

STATE OF MICHIGAN
DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES



MARKET CONDUCT EXAMINATION

NUMBER 2015C-0085

July 9, 2015

TARGETED MARKET CONDUCT EXAMINATION REPORT

OF

MINNESOTA LIFE INSURANCE COMPANY

ST. PAUL, MINNESOTA

NAIC COMPANY CODE 66168

For the Period January 1, 2013 through December 31, 2014

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I. EXECUTIVE SUMMARY

Minnesota Life Insurance Company (the Company) is an authorized Michigan 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, 2014 and was conducted under the supervision of Sherry J. Bass-Pohl, Manager of the Market Conduct Company Examination Unit.

This is a targeted examination, conducted via email, as a result of the analysis of the Company's NAIC Market Conduct Annual Statement (MCAS) submission.

Findings:

There are no findings from this targeted examination.

Recommendations:

It is recommended that the Company improve its system for verifying their submitted MCAS data, consider an automated suitability system, verify information and product understanding with the applicant directly, and take action to clean up their producer database.

DIFS will follow up with analysis of the NAIC Market Conduct Annual Statement data submitted by the Company in 2016.

II. INTERROGATORY TO COMPANY

Following is each interrogatory provided to the Company, followed by the Company response and DIFS analysis of and commentary on that response:

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.

- 1) After reviewing the 2013 Market Conduct Annual Statement (MCAS) data, it appears that approximately 66.7% of all contracts issued were replacement contracts, more than three times the Michigan average. Please explain the circumstances under which the Company allows a replacement contract to be sold.

Company Response:

For 2013 Minnesota Life sold a total of 16 fixed contracts in Michigan; 10 immediate contracts and 6 deferred contracts. We had a total of 4 replacements. This results in a 25% replacement ratio. We believe this falls more closely into the Michigan average.

DIFS' Comment on Company Response:

The replacement data provided in response to this examination brings the Company's ratio into line with the Michigan market-wide average. However, 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, there is clearly an issue with the Company's reporting system. The Company needs to address this.

- 2) The MCAS data also indicate that 50% of the Company's total replacement contracts are sold to annuitants over the age of 80. This is more than five times the Michigan average. Please provide an explanation as to why the Company sells so many replacement contracts to annuitants over the age of 80?

Company Response:

Minnesota Life offers two deferred annuities one of which has a maximum issue age of 88 and one which has a maximum issue age of 90. Many of our peer companies have lower issue age maximum and also require the contracts to mature close to the 88 and 90 ages. As such we often find that seniors apply who could not get an annuity elsewhere. They are often looking to delay the election to annuitize in order to keep their funds tax deferred as long as possible. Furthermore, please note that there was 1 replacement in 2013 and 1 replacement in 2014 to applicants over the age of 80.

DIFS' Comment on Company Response:

The Company's Ratio 1 does not match the data reported herein. It appears that the Company may have an issue with the MCAS reporting system. The data reported in the previous question shows that four (4) replacements were made; the data provided in response to this question shows that one (1) of those was to an individual over 80. If the data provided in response to this examination is accurate, the Ratio 2 should be 0.25 not 0.5 as reported. Again, it is vital that the Company provide accurate data in response to MCAS.

The availability of an annuity product to an individual of such advanced age is usually a concern. However, the rationale behind offering these products is sound provided the Company has a stringent suitability program in place, which appears to be the case.

- 3) The MCAS data also indicate that 50% of the Company's deferred annuities are sold to annuitants over the age of 80. This is more than five times the Michigan average. Please provide an explanation as to why the Company sells so many deferred contracts to annuitants over the age of 80?

Company Response:

Minnesota Life offers two deferred annuities which have maximums age limits of either 88 or 90. We find that many companies have lower age limits and as such we get a higher percentage of clients in the upper age range. Also with only 8 deferred contracts issued the age distribution is not statistically credible.

DIFS' Comment on Company Response:

As previously stated, the availability of an annuity product to an individual of such advanced age is usually a concern. However, the Company's suitability protocol appears to mitigate these concerns.

- 4) The MCAS data also indicate that 72.7% 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:

Minnesota Life sold a large number of Multi-Year Guarantee (MYG) contracts with a 5 year guarantee period during 2008 and 2009. The contracts allow for surrender without Deferred Sales Charge (DSC) or Market Value Adjustment (MVA) at the end of the guarantee period. Many clients elected to surrender at the end of the period because interest crediting rates available at renewal were lower than the initial rate.

DIFS' Comment on Company Response:

The regulatory concern with regards to contracts surrendered after less than ten (10) years deals with the suitability of the initial sale as well as the amount of money lost upon surrender. Given the Company's suitability protocol, the first does not seem to apply at this time. The second concern is ameliorated by the fact that the penalty is diminished on these particular contracts.

- 5) Please give a brief description of the product development process currently in place in the Company. What measures do you take during the product development phase to help ensure that the products developed will be sold to suitable clients?

Company Response:

The product development process involves several multi-disciplinary groups that include representatives from marketing, sales, and administration. There is discussion in those groups about the product features and the target market. As marketing materials are developed, they are reviewed by multiple areas to ensure technical accuracy, compliance with regulatory requirements, and appropriate balance in how product features are represented. Training of the wholesaling staff is done by home office associates from actuarial, marketing and administration for new products or features.

DIFS' Comment on Company Response:

Bringing together all company compliance stakeholders allows the Company to develop products with a firm initial foundation of suitability. DIFS has no concerns with product development at this time.

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

Company Response:

The review is designed to determine if the sale is appropriate based on the client's investment needs, objectives and current financial situation. In addition, the review is designed to satisfy the NAIC Suitability in Annuity Transactions Model. The suitability factors we look at for Michigan applications include: age, annual income, financial situation and needs, including the financial resources used for funding 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 next worth, risk tolerance and tax status.

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).

- 7) 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:

Minnesota Life does not allow the sale of an annuity if the applicant refuses to provide necessary suitability information.

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. The Company is to be commended for engaging in the best practice of refusing to sell an annuity contract in that situation.

- 8) 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:

Minnesota Life does not use a computer system; all applications for suitability are screened by individuals in the annuity administration department. Since we do not have a computer system we do not automatically reject an application. An application could be held for missing information. Also, two suitability reviews are performed on applications from individuals over the age of 80.

DIFS' Comment on Company Response:

Given the small number of Company annuity sales in the State of Michigan, the manual screening system appears to be adequate. The two (2) separate suitability reviews performed on annuity applications from individuals over the age of 80 shows that the Company takes their responsibilities with an appropriate level of concern. The Company is encouraged to consider investing in an application screening computer system to help eliminate suitability errors.

- 9) 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:

Minnesota Life does create a Report to Senior Management. The 2013 report is attached. Please note that the 2014 report will be available in August. Please let us know if you would like to see the 2014 report when it's available.

DIFS' Comment on Company Response:

The Company report as provided appears to meet the requirements of MCL 500.4158(f).

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

Company Response:

Similar to other companies, we provide fixed annuity product training for producers through a web based platform hosted on the Company's website.

DIFS' Comment on Company Response:

By providing training in this matter, it appears that the Company complies with the product-specific training requirement as noted in MCL 500.4158(c).

11) 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 provides continuing product information as products are changed or updated. When there are significant product changes, producers must complete the new product training modules on our website. The producers are notified by e-mail about the changes and provided a link to our website to complete the new module.

If product changes are not as significant, an e-mail is sent to producers who have already taken the prior training. This e-mail contains a description of the product changes and explains the need to review to satisfy training requirements. For producers who have not yet taken the training, they must complete the new module prior to any sale.

Prior to the acceptance of any new application, there is a compliance check using our Central Licensing system which confirms that the producer is licensed, appointed in the required jurisdiction and that the appropriate product training was completed. If the producer has not completed the product training they are notified that the business cannot be accepted. They then must complete the required training before submitting new business.

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 be in compliance with MCL 500.4160(10).

12) 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 total number of fixed applications was 19 during the two years review period. The low volume of applications do not support a statistical trend. Also, please note that all producers are required to review and comply with the Company's policies and procedures regarding sales practices, which include suitability.

DIFS' Comment on Company Response:

DIFS acknowledges that the low number of applications in Michigan for the exam period negates the Company's opportunity to analyze the suitability performance of their individual producers. DIFS encourages the Company to monitor the suitability performance of its sales force.

13) 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:

Generally, advertising pieces created for Individual Fixed Annuities are created by the Company. It is the Company's general policy to have producers use Company created materials, especially product materials. However, we do allow producers to create materials such as client letters or general concept materials. If a producer does create material, they must work with the business unit's marketing area to have it reviewed and approved by home office compliance staff.

During the exam scope period, Minnesota Life has no record of materials being created by any Michigan producer related to its individual fixed annuities.

DIFS' Comment on Company Response:

DIFS has no comments in connection with this question.

B. UNDERWRITING AND RATING

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

Standard 1: Pertinent information on applications that form a part of the policy and contract is complete and accurate. NAIC *Handbook*, Chapter 19.

14) Please provide a brief description for each of the Company's Individual Fixed Annuity products available in Michigan during the exam period. Please be sure to describe each product's target demographic, any surrender period and penalties, deferment periods, fees and interest rates for each. Please also include the most recent SERFF Tracking Number proving that each annuity sold here has been approved for sale in Michigan.

Company Response:

Please see attached exhibit titled [MI Market Conduct – Item 5 Responses.xlsx].

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 Company provided a list of the three (3) Individual Fixed Annuity products which were available for sale in Michigan during the examination period. The listed products, as filed, have been properly approved for use within the State of Michigan. DIFS has no recommendations in connection with this question.

15) 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:

Minnesota Life does not have any procedures specific to rejected applications, we follow the same procedures for all applications. If we need additional information we work through the agent to get that information. We may ask for something in writing from the client, but generally that would be done via the agent. For clients age 60 and above we ask if a third party was involved in assisting the client.

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 is encouraged to consider creating such a program to help prevent elderly abuse and ensure all annuities are suitable at the time of sale.

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.

16) Please include a listing of all licensed Michigan producers from whom the Company accepted applications during the exam period. This listing should contain at least the following information for each appointed producer: name, address, NPN, date appointment, and date the Company first accepted business from the producer.

Company Response:

Please see the attached exhibit titled [*MI Market Conduct Exam Exhibit D - Exhibit.xlsx*].

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 Company provided a list of 22 producer names. The producers were checked against DIFS' internal producer appointment records. No appointment errors were found. It appears that the Company is in compliance with the Michigan Insurance Code with regards to producer appointments in Michigan.

It is noted, however, that several duplicate names appear in the list. It is recommended that the Company take action to clean up their producer records to eliminate potential confusion, commission payment errors, or potential appointment or continuing education issues in the future.

Recommendations:

It is recommended that the Company take the following actions with regards to Individual Fixed Annuity sales in Michigan:

- 1) Analyze and address the systematic errors that caused the Company to report incorrect information on the 2013 MCAS. Accurate data is vital for statistical analysis and the Company must ensure they provide accurate information.
- 2) Consider investing in an application screening computer system. Automated systems can help flag suitability issues in companies by minimizing human error.
- 3) Consider adopting an applicant outreach program whereby the Company contacts the applicant directly to verify information and to confirm that they in fact understand what they have applied to purchase. This may help prevent unsuitable sales and the potential for elder abuse.
- 4) Remove duplicates from the producer database to prevent errors in commission, continuing education/appointments, and the possibility of unlicensed activity.

Company Responses to Recommendations:

- 1) As a result of a review of your recommendation and the Company data provided, it was discovered that year end 2014 data was inadvertently provided in our response to Question #1; rather than year end 2013 data as requested. This error impacted your review of both question #1 and #2 of the survey.

In summary, we believe that the data submitted as part of the MCAS in 2013 and in 2014 is accurate and we apologize for any confusion this error may have caused.

- 2) The Company appreciates this feedback and will take this recommendation under advisement.
- 3) The Company is actively working to develop and implement a program similar to the program described in this recommendation.
- 4) The Company has reviewed its producer database and has confirmed that the data included is accurate and complete.

DIFS will follow up with analysis of the NAIC Market Conduct Annual Statement data submitted by the Company in 2016.

III. ACKNOWLEDGEMENT

This targeted examination report of Minnesota 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.

Zachary J. Dillinger, MCM
Examiner-in-Charge
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