

**STATE OF MICHIGAN**

**DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES**



**MARKET CONDUCT EXAMINATION**

**NUMBER 2015C-0083**

**November 6, 2015**

***TARGETED MARKET CONDUCT EXAMINATION REPORT***

***OF***

***JEFFERSON NATIONAL LIFE INSURANCE COMPANY***

***DALLAS, TEXAS***

***NAIC COMPANY CODE 64017***

***For the Period January 1, 2013 through December 31, 2013***

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## **I. EXECUTIVE SUMMARY**

Jefferson National Life Insurance Company (the Company) is an authorized Texas domiciled company. This targeted examination was conducted by the Michigan Department of Insurance and Financial Services (DIFS) in conformance with the National Association of Insurance Commissioners (NAIC) *Market Regulation Handbook* (2014) (*Handbook*) and the Michigan Insurance Code, MCL 500.100 et seq. (the Code).

The examination covers the period January 1, 2013 to December 31, 2013 and was conducted under the supervision of Sherry J. Bass-Pohl, Manager of the Market Conduct Company Examination Unit.

DIFS conducted this examination in accordance with statutory authority of MCL 500.222 et seq. All Michigan laws, regulations and bulletins cited in this report may be viewed on the DIFS website at [www.michigan.gov/difs](http://www.michigan.gov/difs) or <http://www.legislature.mi.gov>. Note: Code citations may be sans specific statutory language when a statute is significantly long or a chapter is applied broadly to one or more standards (“et seq.” will then be used). However, statutory language may be included with certain citations, when and if there are findings, observations or discussion points within the report or management letter that benefit from specific reference.

This is a targeted examination of the Company’s individual variable annuity line of business, conducted remotely, as a result of the analysis of the Company’s NAIC Market Conduct Annual Statement (MCAS) submission.

### **Findings:**

There is one finding noted in this examination. The Company has failed to produce the required Report to Senior Management and this must be corrected.

### **Recommendations:**

The Company must produce the required Report to Senior Management as noted above. It is also recommended that the Company review their consumer outreach / suitability determination procedures to ensure that all contracts sold are suitable, and that the Company review its producer appointment procedures to avoid engaging in unappointed activity.

DIFS will follow up with analysis of the NAIC Market Conduct Annual Statement data submitted by the Company and with a request to produce the required Report to Senior Management in 2016.

### **Company Response:**

The Company will add to its compliance calendar to produce the required Report to Senior Management on an annual basis. The Company will also review its suitability procedures and appointment procedures for effectiveness.

## II. EXAMINATION FINDINGS AND RECOMMENDATIONS

### A. MARKETING AND SALES

**Standard 1:** All advertising and sales materials are in compliance with applicable statutes, rules and regulations. NAIC *Handbook*, Chapter 19.

**Standard 2:** The insurer's rules pertaining to producer requirements in connection with replacements are in compliance with applicable statutes, rules and regulations. NAIC *Handbook*, Chapter 19.

**Standard 3:** The insurer's rules pertaining to replacements are in compliance with applicable statutes, rules and regulations. NAIC *Handbook*, Chapter 19.

**Standard 5:** The insurer has suitability standards for its products, when required by applicable statutes, rules and regulations. NAIC *Handbook*, Chapter 19.

**Standard 9:** Insurer rules pertaining to producer requirements with regard to suitability in annuity transactions are in compliance with applicable statutes, rules and regulations. NAIC *Handbook*, Chapter 19.

**Standard 10:** Insurer rules pertaining to suitability in annuity transactions are in compliance with applicable statutes, rules and regulations. NAIC *Handbook*, Chapter 19.

**Standard 11:** The insurer has procedures in place to educate and monitor compliance with insurer-specific education and training requirements and with applicable statutes, rules and regulations regarding the solicitation, recommendation and sale of annuity products. NAIC *Handbook*, Chapter 19.

**Standard 12:** The insurer has product-specific training standards and materials designed to provide producers with adequate knowledge of the annuity products recommended prior to soliciting the sale of annuity products. The insurer must also have reasonable procedures in place to require its producers to comply with applicable producer training requirements. NAIC *Handbook*, Chapter 19.

The examiners asked the Company to respond to a series of interrogatory questions designed to assess the strength of the Company's annuity suitability verification program. Below, each question, the Company's response, and the examiner's analysis of that response is presented.

- 1) After reviewing the 2013 Market Conduct Annual Statement (MCAS) data, it appears that approximately 80.9% of all contracts issued were replacement contracts. Please explain the circumstances under which the Company allows a replacement contract to be sold.
- 2) The MCAS data also indicate that 14.0% of the Company's total replacement contracts are sold to annuitants over the age of 80. This is nearly three (3) times the national average. Please

provide an explanation as to why the Company sells so many replacement contracts to annuitants over the age of 80.

- 3) The MCAS data also indicate that 11.9% of the Company's deferred annuities are sold to annuitants over the age of 80. This is five (5) times the national average. Please provide an explanation as to why the Company sells so many deferred contracts to annuitants over the age of 80.

**Company Response:**

Examiner's Note: The Company did provide an acceptable answer to the above three (3) questions. However, due to the proprietary nature of the information contained within the response, it has not been included in this report.

**DIFS' Comment on Company Response:**

DIFS has no comment or recommendations with regards to the MCAS ratios at this time.

- 4) What specific factors does the Company consider when determining if an annuity is suitable for a specific applicant?

**Company Response:**

The Company does not speak with retail customers or give investment advice. Therefore, the Company is not performing suitability analysis for clients who are purchasing its variable annuity products. The Company does collect with each application a suitability form, and obtains certifications annually from a sampling of producers and investment advisors as to the process used to determine if Monument Advisor is appropriate for each client.

**DIFS' Comment on Company Response:**

Within the constraints of MCL 500.4158, the Company has a legal responsibility to ensure that every contract sold is suitable, even if relying on contractual relationships with its sale force. Based on the information provided to DIFS, it appears that the Company may have adequate procedures as required by law, but the Company may wish to examine their supervisory procedures annually to ensure that no unsuitable contracts are sold within the State of Michigan.

- 5) Does the Company allow the sale of an annuity if the applicant refuses to provide the necessary suitability information on the application? Please attach the Suitability form that the Company uses for Individual Variable Annuity sales in Michigan.

**Company Response:**

If the Company does not receive the signed suitability form from the applicant, it is deemed not in good order and is not issued.

**DIFS' Comment on Company Response:**

The Michigan Insurance Code does not specifically prohibit the sale of an annuity product to an individual who refuses to provide suitability information. However, the obvious opportunity for disguising an unsuitable sale makes this practice questionable. Refusing to sell an annuity contract in that situation could be considered a best practice for the industry.

- 6) Does the Company utilize a computer system with built-in suitability “red flags” to screen applications or is every application manually screened for suitability? Under what circumstances would the Company automatically reject an application or hold it for further review?

**Company Response:**

The Company does not utilize a computer system with built in suitability “red flags”. Each application is reviewed to ensure that the required suitability form has been completed, and signed, by the applicant. The Company would automatically reject an application if the owner was older than the maximum issue age allowed for the contract. Applications are held for further review if deemed not in good order.

**DIFS' Comment on Company Response:**

A computer system can speed up processing and help reduce human errors, and many companies use them for that reason. A multi-stage review of an application is also extremely effective with regards to ensuring the suitability of an annuity at the time of sale.

The Company's efforts to reduce unsuitable annuity sales by declining applications or holding them for additional review as named appear to be within best practice guidelines. DIFS has no recommendations with regards to application screening at this time.

- 7) Does the Company currently create a Report to Senior Management with regards to the internal annuity suitability supervision system in Michigan? If so, please attach a copy of the most recent report. If not, please attach a copy of the most recent internal audit report relevant to this line of business in Michigan. In this case, please detail why the Company does not currently produce a Report to Senior Management for Michigan. Does the Company have plans to generate this report in the future?

**Company Response:**

The Company does not currently create a report to senior management with regards to the annuity suitability supervision system in Michigan. A task will be added to the compliance calendar to ensure an annual report is sent to management and internal audit which outlines the producers who were required to take product specific training, as well as the annuity suitability course for Michigan.

**DIFS' Comment on Company Response:**

The Company appears to be in violation of MCL 500.4158(f), which requires that a Report to Senior Management be created at least annually. The Company must comply with this section by creating the report as required, which should contain at least the following: a detailed description of the Company's supervision system including all written procedures, any testing of that system which was conducted, numerical information with regards to the Company's treatment of applications, any changes that were made to the supervision system in the reporting year, and any complaints or actions taken against the Company regarding suitability.

8) How does the Company provide product-specific training to producers in Michigan?

**Company Response:**

The Company utilizes the RegEd Annuity Training Platform. The insurance producer creates a login to access the product specific training required by the Company.

**DIFS' Comment on Company Response:**

By providing training in this manner, it appears that the Company complies with the product-specific training requirement as noted in MCL 500.4158(c). DIFS has no recommendations or findings with regards to this question at this time.

9) Does the Company require continuing education with regard to the products offered? Please describe your supervision system which ensures that requirements are met, and that the producers are adequately explaining the terms and conditions of an annuity before submitting the application.

**Company Response:**

The Company only has one product which is actively offered in Michigan. When new features are added to this product, Monument Advisor, all producers are contacted, webinars are held, and brochures are created and sent to each producer. The Company communicates with producers on a regular basis to make sure they are knowledgeable of its product.

**DIFS' Comment on Company Response:**

Under MCL 500.4158(c), the Company must explain all material features of its products to its sales force. By providing continuing education when those products change, the Company appears to meet its responsibilities under the Michigan Insurance Code with regards to keeping producers up to date with the products they are expected to sell. DIFS has no recommendations or findings with regards to this question at this time.

10) Does the Company monitor its producers in terms of the suitability of applications they turn in to the Company, or those which frequently withdraw applications instead of allowing them to be rejected? Does the Company maintain a list of those producers with a higher than average number of unsuitable applications or withdrawals? Does the Company require additional product training for those producers to help them match the appropriate product with its target

demographic, or those which may require additional automatic scrutiny of the producer's submitted applications?

**Company Response:**

The Company does not monitor producers in terms of the suitability of applications they turn in to the Company, or those which frequently withdraw applications instead of allowing them to be rejected. We do, however, monitor free looks. The data is monitored quarterly, tracking date of occurrence, the owner, the producer, the amount free looked, the type (Account Value or Return of Premium – based on state regulations), and the state in which it occurred. This data can be analyzed for trends in producers and owners with multiple free looks.

**DIFS' Comment on Company Response:**

Monitoring free looks is a valid way of tracking producer suitability performance. DIFS has no recommendation with regards to this question at this time.

11) Are advertising pieces for Individual Fixed Annuities created by the Company or by the Company's producers? If created by producers, please describe the approval process utilized by the Company to ensure compliance with the Insurance Code of the State of Michigan, MCL 500.001 et seq.

**Company Response:**

Advertising pieces are only created by the Company.

**DIFS' Comment on Company Response:**

The Company appears to be compliant with MCL 500.2007. However, DIFS suggests that the Company specifically add producer social media for periodic monitoring. Non-compliant advertising materials, offers of illegal inducement, etc. can easily be sent without the Company being aware that it has occurred if the Company does not monitor the producer's social media output.

**B. UNDERWRITING AND RATING**

**Standard 5:** All forms, including contracts, riders, endorsements, and forms are filed with the insurance department, if applicable. NAIC *Handbook*, Chapter 16.

The examiners requested a description of all individual fixed annuity products available for purchase in Michigan during the exam period. This listing was used to verify that all products had been properly filed for use with DIFS.

**Findings:**

There are no findings or recommendations related to Underwriting and Rating. All Company contracts in use in Michigan during the exam period were properly filed with DIFS.

The examiners also asked the following interrogatory question with regards to the area of Underwriting and Rating:

12) For rejected applications, please describe the process the Company utilizes to verify the information provided. Does the Company ever directly contact the applicant or does the Company rely on the producer to verify? If no contact is made with the applicant, how does the Company ensure that they do not have diminished capacity which may prevent them from fully understanding the terms of the contract?

**Company Response:**

If the Company was going to reject an application based on the age of the owner, a customer service representative would contact the producer to verify the date of birth of the applicant. There may also be times in which the client is contacted, if the Company deems such contact to be necessary and appropriate.

**DIFS' Comment on Company Response:**

When an application is rejected, the possibility that a producer may simply modify the application to comply with the suitability check is of concern to DIFS. This may be especially prevalent in circumstances when the applicant may not have the capacity to understand all of the terms and conditions of the product they are being sold. DIFS considers it a best practice to make an effort to verify the application information with the applicant when the application is rejected.

DIFS recommends that the Company consider increasing the frequency of suitability outreach. Calling a sampling of applicants to ensure all suitability information provided is accurate and that the applicant understands the product for which they have applied should be considered a "best practice" by the industry.

**C. PRODUCER LICENSING**

**Standard 1:** Regulated entity records of licensed and appointed (if applicable) producers and in jurisdictions where applicable, licensed company or contracted independent adjusters agree with insurance department records. NAIC *Handbook*, Chapter 16.

**Standard 2:** The producers are properly licensed and appointed and have appropriate continuing education (if required by state law) in the jurisdiction where the application was taken. NAIC *Handbook*, Chapter 16.

The examiners requested a listing of all Michigan producers from whom the Company accepted applications during the exam period.

<b>File Data</b>	<b>Population Size</b>	<b>Maximum Number of Failures Permitted in Sample</b>	<b>Stage 1 Sample Size</b>	<b>Date Sample Pulled</b>	<b>Errors Found</b>
Michigan producers from whom the Company accepted business during the examination period	16	n/a	n/a	n/a	4

The examination team conducted a census review of all Michigan producers from whom the Company accepted business during the examination period by comparing Company-provided data against the DIFS internal producer licensing database.

**Findings:**

The Company appears to have accepted business from four (4) unappointed producers. The Company did note that these appointments had been rejected by the State of Michigan and provided proof of that rejection but that, due to an internal oversight, the errors were not corrected. They have been properly appointed now. No other errors were noted with regards to producer appointments.

**Recommendations:**

The Company should be aware that each of the four (4) unappointed producers would be considered a separate violation of MCL 500.1208a(2). It is recommended that the Company examine its producer appointment procedures to ensure that all producers are properly appointed before accepting business from them.

13) Please describe the commission structure used to pay producers who sell Individual Fixed Annuities for the Company. Does the commission vary depending on type of product sold or the manner in which it is funded, e.g. deferred versus immediate, 1035 exchange, etc.?

**Company Response:**

There is no variation of commission depending on the manner in which the product was funded. Note: Monument Advisor is the Company’s flagship product and no commissions are paid on this product. Advantage Strategy, Advantage Plus, and Advantage are no longer sold.

Examiners Note: The Company attached specific information regarding the commission structure in an Excel spreadsheet which has not been reproduced in this Examination Report.

**DIFS’ Comment on Company Response:**

The commission structure as outlined above appears to be compliant with the Michigan Insurance Code. The fact that the Company does not alter commission based on how the annuity is funded, and the reduction in commission paid for sales to the elderly are likely to aid the Company in

reducing the problems of “twisting” and “churning” in the annuity sales industry. DIFS has no recommendations or findings with regards to this question at this time.

### **III. ACKNOWLEDGEMENT**

This targeted examination report of Jefferson National Life Insurance Company is respectfully submitted to the Director of the Department of Insurance and Financial Services, State of Michigan.

The courteous cooperation and assistance of the officers and employees of the Company extended to the examiners during the course of the examination is hereby acknowledged.

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