

Report On
The Targeted Market Conduct Examination
of
American Equity Investment Life Insurance Company

NAIC Group Code 2658
NAIC Company Code 92738
NAIC Market Action Tracking System No. RI006-1

as of
December 31, 2016



State of Rhode Island and Providence Plantations
Department of Business Regulation
Insurance Division



State of Rhode Island and Providence Plantations
DEPARTMENT OF BUSINESS REGULATION
1511 Pontiac Avenue, Bldg. 69-2
Cranston, Rhode Island 02920

Insurance Division

DIRECTOR'S ORDER

The attached Report on The Targeted Market Conduct Examination as of December 31, 2016, of AMERICAN EQUITY INVESTMENT LIFE INSURANCE COMPANY, was recently completed by duly qualified examiners, pursuant to the provisions of the Rhode Island General Laws.

Due consideration has been given to the comments of the examiners regarding the operation of the Company and its financial condition, as reflected in the report.

It is therefore ORDERED that said Report be, and it is hereby, adopted and filed and made an official record of this Department as of this date subject to the following conditions:

- That a consent agreement between the Company and the Insurance Division be executed requiring the Company to implement all corrective actions and provide the Insurance Division with all requested follow-up information and reports, as outlined in their responses to the examination report recommendations.
- That the Company agree and make payment to the state of an appropriate monetary penalty to be determined by the Insurance Division based upon the violations noted by the examiners as a result of the examination.
- That enhanced monitoring of the Company's business activity in Rhode Island by the Insurance Division be continued thorough performance of annual MARS analysis until this is no longer deemed necessary.
- That the Insurance Division market conduct staff determine the need for the performance of a follow-up examination after The Company has been given sufficient time, for the purpose of evaluating the implementation of all corrective measures and any other matters that may be noted as the result of the ongoing monitoring by the Insurance Division.

DEPARTMENT OF BUSINESS REGULATION

Elizabeth Kelleher Dwyer
Deputy Director and
Superintendent of Banking and Insurance

DATED: 7/27/2018

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February 1, 2018

Ms. Elizabeth Kelleher Dwyer
Deputy Director and Superintendent of Banking and Insurance
State of Rhode Island and Providence Plantations
Department of Business Regulation
1511 Pontiac Avenue, Bldg. 69-2
Cranston, Rhode Island 02920

Dear Superintendent Dwyer:

In accordance with your instructions, and pursuant to the statutes of the State of Rhode Island, a Targeted Market Conduct Examination has been conducted of:

AMERICAN EQUITY INVESTMENT LIFE INSURANCE COMPANY
6000 Westown Parkway, West Des Moines, IA 50266-5921

The report of such examination on American Equity Investment Life Insurance Company, hereinafter referred to as “American Equity” or “the Company,” is herewith submitted.

The examination was conducted at the Rhode Island Department of Business Regulation, Insurance Division’s office at 1511 Pontiac Avenue in Cranston, Rhode Island and on-site at the Company’s home office.

FORWARD

This Targeted Market Conduct Examination Report is a report by exception. Information relating to practices, procedures, and/or files subject to review during our examination has been omitted from the report if errors and/or irregularities were not indicated.

SCOPE OF EXAMINATION

Authority for this examination is provided by R.I. Gen. Laws §§ 27-13.1-1 et seq. and R.I. Gen. Laws § 27-71-1 et seq. This examination covered the period from January 1, 2014 through December 31, 2016 and was conducted in accordance with standards established by the National Association of Insurance Commissioners (“NAIC”), and procedures developed by the Rhode Island Department of Business Regulation, Insurance Division (“the Department”).

The examination encompassed a review of the Company practices and procedures relating to Operations and Management, Complaint Handling, Marketing and Sales of Annuities, Producer Licensing, Policyholder Services and Underwriting and Rating. The line of business examined was individual annuities.

This was a targeted examination conducted for the purpose of determining the Company’s compliance with Rhode Island statutes and regulations concerning its sales practices related to the suitability and replacement of annuity contracts.

The test work performed during the examination satisfied this purpose and formed the basis for the findings and recommendations presented in this report. The examination consisted of verification and evaluation, on a test basis, of information contained in the Company’s files and

records. The annuity contracts reviewed by the examiners were generally selected from the appropriate population of contracts issued in Rhode Island during the examination period using statistical methods. The number of contracts reviewed was judgmentally limited when a sufficient number of errors were noted by the examiners to reasonably conclude on the existence of anomalies above an acceptable level within the population. Failure to identify or comment on the improper or noncompliant business practices in this state or other jurisdictions does not constitute acceptance of such practices.

PROFILE OF COMPANY

History

American Equity Investment Life Insurance Company (“the Company”) is a wholly owned subsidiary of American Equity Investment Life Holding Company (the “Holding Company”). The Company owns 100% of the outstanding common stock of American Equity Investment Life Insurance Company of New York (“American Equity NY”) and Eagle Life Insurance Company (“Eagle Life”).

The Company was incorporated on December 29, 1995 as a stock life insurance company in the State of Iowa. Through a Quota Share Reinsurance Agreement entered on December 31, 1995 between the Company and American Life and Casualty Insurance Company, the Company acquired a block of group term life, individual accident and health, and individual life policies to administer and service.

On September 30, 1996, the Company merged with Century Life Insurance Company, with Century Life Insurance Company being the surviving entity but with the name simultaneously

changed to American Equity Investment Life Insurance Company. Century Life Insurance Company had been incorporated December 19, 1980 in the state of Iowa as a legal reserve stock life insurance company.

The Company commenced issuing annuity contracts in November 1996 in certain states. American Equity obtained a license to write insurance from the State of Rhode Island effective August 27, 2004. No annuity contracts were issued in the State of Rhode Island until 2005. The Company is currently licensed in Rhode Island with Accident and Health, Life, and Annuities lines of authority.

Operations

The Company sells individual traditional fixed and fixed indexed annuities. In addition, the Company sells individual and group term life insurance, but this business accounts for less than 0.2% of total written premium nationwide in 2016. The products are sold by independent producers, broker/dealers, banks, and registered investment advisors. The Company uses a distribution network of national marketing organizations to recruit producers. The various annuities sold by the Company are generally known as any of the following:

- Premier Eagle 10
- Premier Eagle 12
- Bonus Gold
- Retirement Gold
- Integrity Gold
- Advantage Gold
- Choice 6
- Choice 8
- Choice 10
- Foundation Gold
- Traditions Gold
- Guarantee Series
- Immediate Annuity

The Company's Rhode Island annuity considerations (individual annuities) as of December 31st for years 2014, 2015 and 2016 are as follows:

Line of Business	Year	Amount
Individual Annuities (annuity considerations)	2014	\$14,055,118
	2015	\$19,227,503
	2016	\$20,821,800

This data indicates that Individual Annuity premium increased 37% from 2014 to 2015 and 8% from 2015 to 2016.

Directors

As of December 31, 2016, the Directors of American Equity were as follows:

James Michael Gerlach	Ronald James Grensteiner	John Michael Matovina
David Jeff Noble	Terry Allan Reimer	Debra Jane Richardson

Management

As of December 31, 2016, the officers of American Equity were as follows:

Ronald James Grensteiner, President

Ted Morris Johnson, Chief Financial Officer and Treasurer

Renee Denise Montz, Executive Vice President, General Counsel & Secretary

John Robert Miller, Vice President, Chief Actuary & Illustration Actuary

EXECUTIVE SUMMARY

On February 1, 2017, this targeted market conduct examination was ordered by the Department's Deputy Director and Superintendent of Insurance. The Department had made inquiries of the Company prior to the ordering of the examination in response to consumer complaints of specific

activities. This examination was conducted for the purpose of determining the Company's compliance with Rhode Island statutes and regulations concerning its sales practices related to the suitability and replacement of annuity contracts written from January 1, 2014 through December 31, 2016. The examination encompassed a review of the following areas: Operations and Management, Complaint Handling, Marketing and Sales of Annuities, Producer Licensing, Policyholder Services and Underwriting and Rating.

A focus of the examination was to evaluate whether the Company maintained sufficient supervision and oversight of its annuity sales activity including its practices related to suitability and replacements. In addition, other general business practices deemed not in compliance with Rhode Island laws or regulations were identified. As the result of this examination, the following findings were noted regarding both supervision of sales activity and general business practices:

- Finding No. 1: The Company did not adequately supervise its producer licensing function.
- Finding No. 2: The Company did not maintain evidence in its contract files that sufficient notice was provided to annuity applicants that the producer had left sales material.
- Finding No. 3: The Company did not use a required policy form.
- Finding No. 4: The Company did not file with the insurance commissioner the required Table of Guaranteed Values prior to inserting it into various products.
- Finding No. 5: The Company provided incorrect notices for the "free look" period for annuity contract replacements.
- Finding No. 6: The Company did not provide accurate illustrations of certain products.
- Finding No. 7: The Company does not have sufficient procedures to prevent twisting and churning.
- Finding No. 8: The Company does not have sufficient procedures to monitor its producers' cross-state border sales.

- Finding No. 9: The Company did not maintain proper “black box” algorithm/logic to adequately flag policies that require enhanced suitability review.
- Finding No. 10: The Company did not maintain evidence in its contract files that the information necessary in order for the producer to have reasonable grounds to make a suitability recommendation was obtained by the producer from the contract purchaser.
- Finding No. 11: The Company did not maintain evidence in its contract files that adequate information specifically tailored to the purchaser had been provided to the purchaser in order that they be reasonably informed of the products’ features and benefits.
- Finding No. 12: The Company did not maintain evidence in its contract files that adequate consideration was given to the net benefits of a change related to surrendering other contracts/policies.
- Finding No. 13: The examiners had certain other observations/concerns with the Company’s marketing and sales practices related to the suitability and replacement of annuity contracts. While not necessarily specific violations, these issues represent possible deficiencies with the policies and procedures used by the Company, or with the Company’s adherence to their own policies and procedures.

FACTUAL FINDINGS

Finding No. 1

The Company did not adequately supervise its producers’ marketing and sales of annuity contracts to ensure that producers are properly licensed, and this resulted in at least one known case of an improper commission payment in violation of R.I. Gen. Laws § 27-2.4-15, Insurance Regulation 12, Section 6F and Insurance Regulation 29, Section 5A.

Finding No. 1 – Background Information

The Company was requested to provide a list of all producers appointed to conduct annuity sales in Rhode Island at any time during the examination period. A random sample of 84 producers

was reviewed by the examiners for proper licenses. Producer licenses were also verified during the testing of annuity contract files used for newly issued annuities not involving a replacement of a prior product (“New Business”) and annuities that did involve a replacement of a prior product (“Replacements”) reviews by examiners.

During the above testing, the examiners identified that a producer who had his license revoked by the Division in August 2016 had submitted two post-revocation applications to the Company for issuance of annuities. Of the two applications, one was subsequently issued and a commission in the amount of \$2,038.34 was paid on October 15, 2016, in violation of R.I. Gen. Laws § 27-2.4-15. The other application was declined for suitability reasons. As a result of this finding, the examiners made further inquiry into the Company’s policies and procedures regarding producer licenses.

In response to the examiner’s inquiry, the Company indicated that it conducts background checks for all new producers. The Company further stated that, in states requiring producer appointments, it obtains additional periodic information. However, Rhode Island does not require insurance companies to file appointment information regarding each producer authorized to act on behalf of the company. In non-appointment states such as Rhode Island, the Company makes no further inquiry and performs no periodic licensing audits until the record date for license expiration and renewal, typically a two-year period. In addition, the Company did not verify active licensure at the time of commission payments. The Company acknowledged that the license revocation described above was not known by the Company since this had occurred prior to the date that the producer’s license was due to expire on September 30, 2017. The Company also acknowledged that its licensing oversight system was not designed to identify such mid-

term terminations in non-appointment states and, due to the significance of this, and while the examination was in-progress, the Company created an interim internal process to review producer licenses in non-appointment states to prevent this from occurring in the future.

Recommendation No. 1

It is recommended the Company ensure that the internal process created during the examination in response to the examiners' finding is adequately designed and utilized effectively to confirm that its insurance producers are properly licensed with the state prior to the acceptance of annuity applications and the payment of corresponding commissions, pursuant to R.I. Gen. Laws § 27-2.4-15, Insurance Regulation 12, Section 6F and Insurance Regulation 29, Section 5A. The enhanced procedure may include, but should not be limited to, a review of the Department's website where information regarding revoked insurance producer licenses is regularly listed.

Finding Nos. 2 to 12 - Background Information

The Company was requested to provide a list of all new and replaced annuity contracts issued during the examination period. The Company provided a list of 492 New Business and 157 Replacements during the examination period. Random samples consisting of 86 of the New Business annuities and 79 Replacements were selected and corresponding contract files were requested from the Company. As noted in the Scope of Examination section above, testing of contracts was judgmentally limited when a sufficient number of errors were noted by the examiners to reasonably conclude on the existence of anomalies above an acceptable level within the population. For these test samples, the examiners reviewed 25 New Business files and 26 Replacements files to determine whether these contracts were processed in compliance with the Rhode Island General Laws and the Rhode Island Insurance Division Regulations.

Finding No. 2

In all annuity contract files reviewed by the examiners (25 New Business and 26 Replacements), the Company did not maintain evidence that sufficient notice was provided to annuity applicants that the producer has represented that “copies of all sales material have been left with the applicant...” in violation of R.I. Insurance Regulation 29, Section 6C(2)(a).

Finding No. 2 – Background Information

The Company indicated a welcome letter is sent with each annuity contract when it is delivered. The letter is not bound in the contract but is part of the package provided to the consumer when the contract is delivered along with the Buyer’s Guide, delivery receipt, guaranty association notice, consumer complaint notice, and privacy notice. The welcome letter states, in part, as follows:

“If the purchase of your new contract replaced an existing life insurance policy or annuity contract, and your agent provided you with sales material including a disclosure form, we suggest you keep these materials with your new contract. Should you have any questions about these materials, or if your agent did not leave copies with you, please contact our Compliance Department at the phone number below, or by emailing...”

R.I. Insurance Regulation 29, Section 6C(2)(a) states that within ten (10) days of the issuance of a replacement annuity, the Company shall:

“Notify the applicant by sending a letter or by verbal communication with the applicant by a person whose duties are separate from the marketing area of the insurer, that the producer has represented that copies of all sales material have been left with the applicant in accordance with Section 4D.”

Recommendation No. 2

It is recommended the Company establish and maintain appropriate procedures to ensure the Company provides notice to annuity applicants that the producer has represented that copies of

all sales material have been left with the applicant pursuant to R.I. Insurance Regulation 29, Section 6C(2)(a).

Finding No. 3

In all annuity contract files reviewed by the examiners (25 New Business and 26 Replacements), the Company did not use a complete form or one that had been approved by the Department in compliance with R.I. Insurance Regulation 29, Sections 4B, 4C, and 5D.

Finding No. 3 – Background Information

Rhode Island has adopted NAIC Model Regulation 613, Life Insurance and Annuities Replacement Model Regulation that has been adopted by over 45 NAIC member jurisdictions. The Company uses a form, Form 4000 - Important Notice: Replacement of Life Insurance or Annuities, to comply with R.I. Insurance Regulation 29, Appendix A. The form varies from the regulatory form by omitting the sentence found in Appendix A stating as follows: “The existing policy or contract is being replaced because _____.” In addition, the Company adds the following language that does not appear in Appendix A:

“IF A REPLACEMENT OF AN EXISTING LIFE INSURANCE POLICY OR ANNUITY CONTRACT TAKES PLACE, YOU HAVE THE RIGHT TO RETURN THE POLICY OR CONTRACT WITHIN 30 DAYS OF DELIVERY AND RECEIVE AN UNCONDITIONAL FULL REFUND OF ALL PREMIUMS PAID, OR IN THE CASE OF A VARIABLE OR MARKET VALUE ADJUSTED POLICY, A REFUND OF CASH SURRENDER VALUE PROVIDED UNDER THE POLICY/CONTRACT PLUS FEES AND OTHER CHARGES DEDUCTED”

While substantially similar versions of Appendix A are permitted with the approval of the Department pursuant to Insurance Regulation 29, Section 4B, the Company did not seek nor did it obtain the Department’s approval of Company Form 4000 prior to its use.

Recommendation No. 3

It is recommended the Company establish and maintain procedures to ensure that it uses the complete and correct forms pursuant to R.I. Insurance Regulation 29, Sections 4B, 4C, and 5D, and if it wishes to seek to use a modified Appendix A, it should obtain proper approval from the Department prior to using such a modified version of the R.I. Insurance Regulation 29, Appendix A.

Finding No. 4

The Company did not file its Table of Guaranteed Values with the Department prior to inserting the Table into the following annuity contracts issued in Rhode Island: Bonus Gold, Retirement Gold, Advantage Gold, Premier Eagle 10, and Premier Eagle 12. The Company did not file its Table with the Interstate Insurance Product Regulation Compact (the "IIPRC") prior to inserting the Table into the following annuity contracts issued in Rhode Island: Traditions Gold, Foundation Gold, Integrity Gold, Choice 10, Choice 8, and Choice 6. The use of forms not filed for approval with either the Department or the IIPRC is a violation of R.I. Gen Laws § 27-4-24.

Finding No. 4 – Background Information

Rhode Island has enacted legislation becoming a part of the 45-jurisdiction IIPRC. R.I. Gen. Laws § 27-4-24 requires that companies shall file all annuity contract forms prior to use in the state, and companies may either file those for approval directly with the Department or with the IIPRC. Regardless of the method of filing, R.I. Gen. Laws § 27-4.4-3(a)(3) requires that sufficient information be included with contract forms in order that the amount of minimum benefits under the annuity contracts can be determined. The examiners' procedures included a comparison of annuity contracts issued during the examination period with the annuity contract

forms filed with the Department using the test sample described above. This comparison demonstrated the Company inserted a Table of Guaranteed Values (the “Table”) into its issued annuity contracts that was not included in the original product filing with the Department. Additional testing by the examiners identified a similar not-filed table was inserted into annuity contracts filed with the IIPRC. The Company has proposed removing the Table of Guaranteed Values from the aforementioned affected contracts, however, this will not adequately resolve the issues noted.

Recommendation No. 4

It is recommended the Company establish and maintain procedures to ensure the Company does not insert unapproved forms into contracts in the future. Such procedures should include a requirement to submit all forms for approval prior to use to either the Department or the IIPRC, as required by R.I. Gen. Laws § 27-4-24. Additionally, before the Company issues any new annuity contracts, the Company **must** re-file with the Department and/or the IIPRC all affected contract forms for review and approval, including the front cover and associated contract schedule pages. Complete contract form filings must include sufficient information to determine the amounts of minimum benefits under the annuity contract, pursuant to R.I. Gen. Laws § 27-4.4-3(a)(3).

Finding No. 5

The Company lists a 20-day right to examine contract (the client’s “free look”) period on the first page of five of its replacement annuity contracts in violation of R.I. Insurance Regulation 29, Section 6A(4) that requires a 30-day “free look” for replacement products, and R.I. Gen. Laws § 27-29-4(2) that prohibits misleading information. The Company is misleading consumers by

providing incorrect information to the purchaser of a replacement annuity contract by indicating that they have the option to return and receive a refund for a shorter time period than the required 30-day “free look” period.

Finding No. 5 – Background Information

When the Company issues contracts, it prints a 20-day “free look” period on page 1 of its new and replacement annuity contracts for the following products: Bonus Gold, Retirement Gold, Advantage Gold, Premier Eagle 10, and Premier Eagle 12. R.I. Insurance Regulation 29, Section 6A(4) require a 30-day “free look” period for replacement annuities. R.I. Gen. Laws § 27-29-4(2) prohibits insurers from disseminating misleading information. The Company has identified that it provides the consumer notice of the correct “free look” period on Form 4000, but this is an attachment to the annuity contract that itself on page 1 lists the incorrect 20-day period.

Recommendation No. 5

It is recommended that the Company establish and maintain procedures to ensure that it provides the proper "free look" notice in its replacement contracts. In addition, pursuant to R.I. Gen. Laws § 27-4-24, prior to the continued sale of any of these affected annuity contracts, the Company **must** re-file with either the Department or the IIPRC all affected contract forms for review and approval.

Finding No. 6

The Company did not provide accurate illustrations with its Foundation Gold and Retirement Gold products as these displayed “Premium and Bonus” amounts in the first-year of the contract

that actually accrue over a period of several years. This practice is a violation of R.I. Insurance Regulation 41, Section 6.

Finding No. 6 – Background Information

The Company indicated it began using illustrations for its annuity products in 2016. When it had initially filed the contracts for approval, the Company asserted in its form filings that it would not illustrate these products, and as such, the illustrations have not previously been reviewed by the Department. In the illustrations used for the Foundation Gold and Retirement Gold products, it was noted by the examiners that one of the columns shown in various tables is entitled “Premium and Bonus.” This column reflects amounts in year one of the contract that actually accrue over a period of several years.

Recommendation No. 6

It is recommended the Company establish and maintain procedures to ensure it provides accurate illustrations for its annuity products pursuant to R.I. Insurance Regulation 41, Section 6.

Finding No. 7

The Company does not have written procedures that are reasonably sufficient to detect and prevent the practice of Twisting and Churning policies or contracts that it has issued, in violation of R.I. Gen. Laws § 27-29-4.7 and R.I. Insurance Regulation 29, Section 9.

Finding No. 7 – Background Information

When the examiners inquired about twisting and churning policies, the Company pointed to one sentence on its Producer Compliance webpage that states: “No agent shall engage in the act of

twisting, churning or rebating.” Another document entitled “Agent Guide to Replacements,” states:

“American Equity does not encourage the willful act of 'twisting or churning' or the deliberate replacement of annuity or life insurance policies. We acknowledge that replacements may indeed be in the interest of the client. However, each replacement must be reviewed based on the circumstances of the customer and the features of the existing and proposed annuity.”

In addition to the fact that neither of these documents defines or sufficiently describes the prohibited practices, there were other factors noted that raise concerns about the adequacy of the Company’s efforts to prevent twisting and churning. First, interviews of Company’s officers revealed little or no knowledge of these procedures. Second, a senior compliance officer stated in an interview that twisting and churning only applied to securities. Third, although the Company uses an automated system to flag annuity sales for an enhanced manual review, this system does not contain a flag for situations where the same producer is involved with the sale of both the replacement and the existing annuities. This type of scenario would be an indication that twisting or churning of the policy could be occurring.

Recommendation No. 7

It is recommended the Company establish and maintain procedures that are reasonably sufficient to detect and prevent the practice of twisting and churning by its producers pursuant to R.I. Gen. Laws § 27-29-4.7 and R.I. Insurance Regulation 29, Section 9.

Finding No. 8

The Company does not have sufficient written procedures to identify and perform an enhanced review of cross-state border sales to evaluate the suitability of the sale to the purchasers pursuant to R.I. Insurance Regulation 12, Section 6F(1)(e), including consideration as to whether the same

or similar product is available to the purchasers in their home state or whether there are any other home state restrictions to such sales.

Finding No. 8 - Background Information

During the course of the examination, the examiners noted that certain sales were being made in Rhode Island to non-residents. After questioning the Company, the Company identified that it had certain procedures from January 1, 2014 through January 2015, and others from January 2015 through the end of 2016. It was noted that that the Company lacked sufficient procedures throughout the entire period to monitor cross-state border business, including reviewing whether its producers document a valid reason for such sales or whether a review has been conducted identifying whether a similar product is available in the purchaser's home state or any verification of other home state restrictions.

The examiners reviewed 18 annuity contracts sold in Rhode Island to Connecticut residents and determined that only three of these appeared to have valid reasons for the cross-border sale. There was no evidence found that any of the 18 contract forms had been reviewed to ensure that the forms had been approved in the purchaser's home state or to identify any other home state restrictions. The examiners compared filed versions of contracts approved in Rhode Island to those approved in Connecticut and identified several contractual provisions to be different.

Recommendation No. 8:

It is recommended the Company establish and maintain procedures to identify and perform an enhanced review of cross-state border sales to ensure that there is an appropriate justification and benefit of the sale to the purchasers pursuant to R.I. Insurance Regulation 12, Section 6F(1)(e),

including consideration as to whether the same or similar product is available to the purchasers in their home state, or whether there are any other home state restrictions to such sales.

It is also recommended that the Company perform a re-evaluation of all contracts sold in Rhode Island to all non-residents during the examination period to determine if the suitability and appropriateness of these contracts had been adequately considered prior to issuance. All contracts for which adequate evidence of an appropriate review had not been performed prior to the sale must be remediated by the Company to the satisfaction of the purchaser by making appropriate offers such as waiver of surrender charge and/or bonus vesting, etc. The re-evaluation plan must be submitted to the Department for approval prior to implementation, and the subsequent results of the re-evaluation, and the remediation plan for any contracts found not to be suitable for any reason must also be submitted to the Department for approval prior to implementation.

Finding Nos. 9, 10, 11 and 12 - Background Information

The Company uses a combination of automated and manual systems to review the appropriateness of suitability and replacement annuity contracts. Potential sales are manually reviewed if the automated system identifies a contract where an enhanced review is needed based upon pre-determined criteria.

In reviewing a sample of replacement annuity contract files, the examiners noted that for some files, the application forms were incomplete and/or inaccurate and the documents used as evidence of the source of existing funds used to purchase the replacement annuities were also outdated or incomplete.

The examiners also reviewed six files to evaluate the suitability standards applied by the Company. These files were selected from the complaints and replacement files that had been previously selected for other reviews during the examination. The algorithms used in the automated system to flag items needing enhanced review were reviewed. Based upon this review, the following observations were made by the examiners:

- Funds used to pay for two replacement annuities for the same purchaser, both sold by the same producer, were from existing annuities, even though the application stated the funds were to originate from Certificates of Deposit (CDs). The Company's chief compliance officer also noted this concern, but the replacement sales were completed with no further consideration by the Company.
- There does not appear to be any automatic enhanced review of potential annuity sales when the replacing producer is the same as the original producer.
- While the Company states that several factors are combined in the automated review to give a suitability score and possible enhanced review prior to contract sale and issuance, the thresholds used by the Company to trigger this review do not appear to be sufficient. For example, there appears to be no low income trigger unless this is below \$20,000. There is also no trigger when income is lower, or only slightly more, than the applicant's living expenses.

Finding No. 9:

The LifePro automated "black box" algorithm/logic does not appear to adequately flag policies that require additional suitability review prior to the sale and issuance of an annuity contract as required by R.I. Insurance Regulation 12, Section 6F(1)(d).

Recommendation No. 9:

It is recommended that the Company establish and maintain procedures to ensure that appropriate manual and automated methods, thresholds, and other factors are used to identify annuity contract sales that may pose a potential suitability issue and require additional review per R.I. Insurance Regulation 12, Section 6F(1)(d) prior to issuance. Contracts should be subjected to additional review by the Company, particularly when the sale involves a replacement by the producer, or an affiliate of the producer, of the original contract.

Finding No. 10:

Three of the six annuity contract files reviewed did not contain evidence that the agent had collected sufficient information from the applicant necessary to have grounds to make a suitability recommendation. These are violations of R.I. Insurance Regulation 12, Sections 6A and C.

Recommendation No. 10:

It is recommended the Company establish and maintain procedures to ensure that the information necessary for the producer to have reasonable grounds to make a suitability recommendation per R.I. Insurance Regulation 12, Sections 6A and C is obtained from the applicant. It is further recommended that the Company monitor the collection of such evidence and that, in order to do so, the company require such information to be kept as part of the contract file. In addition, all contracts reviewed by the examiners that did not contain evidence of the necessary information and suitability recommendation must be remediated by the Company by making appropriate offers to the purchasers such as waiver of surrender charge and/or bonus vesting, etc. The

remediation plan for these contracts must be submitted to the Department for approval prior to implementation.

Finding No. 11:

Five of the six annuity contract files did not contain evidence that adequate information per R.I. Insurance Regulation 12, Section 6A, specifically tailored to the purchaser, had been provided to the purchaser in order that they be reasonably informed of the products' features, and that these features would be of benefit to them.

Recommendation No. 11:

It is recommended that the Company establish and maintain procedures to ensure that adequate information, as defined in R.I. Insurance Regulation 12, Section 6A, had been provided to the purchaser in order that they be reasonably informed of the products' features, and that these features would be of benefit to them.

Finding No. 12:

Five of the six annuity contract files reviewed did not contain evidence that adequate consideration was given to the net benefits of a change related to surrendering other contracts/policies per R.I. Insurance Regulation 12, Section 6A(4).

Recommendation No. 12:

It is recommended the Company establish and maintain procedures to ensure contract files reviewed contain evidence that adequate consideration was given to the net benefits of a change related to surrendering other contracts/policies per R.I. Insurance Regulation 12, Section 6A(4).

In addition, the Department recommends that the Company review all annuity contracts sold in Rhode Island from January 1, 2014 through December 31, 2016, for the purpose of determining the potential number of contracts that were not subject to an adequate suitability assessment by the Company and/or its producers. If the Company chose not to conduct such an internal suitability review, the Department will consider conducting a follow-up examination focused on this issue. Any review must include the use of valid statistical sampling, and the testing plan must be submitted to the Department for approval prior to commencement. Upon completion of the internal review, the results are to be reported to the Department together with planned remediation for all contracts found not to meet appropriate suitability standards. The Department will review the results of the Company's internal review and perform verification procedures to ensure the validity of the testing process. Any further action necessary by the Company will be determined based upon the results of the Company's testing and the Department's verification procedures.

Finding No.13 – Background Information

The examiners made certain other observations that raised concerns with the Company's marketing and sales practices related to the suitability and replacement of annuity contracts. While not necessarily specific violations, these issues represent possible deficiencies with the policies and procedures used by the Company, or with the Company's adherence to their policies and procedures.

Finding No. 13:

- A. The Company's thresholds in place for monitoring producers' replacement sales are not sufficient. The Company states that review of incoming replacements is based on the

block of business a producer writes at the Company level and not by individual state. Quarterly, the Company identifies all producers who have written 10 contracts within a quarter and have a replacement percentage of 40% or greater. The examiners noted that for a certain producer's Rhode Island sales during the examination period, 100% (10 annuities) of the replacement business involved the same replaced company; however, as a result there was no additional review of this activity by the Company.

- B. The Company does not perform random audits of the book of business of producers. The Company states that it does perform audits based upon noted trends or concern that has been identified. However, a procedure to perform random audits could identify potential problems before they escalate.
- C. The Company's Code of Ethics calls for business conduct and ethics training for its producers. However, the examiners were unable to determine if this training is actually being conducted by the Company, or with sufficient frequency.
- D. R.I. Insurance Regulation 41, Section 5B(3)(h) requires the Company to provide disclosures describing the impact of any contract riders. The Company states that disclosure for the Nursing Care Rider and Terminal Illness Rider are found in the product disclosure brochure, but there is insufficient evidence in the contract files to document the actual provision of these brochures to the contract purchaser. These brochures were not found in the contract files provided to the examiners, and the Company stated that they are not included in the files since each sale for a particular product has the same brochure. In addition, while other disclosure documents require signatures and/or initials of the purchaser, the Company does not require any type of acknowledgement for this brochure. The Company has indicated that there are general acknowledgements in the

files by the applicant or producer, but none describe the specific brochures that were provided.

E. The Company began using certain product illustrations in 2016. However, it has no means to supervise and oversee the appropriateness of illustrations actually used by producers either prior to that time or after producers were allowed to illustrate those products.

F. The Company does not have a dedicated Quality Control unit. There is no policy and procedure to ensure that new business forms taken by the Company are being properly checked for accuracy and completeness. And there is no process or system in place to ensure that data manually entered into the system is input correct.

Recommendation No. 13

It is recommended that the Company review and test each of the examiners' observations and concerns noted above to determine that adequate policies and procedures are in place and that these are being adhered to by staff and/or producers as applicable. The Company shall report to the Department results of this review and testing and describe the enhancements needed, including a timeline for implementation. The Company should also provide an appropriate explanation for any of the above items that are not deemed to be in need of corrective actions.

SUMMARY OF RECOMMENDATIONS

No.	Recommendation	Page No.
1	It is recommended the Company ensure that the internal process created during the examination in response to the examiners' finding is adequately designed and utilized effectively to confirm that its insurance producers are properly licensed with the state prior to the acceptance of annuity applications and the payment of corresponding commissions, pursuant to R.I. Gen. Laws § 27-2.4-15, Insurance Regulation 12, Section 6F and Insurance Regulation 29, Section 5A. The enhanced procedure may include, but should not be limited to, a review of the Department's website where information regarding revoked insurance producer licenses is regularly listed.	11
2	It is recommended the Company establish and maintain appropriate procedures to ensure the Company provides notice to annuity applicants that the producer has represented that copies of all sales material have been left with the applicant pursuant to R.I. Insurance Regulation 29, Section 6C(2)(a).	12
3	It is recommended the Company establish and maintain procedures to ensure that it uses the complete and correct forms pursuant to R.I. Insurance Regulation 29, Sections 4B, 4C, and 5D, and if it wishes to seek to use a modified Appendix A, it should obtain proper approval from the Department prior to using such a modified version of the R.I. Insurance Regulation 29, Appendix A.	14
4	It is recommended the Company establish and maintain procedures to ensure the Company does not insert unapproved forms into contracts in the future. Such procedures should include a requirement to submit all forms for approval prior to use to either the Department or the IIPRC, as required by R.I. Gen. Laws § 27-4-24. Additionally, before the Company issues any new annuity contracts, the Company must re-file with the Department and/or the IIPRC all affected contract forms for review and approval, including the front cover and associated contract schedule pages. Complete contract form filings must include sufficient information to determine the amounts of minimum benefits under the annuity contract, pursuant to R.I. Gen. Laws § 27-4.4-3(a)(3).	15
5	It is recommended that the Company establish and maintain procedures to ensure that it provides the proper "free look" notice in its replacement contracts. In addition, pursuant to R.I. Gen. Laws § 27-4-24, prior to the continued sale of any of these affected annuity contracts, the Company must re-file with either the Department or the IIPRC all affected contract forms for review and approval.	16
6	It is recommended the Company establish and maintain procedures to ensure it provides accurate illustrations for its annuity products pursuant to R.I. Insurance Regulation 41, Section 6.	17
7	It is recommended the Company establish and maintain procedures that are reasonably sufficient to detect and prevent the practice of twisting	18

	and churning by its producers pursuant to R.I. Gen. Laws § 27-29-4.7 and R.I. Insurance Regulation 29, Section 9.	
8	<p>It is recommended the Company establish and maintain procedures to identify and perform an enhanced review of cross-state border sales to ensure that there is an appropriate justification and benefit of the sale to the purchasers pursuant to R.I. Insurance Regulation 12, Section 6F(1)(e), including consideration as to whether the same or similar product is available to the purchasers in their home state, or whether there are any other home state restrictions to such sales.</p> <p>It is also recommended that the Company perform a re-evaluation of all contracts sold in Rhode Island to all non-residents during the examination period to determine if the suitability and appropriateness of these contracts had been adequately considered prior to issuance. All contracts for which adequate evidence of an appropriate review had not been performed prior to the sale must be remediated by the Company to the satisfaction of the purchaser by making appropriate offers such as waiver of surrender charge and/or bonus vesting, etc. The re-evaluation plan must be submitted to the Department for approval prior to implementation, and the subsequent results of the re-evaluation, and the remediation plan for any contracts found not to be suitable for any reason must be also be submitted to the Department for approval prior to implementation.</p>	19
9	It is recommended that the Company establish and maintain procedures to ensure that appropriate manual and automated methods, thresholds, and other factors are used to identify annuity contract sales that may pose a potential suitability issue and require additional review per R.I. Insurance Regulation 12, Section 6F(1)(d) prior to issuance. Contracts should be subjected to additional review by the Company, particularly when the sale involves a replacement by the producer, or an affiliate of the producer of the original contract.	22
10	It is recommended the Company establish and maintain procedures to ensure that the information necessary for the producer to have reasonable grounds to make a suitability recommendation per R.I. Insurance Regulation 12, Sections 6A and C is obtained from the applicant. It is further recommended that the Company monitor the collection of such evidence and that, in order to do so, the company require such information to be kept as part of the contract file. In addition, all contracts reviewed by the examiners that did not contain evidence of the necessary information and suitability recommendation must be remediated by the Company by making appropriate offers to the purchasers such as waiver of surrender charge and/or bonus vesting, etc. The remediation plan for these contracts must be submitted to the Department for approval prior to implementation.	22
11	It is recommended that the Company establish and maintain procedures to ensure that adequate information, as defined in R.I. Insurance Regulation 12, Section 6A, had been provided to the purchaser in order that they be reasonably informed of the products features, and that these	23

	features would be of benefit to them.	
12	It is recommended the Company establish and maintain procedures to ensure contract files reviewed contain evidence that adequate consideration was given to the net benefits of a change related to surrendering other contracts/policies per R.I. Insurance Regulation 12, Section 6A(4). In addition, the Department recommends that the Company review all annuity contracts sold in Rhode Island from January 1, 2014, through December 31, 2016 for the purpose of determining the potential number of contracts that were not subject to an adequate suitability assessment by the Company and/or its producers. If the Company chose not to conduct such an internal suitability review, the Department will consider conducting a follow-up examination focused on this issue. Any review must include the use of valid statistical sampling, and the testing plan must be submitted to the Department for approval prior to commencement. Upon completion of the internal review, the results are to be reported to the Department together with planned remediation for all contracts found not to meet appropriate suitability standards. The Department will review the results of the Company's internal review and perform verification procedures to ensure the validity of the testing process. Any further action necessary by the Company will be determined based upon the results of the Company's testing and the Department's verification procedures.	23
13	It is recommended that the Company review and test each of the examiners' observations and concerns noted above to determine that adequate policies and procedures are in place and that these are being adhered to by staff and/or producers as applicable. The Company shall report to the Department results of this review and testing and describe the enhancements needed, including a timeline for implementation. The Company should also provide an appropriate explanation for any of the above items that are not deemed to be in need of corrective actions.	26

CONCLUSION

We have applied examination procedures to the data and information contained in this report using the techniques deemed appropriate to support our findings and recommendations. While the examination procedures utilized do not give complete assurance that all errors and irregularities will be detected, those that were detected during the course of this examination have been disclosed in this report. Other than what has been noted in the body of this report, we were not informed of, and did not become aware of any errors or irregularities that could have a material effect on the market conduct practices and procedures of the Company as presented in this report.

EXAMINATION REPORT SUBMISSION

The examination was conducted by Brett Bache, Sarah Neil, Ericka Franzen of the Rhode Island Department of Business Regulation-Insurance Division and Shelly Schuman, J. Joseph Cohen and Lewis Bivona of INS Regulatory Insurance Services, Inc., and is respectfully submitted.

Respectfully submitted,



J. Joseph Cohen
Examiner in Charge