

STATE OF MICHIGAN

DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES



MARKET CONDUCT EXAMINATION

NUMBER 2015C-0082

September 14, 2015

TARGETED MARKET CONDUCT EXAMINATION REPORT

OF

EQUITRUST LIFE INSURANCE COMPANY

CHICAGO, ILLINOIS

NAIC COMPANY CODE 62510

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

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I. EXECUTIVE SUMMARY

EquiTrust Life Insurance Company (the Company) is an authorized Illinois 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 or 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 fixed 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 with regards to the Company’s producer licensing practices which requires action to be taken by the Company.

Recommendations:

It is required under MCL 500.1208a(2) that the Company properly appoint all producers within fifteen (15) days of either signing an agency contract or from when the first insurance application is submitted. It is also recommended that the Company ensure that all data is accurate before filing the Market Conduct Annual Statement.

DIFS will conduct a follow-up review of the Company’s producer licensing records and analysis of the NAIC Market Conduct Annual Statement data submitted by the Company in 2016.

Company Response:

On August 12, 2015, EquiTrust appointed as agents the eight producers identified in the report as not having been previously appointed. EquiTrust has reviewed the remainder of the examination findings and makes no additional comment.

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 examination followed a pre-determined protocol of interrogatories developed by Market Conduct's subject matter expert (SME) for all fixed annuity companies identified through specific MCAS analysis. The interrogatories were designed to assess risk and evaluate compliance in the areas specifically related to the identified MCAS ratios, with an increased focus on suitability and suitability oversight programs and producer licensing. The questions and the Company's responses to those questions are reproduced below.

- 1) After reviewing the 2013 Market Conduct Annual Statement (MCAS) data, it appears that approximately 58.8% of all contracts issued were replacement contracts. Please explain the circumstances under which the Company allows a replacement contract to be sold.

Company Response:

Please note that EquiTrust filed correct MCAS data in January 2015 in a supplementary response to a Data Validation Notification received from the NAIC. EquiTrust discovered that the report used to gather the information for the MCAS misidentified transactions as *replacements* when they were not in fact replacements. This misidentification resulted in an over-reporting of replacements in the MCAS. The correct figures were submitted into the online submission tool prior to last day for submitting 2013 corrections.

Based on the corrected data, approximately 35.5% of all deferred contracts were replacement contracts.

With respect to the circumstances under which EquiTrust allows replacement contracts to be sold, the sale must be suitable. EquiTrust has a robust suitability review process to ensure that any replacements are suitable for the clients. The suitability is determined from reviewing the relevant circumstances of the case as indicated on the suitability and replacement documentation.

Further, EquiTrust sells primarily index annuities, which are an attractive product for older individuals who have already accumulated assets in other vehicles and would like to transition them into something without market exposure. In particular, as clients shift to retirement they are seeking options for the qualified funds they have accumulated in their employer plans during their working years. Additionally, our products offer features which were not available when clients originally purchased their insurance products. These factors contribute to EquiTrust's replacement ratio.

DIFS' Comment on Company Response:

It is vital that the Company provide accurate information when responding to MCAS. Given the discrepancy between the information initially provided in MCAS and the information provided here, DIFS asks the Company to take all necessary precautions to eliminate such errors for future MCAS reporting periods.

Other than the recommendation to ensure that MCAS data is accurate when filed, DIFS has no recommendations with regards to this question at this time.

- 2) The MCAS data also indicate that 100% of the Company's total surrendered contracts are surrendered after less than ten years in force. Please provide an explanation as to why the Company has so many surrendered contracts? What plans, if any, do you have in place to bring this number down?

Company Response:

EquiTrust's first full year selling annuities was in 2004. Therefore, only recently have EquiTrust products been in force longer than ten years. When the 2014 MCAS was filed reporting 2013 data, there were no products in force for ten years. As such, any surrender would necessarily be for a contract in force less than ten years.

As EquiTrust's in force business continues to mature the expectation is for an increase in surrenders greater than ten years and for the ratio to fall more in line with the state average.

DIFS' Comment on Company Response:

DIFS has no recommendations or findings with regards to this question at this time, but we will review the surrender ratio on future MCAS filings to see if it decreases as predicted.

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

Company Response:

EquiTrust's suitability program is based on the NAIC Suitability in Annuity Transactions Model Regulation. EquiTrust explains the suitability philosophy and expectations to agents in the Business Guidelines which all agents are to review annually. A copy of the Business Guidelines is enclosed and marked as Exhibit 2.

In order to make a suitability determination EquiTrust gathers suitability information from each applicant. The information includes the following:

- Age
- Annual Income
- Financial situation and needs, including the financial resources used for the funding of the annuity
- Financial experience
- Financial objectives
- Intended use of the annuity
- Financial time horizon
- Existing assets, including investment and life insurance holdings
- Liquidity needs
- Liquid net worth
- Risk tolerance
- Tax status

After the suitability information is gathered and submitted to EquiTrust, it is reviewed and a suitability determination is made.

DIFS' Comment on Company Response:

The specific suitability factors listed by the Company meet the requirements of the Michigan Insurance Code, specifically those factors required in MCL 500.4151(e). DIFS has no recommendations or findings with regards to this question at this time.

- 4) 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 Fixed Annuity sales in Michigan.

Company Response:

No. If the applicant declines to provide suitability information, then the application will be declined.

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.

- 5) 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:

EquiTrust does not utilize a computer system for suitability review. Each application is reviewed by a Financial Needs Analyst to determine if the proposed product is suitable for the client.

There are two categories of applications that will generally be declined automatically – if the applicant is replacing an annuity that has been in force for less than three years and if the applicant has a reverse mortgage.

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 as named, appear to be well within best practice guidelines. DIFS has no recommendations with regards to application screening at this time.

- 6) 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:

Yes, a report is created for senior management to review on a quarterly basis. The most recent report is from the first quarter of 2015 and enclosed and marked as Exhibit 3.

Examiners Note: The requested information has not been reproduced in this Examination Report.

DIFS' Comment on Company Response:

The Company report as provided appears to meet the requirements of MCL 500.4158(f). There are no findings or recommendations with regards to the Company's Report to Senior Management.

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

Company Response:

EquiTrust ensures that all agents, in all states, complete EquiTrust's product training prior to solicitation of EquiTrust's annuity products. This position is set forth in the Business Guidelines, which agents are to review on an annual basis. EquiTrust has a robust system in place to verify that agents have taken the required product training as well as the annuity CE training. The product training is conducted online using company created training modules.

When a potential agent submits their appointment application they receive an email providing them instructions to access EquiTrust's online product training. Once the training has been completed the agent has the opportunity to print a certificate signifying completion of the training and EquiTrust's internal records are updated to reflect that the product training has been completed. An agent's appointment will not become active until they complete product training.

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.

8) 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:

When EquiTrust introduces a new product, training on the new product is required before agents can solicit applications for it. Additionally, EquiTrust conducts webinars for agents explaining the features and benefits of the products offered by EquiTrust. Typically two webinars are offered a month, one for new agents and one for all agents.

Agents who have not completed the required product training will not be activated and are unable to solicit business until they have completed training. For agents appointed prior to the product training requirement, they receive an email once a month reminding them that product training must be completed prior to soliciting applications for EquiTrust products. This reminder is also sent to marketing organizations so they can work with their agents to have them complete the training. Once an agent has completed the product training, they are removed from the list to which the reminder is sent.

At the time of appointment, EquiTrust also works to make sure that the proposed agent has completed required state training, including the annuity CE training. Submitted CE certificates are verified to ensure that the training is an approved NAIC course. In cases where the training certification is not provided, EquiTrust will pull the CE certificate from the state website. If that is not possible, then EquiTrust will request that it be sent in. When an agent has not completed the necessary CE training, an email is sent to the agent's marketing organization that the agent needs to complete the CE training prior to soliciting business for EquiTrust.

EquiTrust works to confirm that the necessary training needed by agents is verified at the agent appointment stage. But, EquiTrust also has systems in place to verify the agent training has occurred when new applications are submitted. When a new application is submitted by an agent, EquiTrust reviews it to verify that the agent has taken the necessary training, both product training and CE training. If the necessary training has not been completed the agent is notified to verify that EquiTrust's records are accurate and up to date with respect to the agent's training. If they are accurate and the agent does not have the requisite training the application is declined and the funds returned.

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. The Company's system for verifying producer training appears to also be in compliance with MCL 500.4160(10). DIFS has no recommendations or findings with regards to this question at this time.

- 9) 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:

EquiTrust does not maintain a list of producers with a higher than average number of unsuitable applications. If during the course of a complaint investigation EquiTrust discovers that an agent is having issues complying with EquiTrust's Business Guidelines, particularly with ensuring suitability of their recommendations, a letter of education to the agent will be sent clarifying EquiTrust's expectations. Or, if circumstances are warrant, the agent's appointment will be terminated. As discussed above, all applications are reviewed for suitability by a Financial Needs Analyst.

DIFS' Comment on Company Response:

The Company's policy of individually scrutinizing every application may minimize the necessity of tracking producers as described above. DIFS has no recommendation with regards to this question at this time.

10) 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 created by both EquiTrust and agents. If an agent is creating an advertisement referencing an EquiTrust product or could lead a consumer to believe the advertisement is referring to an EquiTrust product it must be submitted to EquiTrust for review. Enclosed is EquiTrust's advertising review process marked as Exhibit 6. Information about EquiTrust's advertising review process is also summarized in the Business Guidelines.

Examiners Note: The requested information has not been reproduced in this Examination Report.

DIFS' Comment on Company Response:

After reviewing the Company's process as provided in Exhibit 6, the Company appears to have sufficient procedures in place to ensure compliance with MCL 500.2007. However, DIFS suggests that the Company specifically add producer social media to its list of websites 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.

11) 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:

EquiTrust pays commission at the rate and the conditions as set forth in the commission schedules provided to agents. A copy is enclosed and marked as Exhibit 5. EquiTrust offers 17 commission levels, with ninety percent of agents appointed at the MGA level. Commissions do vary on the type of product sold, but do not vary based on the manner in which they are funded. For certain annuities the age of the client can have an impact on the amount of the commission, where the commission is reduced for annuities purchased by clients at ages 81 -90.

Examiners Note: The Company attached the requested information 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.

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:

EquiTrust verifies suitability information for all applications, not just rejected applications. Confirmation letters are sent directly to the clients that contain the suitability information submitted with the application material. Clients are asked to review the information and, if there are any inaccuracies, make the necessary correction and send back [to] EquiTrust.

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. The Company exceeds this by individually contacting every applicant at the time of application. DIFS has no recommendations with regard to this question at this time.

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.

MCL 500.1208a(2):

To appoint a producer as its agent, the appointing insurer shall file, in a format approved by the commissioner, a notice of appointment for the qualifications held by the insurance producer within 15 days from the date the agency contract is executed or the first insurance application is submitted.

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

File Data	Population Size	Maximum Number of Failures Permitted in Sample	Stage 1 Sample Size	Date Sample Pulled	Errors Found
Michigan producers from whom the Company accepted business during the examination period	312	n/a	n/a	6/4/15	15

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. After this initial review, the team requested a list of every contract submitted by producers who appeared to be either unlicensed or unappointed at the date of business provided to determine the extent of the unappointed activity. The examination team’s findings are listed below.

Findings:

Of the 312 Michigan producers from whom the Company accepted business during the examination period, fifteen (15) were not properly appointed according to DIFS internal records within fifteen (15) days of the sale for at least one (1) contract, with a total of 29 contracts sold through those unappointed producers. Of the fifteen (15), eight (8) appear to have never been appointed by the Company.

Recommendations:

The Company should be aware that each of the 29 contracts mentioned above would be considered a separate violation of MCL 500.1208a(2). While the identified unappointed activity does not rise to the level of statistical significance and does not warrant an enforcement action at this time, DIFS expects that the eight (8) producers who have never been appointed with the Company will be appointed within fifteen (15) days of receiving this report. DIFS will verify that this has been done later this year and will conduct a followup examination of the Company’s producer licensing practices in 2016.

III. ACKNOWLEDGEMENT

This targeted examination report of EquiTrust 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.

In addition to the undersigned, Michael W. Draminski, MCM and Sherry L. Barrett, MCM, Market Conduct Examiners, also took part in this examination.

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