizon. (Due to short-term market volatility, variable life insurance is often more suitable for long-term investors.)
- Investment experience. (Prospects who have no experience investing in mutual funds might be too intimidated by variable life insurance and the concept of separate accounts.)
- Existing investments and life insurance. (Variable life insurance might be less suitable if a prospect already has other sufficient coverage. If an investor has little or no interest in providing a death benefit to beneficiaries, other options—not life insurance—might be more appropriate.)
- Number of dependents. (At the very least, this can help determine the minimum death benefit to purchase.)
- Investment objectives. (Variable life insurance might be less suitable for someone who is solely concerned about buying the largest death benefit for the lowest possible premium.)
- Source of funds. (In general, variable life insurance might not be suitable if the premium would need to come from tax-deferred retirement accounts or an emergency fund.)

- Debts and reverse mortgages (On one hand, money used to buy variable life insurance might be better spent by paying off debts. However, someone who wants to shield survivors from debts can purchase an appropriately sized death benefit for that purpose. Death benefits from life insurance might even be used to regain equity in property that was part of a reverse mortgage. Money from the death benefit can be used to repay the lender and retain ownership of the mortgaged home.)
- Other considerations. (Suitable recommendations can only happen if a salesperson asks questions and listens carefully to the answers. A seemingly unrelated answer can lead to a better understanding of a prospect's needs and goals.

ADDITIONAL REQUIREMENTS AND BEST PRACTICES

Next, you'll learn about special considerations when selling variable life insurance online. Then, this course will conclude by explaining best practices for selling variable life insurance in either an online or offline environment.

Considerations in Online Insurance Sales

Life insurance transactions are being completed increasingly without the agent physically meeting the applicant. Online options can increase convenience for buyers and eliminate some costs for insurers, but important steps in the sales process—such as identify verification and disclosure of material facts—need to followed regardless of how purchases are made.

Verification of Identity

Identity verification is important to reducing insurance fraud and has become an even larger concern as transactions have moved online.

For insurers engaging in online sales, applicants may be required to upload copies of government identification cards and complete an online facial recognition exercise that establishes a match.

Insurance industry entities, such as the Medical Information Bureau, sometimes offer extensive databases that can find discrepancies in applicant information and/or compare applicant data against a person's credit reports. These databases can often be used to identify an irregular amount of insurance transactions (such as the same Social Security number being used on multiple applications). In a manner similar to health examinations, the extensiveness of the verification process might depend on the amount of requested coverage, with larger policies requiring more extensive verification.

Before receiving a life insurance policy, the intended owner will commonly need to pay the first premium and attest that the insured person's health hasn't changed since the application date. Those tasks, similar to the application, can usually be completed online or in person.

Anti-Money Laundering Requirements

Money laundering involves taking money related to illegal activity and trying to hide it elsewhere in the economy. After going undetected, the money will be used by a criminal either for more criminal activity or as a source of personal wealth.

Money laundering involves three phases:

- Placement: In this phase, money used or intended for illegal activity is deposited into a legitimate part of the economy. (For example, a criminal may attempt to buy a large and unneeded life insurance policy with cash.)
- Layering: In this phase, money is moved from one part of the economy to another, with the sole goal of creating a financial maze that isn't easily traceable by law enforcement. (For example, a criminal may exchange one variable life insurance policy for another insurance product without a seemingly legitimate reason.)
- Receiving: In this phase, the money is withdrawn, usually to fund more criminal activity. (For example, a variable life insurance policyholder may cancel a life insurance policy at great expense for no legitimate reason.)

Money laundering became a larger concern in insurance after the terrorist attacks of September 11, 2001. Law enforcement determined that certain life insurance products might ultimately be used by terrorist groups to hide their assets. Since then, federal law has required that carriers selling cash-value life insurance (including variable life insurance) have an anti-money laundering program. As part of an anti-money laundering program, a life insurer must:

- File reports with the U.S. Department of the Treasury when potential money laundering is detected.
- Train its producers to recognize and respond to warning signs of money laundering.
- Designate a compliance officer who will be in charge of the program.

Possible warning signs of money laundering or other inappropriate transactions are:

- Large purchases are made by people who seem unlikely to afford them (for example, a student buying large amounts of cash-value life insurance).
- The product being purchased is in conflict with a needs-based analysis conducted by a licensed insurance agent or broker.
- Owners or beneficiaries of cash-value products seem unconnected to one another and lack an insurable interest in one another's lives.
- A consumer asks whether certain transactions must be reported to the Internal Revenue Service.
- An applicant wants to purchase an interest-sensitive product but expresses no concern about its performance.
- A cash-value product is surrendered at great expense to the owner.

- Soon after purchase, an owner borrows the maximum amount possible from a cash-value product.
- An applicant insists on paying large premiums with cash.
- The owner surrendering a cash-value product has no reasonable explanation for the surrender.
- Policy ownership is transferred without a reasonable explanation.
- An applicant is very interested in free-look periods that allow for a return of premium after a policy cancellation but expresses little concern about other aspects of the product.
- A consumer is engaging in an irregularly high number of insurance transactions.

Legal Signatures Required on Applications

In general, life insurance applications must be signed by the owner and the insured person. If the owner or insured person is under 18, a parent or guardian must sign the application. Although not always required, it's common practice for the producer selling the policy to sign the application, too. Unless they are also the owner or the insured person, beneficiaries typically don't need to sign the application.

Electronic Signatures and Consent to Electronic Delivery

The ability to sign a document electronically can create more convenience for the public, reduce administrative costs for businesses and, in some ways, make retention of documents more manageable. However, the increased use of electronic signatures has resulted in state and federal laws about the issue.

Under the federal ESIGN Act, a document that is signed electronically will usually be just as valid, and just as enforceable, as a document signed on paper. Meanwhile, most disclosures that must be made as part of business transactions can be provided in an electronic format rather than as hard copies, and most record-retention rules can be satisfied by maintaining electronic versions of documents.

Before presenting a document that would require an e-signature, the consumer must affirmatively consent to transact business electronically. For California insurance transactions, consent can be provided verbally but must be documented in writing by a licensed insurance producer. As part of obtaining consent, the consumer must also receive information about:

- The right to have the document provided in a non-electronic format (and any charge for a hard copy). Note that the California Insurance Code allows consumers to receive one copy of an electronic document per year without charge.
- The right to withdraw consent at any time.
- Whether the consent applies only to a specific transaction or to others as well.

Section 1633 of the California Civil Code requires that any electronic signature be the intended act of the person. An electronic signature that was accidental (such as one that is obtained from unclear or misleading instructions) might not be enforceable. Section 1633 also allows electronic signatures for notarized documents and statements that must be signed under penalty of perjury if certain requirements are met.

Although they're generally beyond the scope of this course, some exceptions that may not allow for electronic signatures are identified within Section 1633.3 of the California Civil Code.

Electronic Delivery

In addition to addressing the validity of e-signatures, California law addresses the ability of insurers to submit disclosures and other insurance documents electronically to applicants and policyholders. In most cases, the notices, reports and other paperwork that must be sent to the public as part of an insurance transaction can be sent in an electronic format rather than traditional mail. However, transmitting those documents electronically requires compliance with the following rules:

- The intended recipient must consent to electronic delivery.
- The intended recipient must be told that electronic delivery is optional.
- The intended recipient must be told that consent to electronic delivery can be waived at any time.
- The type of document that will be transmitted must be explained in advance.
- The intended recipient must be informed about how to change the email address for electronic delivery.
- As part of the delivery, insurance producers must provide their toll-free phone number or website address.

If California law requires delivery confirmation of an insurance document, a producer needs to implement a system to verify receipt. In general, receipt of an electronic insurance document can be verified by:

- Having the person acknowledge receipt by executing an electronic signature.
- Posting the document on a secure website and receiving confirmation that the person logged in and viewed the document. (Clear instructions must be provided regarding how to access the document.)

If receipt of an electronic document isn't confirmed, the producer may need to reverify the person's email address or send a physical copy to the person's physical address.

Specific requirements for confirming receipt of electronic insurance documents can be found in Section 38.6 of the California Insurance Code.

Data Security

Financial institutions (including insurance companies) are required to implement an information security program that includes administrative, technical and physical safeguards designed to achieve the following objectives:

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

Each financial institution must maintain effective information security programs that are in line with their operational complexities. This means that larger organizations offering a diverse range of products and services may need a more complex plan than smaller entities with a limited focus.

Information security programs should:

- Have strong support from senior management.
- Promote integration of security activities and controls throughout the institution’s business processes.
- Establish clear accountability for carrying out security responsibilities.

Cyber Security

Although no cyber security plan is perfect, some important elements of a proper plan are:

- Keep software up to date: Install software patches so attackers can’t take advantage of known problems or vulnerabilities. Many operating systems offer automatic updates. If this option is available, it typically should be enabled.
- Run up-to-date antivirus software: A reputable antivirus software application is an important protective measure against known malicious threats. It can automatically detect, quarantine, and remove various types of malware. (In general, “malware” can be defined as unwanted files or programs that can cause harm to a computer or compromise someone’s data.) Be sure to enable automatic virus definition updates to ensure maximum protection against the latest risks.
- Use strong passwords: Select passwords that will be difficult for attackers to guess, and use different passwords for different programs and devices.
- Change default usernames and passwords: Default usernames and passwords are readily available to malicious actors. Change default passwords, as soon as possible, to a sufficiently strong and unique password.
- Implement multi-factor authentication (MFA): Authentication is a process used to validate a user’s identity. Attackers commonly exploit weak

authentication processes. MFA uses at least two identity components to authenticate a user's identity, thereby minimizing the risk of an attacker gaining access to an account by knowing the username and password.

- Install a firewall: Firewalls may be able to prevent some types of attack vectors by blocking malicious traffic before it can enter a computer system and by restricting unnecessary outbound communications. Some devices' operating systems include a firewall. Enable and properly configure the firewall as specified in the device or system owner's manual.
- Use caution with links, attachments and unexpected emails: Phishing emails are currently one of the most prevalent risks to the average user. The goal of a phishing email is to gain information about users, steal money from them or install malware on a device.
- Back up your data: Regularly back up your documents, photos and important email messages to an external hard drive or the cloud. In the event of an infection, your information will be less likely to be lost.
- Use anti-spyware tools: Spyware is a common virus source, but you can minimize infections by using a program that identifies and removes it. Most antivirus software includes an anti-spyware option that should be enabled.
- Avoid using public Wi-Fi: Unsecured public Wi-Fi may allow an attacker to intercept your device's network traffic and gain access to your personal information.

Safer Emailing

Here are some guidelines and basic recommendations related to email and attachments:

- Be wary of unsolicited attachments, even from people you know. Many viruses can "spoof" the return address, making it look like the message came from someone else. If you can, check with the person who supposedly sent the message to make sure it's legitimate before opening any attachments. This includes email messages that appear to be from your internet service provider (ISP) or software vendor and claim to include patches or antivirus software. ISPs and software vendors do not send patches or software in email.
- Trust your instincts. If an email or attachment seems suspicious, don't open it, even if your antivirus software indicates that the message is clean. Attackers are constantly releasing new viruses, and the antivirus software may not know about it yet. At the very least, contact the person who supposedly sent the message to make sure it's legitimate before you open the attachment. However, especially in the case of forwards, even messages sent by a legitimate sender may contain a virus. If something about the email or the attachment makes you uncomfortable, there may be a good reason.
- Save and scan any attachments before opening them. If you must open an attachment before you can verify the source, take the following steps:
- Be sure the signatures in your antivirus software are up to date.

- Save the file to your computer or a disk.
- Manually scan the file using your antivirus software.
- Turn off the option to automatically download attachments. To simplify the process of reading email, many email programs offer the feature to automatically download attachments. Check your settings to see if your software offers this option, and consider disabling it.
- Consider creating separate accounts on your computer. Most operating systems give you the option of creating multiple user accounts with different privileges. Consider reading your email on an account with restricted privileges. Some viruses need "administrator" privileges to infect a computer.

Avoiding Misrepresentations and Omissions

Materials used to sell, advertise or describe variable life insurance to the public can't be inaccurate or misleading. Be aware that this requirement doesn't just apply to prospecting for new sales. It must also be obeyed when encouraging existing policyholders to retain, renew, modify or replace their existing coverage.

Here are just a few examples of materials that must be compliant:

- Prepared sales presentations.
- Items intended to be used by sales personnel in public interactions.
- Leaflets, bulletins and form letters.
- Printed and published materials.
- Audiovisual materials presented to the public.
- Items distributed in print or broadcast media.
- Scripts.
- Billboards.

When determining the appropriateness of an insurer's sales materials, California's insurance commissioner will consider how the intended audience would likely interpret the insurer's statements. If the intended audience—based on their level of insurance education—would likely misunderstand something, the message is probably deceptive.

Variable life's dual status as both an insurance product and a securities product can create challenges when choosing language in advertising. Above all else, producers and insurers must avoid misrepresenting the product's guarantees or lack thereof.

Section 790.03 of the California Insurance Code prohibits misrepresenting the benefits or guarantees in an insurance product or making misleading statements about an insurer's financial condition. Sections 780 and 781 include similar rules against making knowingly false statements about an insurance product.

Duties in Senior Transactions

Section 785 of the California Insurance Code explicitly requires that insurance producers act with honesty, good faith and fair dealing toward consumers who are 65 or older. As part of this requirement, insurance producers who are also licensed as attorneys, loan originators or other aspects of law or finance may be limited in how they can provide multiple services to the same senior.

Honesty on Insurance Applications

Applications for variable life insurance need to explain that the death benefit may be fixed or change on the basis of market conditions. The application must disclose that the cash value will fluctuate based on economic factors.

Disclosure of Medical Underwriting

Some insurers offer life insurance products without requiring a medical exam. These “simplified-issue” policies tend to have comparatively low death benefits compared to their cost, but they can be helpful for seniors or other prospects who need insurance despite some health issues.

Sometimes, the requirement to complete a medical exam will only be waived if the applicant answers questions a certain way on an application. If an ad mentions the lack of a medical exam, the insurer must disclose any exceptions.

Disclosure of Non-Level Premiums

Premiums for variable whole life insurance are usually the same (“level”) for as long as the insured person lives. If an advertised price will or can change, the insurer must disclose the possibility.

Required Prospectus

No later than when they receive an application for variable life insurance, consumers must be given a prospectus pertaining to the insurer’s separate accounts and acknowledge receipt in writing.

The prospectus is required to contain to following information:

- An explanation, in non-technical terms, of the applicable insurance policy’s main features and how they will be impacted by the financial performance of the separate accounts.
- The investment objectives of the separate account.
- The types of investments that will be made in order to achieve the separate account’s objectives.
- The net investment return of the separate account for each of the previous 10 years.
- An estimate of the bonuses and/or sales commissions that will be paid to agents, brokers or other salespeople if the policy is purchased. (This amount should be expressed as a percentage of the annual premium.)

- The taxes, fees and other charges incurred by the separate account during the previous year. (This should be expressed as a total dollar amount and as a percentage.)
- A summary of how assets within the separate account will be valued.
- The federal tax implications (for the policyholder, the insured and the beneficiary) if the insurance is purchased.
- Illustrations with examples of how benefits may change.

Illustrations and Projections

Projections of future performance must be presented clearly as hypotheticals and NOT guarantees. Illustrations must include the likely impact of fees and other charges. If the illustrations are based on any assumptions—such as the economy performing at least in a certain way or the policyholder utilizing the policy in a certain way—the assumptions must be disclosed. Illustrations must clearly represent the type of policy being sold.

Illustrations need to be provided at least in a legible hard-copy format. Although they may be shown to consumers on a screen, this doesn't waive the requirement to provide a hard copy.

Examples of Inappropriate Conduct

Other activities that have been highlighted by the California Department of Insurance as unacceptable in variable life insurance transactions are:

- Misrepresenting how interest will be credited to cash value (including whether the interest will be applied annually or on some other schedule and whether interest will be applied cumulatively or to only a portion of cash value).
- If variable life insurance will be replacing other insurance, making improper comparisons between the proposed new policy and the old policy.
- Failing to disclose the consequences of surrender charges if the policy is cancelled prematurely.
- Failing to disclose premium increases that will depend on the insured person's age.
- Failing to explain how fees and other charges may increase (especially for variable universal life insurance).
- If variable life insurance will be replacing other insurance, failing to consider whether applying for the new policy will require a new medical exam.
- Recommending a replacement policy that isn't more suitable than the person's exiting policy.
- Failing to disclose what could happen if premiums are invested in an insurer's separate account(s) during a free-look period (and the impact on a possible refund).
- Failing to provide a prospectus that explains material facts about the insurer's separate accounts.

- Failing to disclose fees associated with the policy or any additional charges for optional policy features. (Examples include but aren't limited to fees for riders, administrative fees, investment fees, subaccount fees and fees for accelerated death benefits (which may let the owner access part of the death benefit during a serious illness).
- Failing to disclose a temporary "teaser rate" of interest and how it will last.

Replacement Transactions

As part of the application process, a California life insurance agent needs to document whether the proposed coverage is intended to replace other coverage. If replacement is intended, the agent needs to document the policy that will be replaced and give a special disclaimer to the applicant regarding the risks of replacement (such as new contestability periods, new health exams and surrender charges). Insurance policies that replace others need to include a 30-day free-look period.

Section 10509.8 of the California Insurance Code prohibits making misleading or false statements in an attempt to induce the replacement of one life insurance policy for another.

If a replacement is being recommended, the agent should document the differences in cost, differences in features, and the rationale for the recommendation.

Documentation and Best Practices

Since recommendations of variable life insurance must be not only suitable but also in the consumer's best interest, producers should keep careful documentation of their advice to the public. This documentation should be created at or near the same time as any substantive interaction with a policyholder or prospect. It's often advisable for a producer to use a formal checklist during this process in order to ensure that all of the carrier's suitability standards have been addressed. Documentation should be created and maintained regardless of whether an interaction occurs in person, online, in conversation or in writing.

Producers should create a clear paper trail that addresses why a particular product was recommended (including any riders), the factors that were considered prior to the recommendation, and the major policy features and costs that were communicated. If replacement of existing coverage was proposed, the producer should retain appropriate notes explaining how replacement would benefit the consumer.

Some of the most important items to document as part of a variable life insurance transaction are:

- The quoted premium (and any explanations of how it may change).

- The class and pricing tier (including but not limited to whether the quoted pricing was based on preferred, standard or substandard rates).
- Recommended coverage face amounts vs. the amount actually purchased.
- Recommended riders vs. purchased riders.
- Surrender charges and their duration.
- Information about the consumer's net worth, liquid assets and ability to afford the insurance.

Advertising and Record Retention

An insurer must keep copies of all advertisements (and information about how and where advertisements were distributed) at its home office. Most of these records will need to be maintained for at least four years, although longer periods may be required.

Conclusion

Variable life insurance can result in a higher death benefit and a greater cash value than other types of life insurance. However, the product's potential benefits need to be balanced fairly against its risks. Sellers of variable life insurance in California need to be mindful of the state's laws and rules pertaining to this coverage, most of which are intended to stress proper disclosure and suitability.