

MARKET CONDUCT EXAMINATION REPORT

of

**ALLSTATE LIFE INSURANCE COMPANY
Northbrook, Illinois**

As of

AUGUST 31, 2002

By

**VERMONT DEPARTMENT OF BANKING,
INSURANCE, SECURITIES AND HEALTH CARE
ADMINISTRATION**



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December 19, 2003

The Honorable John Crowley
Commissioner
Vermont Department of Banking, Insurance,
Securities and Health Care Administration
89 Main Street, Drawer 20
Montpelier, Vermont 05620

Dear Commissioner Crowley:

Pursuant to your instructions and in compliance with the provisions of 8 V.S.A. § 3565 et seq. and procedures promulgated by the National Association of Insurance Commissioners, an examination of the market conduct activities has been conducted of:

Allstate Life Insurance Company, NAIC # 60186
3100 Sanders Road
Northbrook, Illinois, 60062-7154

The report thereon, as of August 31, 2002, is respectfully submitted.

FOREWORD

This target market conduct examination report is written generally by exception and additional practices, procedures and files subject to review during the examination were omitted from the report if no improprieties were observed.

The Allstate Life Insurance Company is referred to throughout this report as the “Company” unless specifically mentioned by name. The Vermont Department of Banking, Insurance, Securities and Health Care Administration is referred to as the “Department” or the “Vermont Department”.

The Company’s responses, with respect to the findings of this examination, will be made available upon written request to the Vermont Department.

The examiners wish to acknowledge the exceptional cooperation of the Compliance Directors in facilitating the examination’s process.

SCOPE OF EXAMINATION

EXAMINATION AUTHORITY

The examination of Allstate Life Insurance Company was conducted pursuant to applicable Vermont statutes and regulations.

TIME FRAME

The examination generally covers the period from January 1, 1999 through August 31, 2002.

SAMPLING METHODOLOGY

The examiners used random sampling techniques, utilizing ACL software to determine sample sizes sufficient to achieve a minimum confidence level of 95%. The statistical error tolerance level is 10%, except for claim procedures where the tolerance level is 7%. These standards are in compliance with those established by the National Association of Insurance Commissioners.

The use of 10% and 7% tolerance levels does not signify in any way that the Vermont Department is tolerant of any violations of law. The tolerance levels are merely statistical parameters established for the sole purpose of reducing the estimated number of errors in the total population to allow a margin for possible statistical differences between the percentage of errors in the sample and the percentage of errors in the total population.

EXAMINATION SITUS

The Company's statutory home office is located at 3100 Sanders Road, Northbrook, Illinois 60062-7154, however this examination was conducted entirely off-site. Information, documents and other materials were provided directly to the examiners in hard copy and/or computer diskettes.

MATTERS EXAMINED

Marketing and sales

Consumer complaints

Claims procedures and processing

Replacement procedures

PREVIOUS EXAMINATIONS

The Vermont Department did not conduct an examination of the Company during the last five years.

EXECUTIVE SUMMARY

This was a target examination focused primarily on marketing and sales, claims processing and replacement procedures covering the period from January 1, 1999 through August 31, 2002.

With a few exceptions, the Company has never paid any interest on death claim proceeds, notwithstanding a statutory requirement of 6% interest accrued from the date of death to the date of payment. In cases where the proceeds were not paid on a timely basis, the statutory interest is at 12%. The violations will necessitate substantial corrective action.

The Company failed to establish a monitoring system to insure that producers, whom they appoint, comply with suitability standards.

There was an estimated total of eighty-eight (88) violations of replacement regulations over the examination period.

Various violations were committed with regard to the marketing of individual five-year renewable term policies on a direct response basis to credit cardholders of specific card issuing companies. These consisted of rebating, failure to comply with applicable replacement regulations and unlawful inquiry regarding past HIV related tests.

COMPANY PROFILE

HISTORY

The Company was incorporated as a stock life insurance company under the laws of the state of Illinois on March 6, 1957 and commenced business on September 3, 1957.

Allstate Life Insurance Company is a wholly owned subsidiary of Allstate Insurance Company, which, in turn, is a wholly owned subsidiary of the Allstate Corporation, a Delaware holding company.

Allstate Insurance Company had been a wholly owned subsidiary of Sears, Roebuck and Company until 1993, when it sold 20% of its insurance operations through an initial public offering. Sears spun off the remaining 80% in 1995.

Sales are through a multi-channel distribution system that includes Allstate agencies, independent brokers and agencies, financial institutions such as securities firms and banks.

The Company is licensed in all of the states (except New York), the District of Columbia and Puerto Rico.

STATUTORY HOME OFFICE

3100 Sanders Road
Northbrook, Illinois 60062-7154

VERMONT REPORTED PREMIUMS

	1999	2000	2001
Life	1,040,971	1,022,700	1,076,473
Annuity	872,604	3,037,095	2,113,704
A & H	51,295	239,449	311,380
Deposit Funds	0	0	0
Total	\$1,964,870	\$4,299,244	\$3,501,557

The increase of 118% in premiums between 1999 and 2000 was primarily attributable to an increase in variable annuity sales through a marketing agreement entered into in 1999 with Putnam Investments. The contracts are referred to as the Putnam Allstate Advisor plans.

The examiners observed that Vermont annuity premiums reported by the Company increased by 248% between 1999 and 2000, broken down by line of business as shown below. This was attributable entirely to growth in the sales of variable annuities.

<u>Product</u>	1999	2000
Institutional Business ABO	5,977	0
Allstate Agent Variable Annuity	0	442,194
Allstate Agent Fixed Annuity	574,526	138,215
Putnam Variable Annuity	292,101	2,456,686
<u>Total</u>	872,604	3,037,095

CLAIMS PROCEDURES AND PROCESSING

FAILURE TO PAY STATUTORY INTEREST

The examiners reviewed all individual paid life claim files processed during the examination period. The review revealed that it is the Company's practice to pay interest on death claim proceeds only if the claim remains unsettled after thirty (30) days from receipt of proof of loss. The examiners inquired as to whether the Company had ever paid interest on life claims in those cases where the death proceeds are paid within the thirty (30) day period from receipt of the proof of loss to date paid. The Company responded that "to the best of our knowledge, no."

8 V.S.A. § 3665 (c) (2) clearly states "All payments of claims under policies of life insurance shall include interest accrued from the date of death of the insured. The interest rate shall be the rate paid on proceeds left on deposit, or six percent whichever rate is greater." The Company's failure to apply the statutorily required rate of 6% accrued from the date of death to the date of payment is in violation of 8 V.S.A. § 3665 (c) (2).

Additionally, it has not been the Company's practice to apply the statutory rate of 12% in those cases where the Company may have improperly delayed payment of a claim, in accordance with 8 V.S.A. § 3665 (d).

CLAIMS PROCESSED DURING THE EXAMINATION PERIOD

A total of seventeen (17) claim files were reviewed. Of the seventeen (17), only one claim was paid that included additional interest. This was claim # 774805652, whereby two of the four beneficiaries received interest at the rate of 6% in that their claim was not settled thirty (30) days from receipt of proof of loss.

RECOMMENDED CORRECTIVE ACTION

Since the Company has apparently failed to pay any interest on most individual life insurance claims and insufficient interest on the others since 1987 (date the statutory requirement became effective), it is recommended that the Company take the following corrective action:

1. Go back as far as sufficient records are available and calculate the amount of interest that should have been included when the claim was paid. Add additional interest at the rate of 12% simple interest per annum to the amount of interest that should have been paid originally, from the date the claim was paid until the present.

2. If there is any period for which sufficient records are not available to make the individual calculations described in (1) above, an aggregate estimated amount should be calculated for such period, based on annual statement figures.
3. Payments calculated as described in (1) above should be mailed to the last known addresses of such beneficiaries together with a form letter, approved by the Vermont Department, explaining the reason for making the additional payments.
4. In those cases where the checks are returned and the beneficiaries cannot be located, such amounts together with the sums described in (2) above should be processed in accordance with 27 V.S.A. § 1208 et seq. (Unclaimed Property Act) of the State of Vermont.

See Appendix I

SALES AND MARKETING

SUITABILITY

Upon inquiry by the examiners regarding the Company's compliance with Vermont insurance statutes and regulations governing suitability, the Company responded in part as follows:

With regard to our agents, we firmly believe that they do conduct their sales in compliance with Sec. 4724 and Bulletin 129. As described in my previous letter, our registered agents complete a New Account Form and have the customer read and sign a Customer Acknowledgment Form, which are tools designed to help agents assure that variable product sales are suitable. Similar procedures are employed throughout the securities industry. All broker-dealer firms with which we have selling agreements are legally required and contractually obligated to Allstate Life or Lincoln Benefit Life, as the case may be, to supervise their registered representatives for compliance with the applicable NASD and SEC rules, including suitability requirements.

Although the Company did state that they had a suitability statement in their contract with the contracted financial services firm, they indicated that they did not have a monitoring system in place to insure that producers, which they appoint, were complying with their standards.

Without any procedure to monitor the suitability issues, the Company will have no method to determine if the appointed producers are complying with their standards. The Company can contract the sales function to others but they still are responsible for compliance with suitability regulations. Although the agents are engaged by the contracted financial services firms, they are still appointed by the Company. Under 8 V.S.A. § 48131. (b) appointed producers are agents of the insurer. Title 8 V.S.A. § 4813c provides that every insurance producer acting as an agent of an insurer, who sells insurance of any kind, will be regarded as representing the insurer. Therefore the Company is directly responsible for the actions of its appointed agents notwithstanding any other employment of such agents.

Vermont law is clear concerning the importance of the suitability issues as demonstrated by 8 V.S.A. § 4724 (16), and Vermont Bulletin 129. Since the appointed agent acts as the representative for the insurer as described in Vermont Statute 8 V.S.A. § 4813c, the Company has an obligation to monitor the suitability standards used by its appointed agents.

It is recommended that the Company establish suitability guidelines and procedures for the contracted financial services firms and establish a monitoring system to assure that all appointed producers are following these guidelines.

DIRECT RESPONSE

The Company markets individual five-year renewable term life insurance policies that are offered to credit cardholders of specific card issuing companies. The examiners noted the following violations of Vermont insurance laws with regard to these programs.

Use of Unlicensed Telemarketers

The Company uses telemarketing service representatives to solicit this business by telephone. Although these TSR's are permitted to solicit and explain the benefits and/or details of the policies, they are not properly licensed and appointed as required by 8 V.S.A. § 4793 (a).

The examiners recommend that the Company immediately discontinue using any telemarketers who are not licensed in full compliance with 8 V.S.A. § 4793 (a) to solicit or explain benefits or details of the policy.

Rebate of Initial Premiums

The TSR's inform prospects that the first two months of coverage are at no cost to them complements of the specific credit card issuing company. The premium is \$1.00 for the initial two months of coverage.

Since this coverage is provided by individual policies in Vermont, as opposed to group coverage in most of the other states, the credit card issuing companies are not parties to the contract of insurance. Thus, their payment of the initial two months premium, or offering to do so, would constitute rebates, in violation of 8 V.S.A. § 4724 (8).

The examiners recommend that the Company immediately discontinue offering these illegal rebates to Vermont residents as an inducement to insure.

Failure to Comply with Vermont Regulation 2001-3 §7

The examiners informed the Company that they could find no evidence of their compliance with applicable replacement regulations for this program. The Company's response was that Direct Response does not engage in replacement activity since this plan is not intended to replace any existing policy.

The examiners find that the Company's intent does not exempt them from complying with the provisions of Vermont Regulation 2001-3 § 7, Duties Of Insurers With Respect To Direct Response Solicitations.

The Company should take immediate steps to comply with Vermont Regulation 2001-3 § 7.

Unlawful Inquiry Regarding Past Testing for HIV Related Illness

According to the script utilized in soliciting this business, the TSR's are required to ask the following question:

Have you ever sought or received medical or surgical advice or treatment for Acquired Immune Deficiency Syndrome (AIDS), or tested positive on a AIDS related blood test?

The examiners find that the asking of this question would constitute a violation of 8 V.S.A. § 4724 (20) (A), which reads:

(A) No person shall request or require that a person reveal having taken HIV-related tests in the past."

The examiners recommend that the Company immediately discontinue asking any questions in which a person is required to reveal having taken HIV-related tests in the past.

REPLACEMENTS

The examination included tests on various samples in order to determine compliance with Vermont replacement statutes and regulations. The samples consisted of policies and contracts issued with effective dates between 1-1-99 and 12-31-01. The samples chosen for this review also included all replacements recorded from 1-1-02 to 11-20-02.

Those policies/contracts that were issued prior to 3-1-02 were tested for compliance with Vermont Replacement Regulation 88-2 and those policies/contracts that were issued after 3-1-02, were tested for compliance with Vermont Regulation 2001-3 (Life Insurance & Annuity Replacement Regulation) effective 3-1-02.

SAMPLE I PUTNAM/ALLSTATE

A random sample of fifty (50) variable annuities from a population of one hundred (100) was selected for this compliance review.

Violations of Vermont Replacement Regulations as noted in the review are listed in the table below.

Policy/Contract #	Application Date	Violation
PA00078893	6-21-02	2001-3 § 3 B, C, D, 2001-3 § 4 A. (4), D, G, 2001-3 § 5 A (1), (2)
PA00076793	7-13-02	2001-3 § 3 B, C, D & 2001-3 § 4 D, E, F & G
PA00076983	7-24-02	2001-3 § 3 B, C, D & 2001-3 § 4 D, E, F & G
PA00075892	4-24-02	2001-3 § 3 B, C, D & 2001-3 § 4 D, E, F & G
PA00076220	5-3-02	2001-3 § 3 A & 2001-3 § 4 C
PA00069664	2-4-02	88-2 § 6 B 1 & 88-2 § 8 B 1
PA00022061	No App. Issue date 3-27-00	88-2 § 6 A 1 & 2, 88-2 § 8 A

See Appendix II for additional comments

There are a total of thirty seven (37) separate violations listed in the above chart. Since the total sample consisted of fifty (50) policies, this would mean that the average number of violations per policy, in the sample, is .74. Applying this average to the total population of one hundred (100) policies would give an estimate of seventy four (74) total violations. Reducing the seventy four (74) violation by 10% to account for the 10%

tolerance level included in the examiners' sampling methodology would bring the final number to sixty six (66) estimated violations of the replacement regulations.

REPLACEMENTS RECORDED

Violations of Vermont Replacement Regulations as noted in the review of recorded replacements from 3-1-02 to 11-20-02 are listed in the following tables.

Allstate Life Insurance Replacements

Policy/Contract #	Application Date	Violation
712204737	4-11-02	§ 3B, 3E, 4D, 5A(1), 5A(4),
709315121	9-19-02	§ 3B, 3E,4D,5A(1), 5A(4)
709321715P	10-9-02	§ 3B, 4D, 5A (1), 5A (4)

Allstate Annuity Replacements

Policy/Contract #	Application Date	Violation
795918452	3-19-02	§ 3A, 3B, 3E, 4C, 4D, 5A (1), 5A (4), 5C (2)

See Appendix II for additional comments

Electronic Signature Transmission

In some situations the Company employed a procedure whereby an "e-app" was used in applying for life insurance. Both the applicant's and the producer's signatures are taken through an electronic signature pad and subsequently affixed, by the Company, to the application and various related documents.

Vermont Regulation 2001-3, governing life insurance and annuities replacement, requires the signatures of both the applicant and the producer on certain specified documents pertaining to the replacement transaction.

The question therefore arises as to whether or not the affixing of "electronic signatures" by the Company to these documents would fulfill the "signature requirements" of Vermont Regulation 2001-3.

The Company subsequently discontinued the practice of accepting electronic applications as part of their new business process.

Remote Policy Entry

The Company utilizes an electronic means of policy issuance (Remote Policy Entry) with regard to some of the contracts issued through Allstate/Putnam's broker dealers. All information required to issue a contract (client information, product selection, allocation information, etc.) is included in the electronic record transmitted to the Company's Service Center. This method of issuance does not comply with Vermont's Replacement Regulation 2001-3 § 4 C, which requires with or as a part of each application for life insurance or annuity a signed statement by both the applicant and the producer as to whether the applicant has existing policies or contracts.

The examiners recommend that the Company revise this method of contract transmittal and issuance in accordance with Vermont's Replacement Regulation 2001-3.

INTERNAL AUDITS

As a part of the examiners' review, a request was made of the Company for a listing of all internal audits conducted during the period under examination and a copy of all compliance audit reports covering the examination period.

The Company complied with the examiners' request for a listing of all internal audits conducted by them but denied the request for copies of the compliance audit reports.

The Company's stated grounds for denial of the examiners' request for copies of the compliance audit reports were as follows.

Please note that several of the internal audits on the attached list, which includes all the compliance audits, were conducted at the direction of the companies' General Counsel and are protected by the work product doctrine, the attorney-client privilege, and the insurance compliance self-evaluative privilege. We are unable to provide you with copies of such privileged compliance audits because the voluntary disclosure to the Vermont Insurance Department or its examiners would result in a waiver of these privileges. We will gladly make all the underlying documents and insurance records available to you for testing, analysis, and review. However, because of legal and public policy considerations, the requested internal compliance audits are not being provided in order to maintain their privileged character."

The Company also included a more detailed discussion of their position as summarized above.

The examiners question whether the Company's refusal, to furnish copies of the requested compliance audit reports constitutes violations of 8 V.S.A. § 3565 (b).

It is suggested that the Vermont Department's legal counsel may wish to review this issue.

FINES, PENALTIES & FORFEITURES

The Company failed to file a listing of reportable administrative actions between the insurer and state insurance departments for each of the years 1999, 2000 and 2001, as required by Vermont Bulletin 30.

Upon reviewing the listing provided to the examiners, it was noted that the Company incurred a total of six fines by various states over the period 1-1-99 to 10-31-02. All of the fines were \$10,000 or under except for a \$200,000 administrative fine paid to the state of Nevada on December 30, 2000, stemming from a 1998 market conduct examination. The examiners requested and reviewed the Nevada report for purposes of identifying any issues, which may also have a bearing on the Company's operations in Vermont. Any issues that might also be applicable to Vermont were reviewed and included in this report.

POLICY LOAN INTEREST

The maximum policy loan fixed interest rate permitted by section 8 V.S.A. § 3731 (7) (A) (i) is 8% per annum. This is the same maximum rate specified in the Company's universal type policies as well as the rate, which the Company is actually charging for policy loans on its universal type life insurance policies.

In addition to paying policy loan interest, the policyholder incurs an additional cost for the policy loan under situations where the Company credits a lower rate of interest to the loaned portion of the accumulation value, than it does to the unloaned portion.

The total cost of the policy loan would therefore equal 8% plus the amount by which the Company reduced the rate which it would otherwise have credited to the accumulation value had there been no policy loan. As an example, assume that the Company's current crediting rate is 5% on the unloaned portion of the accumulation value and 4.5% on the loaned portion. By taking out a policy loan, the insured would lose ½% interest on the portion of accumulation value equal to the loan amount. Thus, the actual net cost of the policy loan would be 8.5% which is in excess of the maximum 8% rate permitted by statute.

The Company contends that the statute regulates the maximum interest that may be charged on a life insurance policy loan and that the additional cost described above is not loan interest, and therefore, not relevant to the statute. The examiners, on the other hand, believe that the statute would be completely meaningless if the total net cost of the loan could be increased beyond the 8% maximum interest rate permitted by the statute if the Company could do so by simply reducing the crediting rate on a portion of the policy value equal to the loan amount. It would make little, if any, difference to a borrower as to whether he or she paid more interest on the loan amount or received less interest credited to the very same amount.

CONSUMER COMPLAINTS

The Company failed to file annual reports concerning its Vermont complaints with the Commissioner as required by Vermont Regulation 76-1 § 5, for any of the years covered by this examination. Upon bringing this to the Company's attention, the Company responded that they would develop and implement procedures for filing consumer complaint reports annually with the Vermont Department of Insurance, in accordance with Regulation 76-1.

The Company reported having received only eight (8) consumer complaints during the examination period. The examiners reviewed the files and did not find any evidence of intentional mistreatment of policyholders.

SUMMARY OF RECOMMENDATIONS

1.

Page 8

The Company should revise its practices so as to apply the statutory rate (currently 12%) in those cases where it may have improperly delayed payment of a claim, in accordance with 8 V.S.A. § 3665 (d)

2.

Page 8

Since the Company has apparently failed to pay any interest on most individual life insurance claims and insufficient interest on the others for a period of forty-six (46) years. It is recommended that the Company take the following corrective action:

A. Go back as far as sufficient records are available and calculate the amount of interest that should have been included when the claim was paid. Add additional interest at the rate of 12% simple interest per annum to the amount of interest that should have been paid originally, from the date the claim was paid until the present.

B. If there is any period for which sufficient records are not available to make the calculations described in (A) above, an aggregate amount should be calculated for such period.

C. Payments calculated as described in (A) above should be mailed to the latest known addresses of such beneficiaries together with a form letter, approved by the Vermont Department, explaining the reason for making the additional payments.

D. In those cases where the checks are returned and the beneficiaries cannot be located, such amounts together with the sums described in (B) above should be processed in accordance with 27 V.S.A. § 1208 et seq. (Unclaimed Property Act) of the state of Vermont.

3.

Page 10

It is recommended that the Company establish suitability guidelines and procedures for the contracted financial services firms and establish a monitoring system to assure that all appointed producers are following these guidelines.

4.

Page 11

The examiners recommend that the Company discontinue using any telemarketers who are not licensed in full compliance with 8 V.S.A. § 4793 (a).

5.

Page 11

The Company should immediately discontinue offering the first two months of coverage at no cost to the insured, in violation of 8 V.S.A. 4724 (8).

6.

Page 11

The Company should amend its procedures for marketing direct response life insurance so as to comply with Vermont Regulation 2001-3 § 7.

7.

Page 12

The examiners recommend that the Company immediately discontinue the practice of asking questions of applicants, which require such persons to reveal having taken HIV-related tests in the past.

8.

Page 13

Although most of the violations of Vermont Regulation 2001-3 occurred when the regulation first became effective in March, 2002 and shortly thereafter i.e., when it was first being implemented, it is recommended that the procedures be reviewed to insure that they are all being followed.

9.

Page 14

The examiners suggest that the Department's legal counsel may wish to review the issue of whether or not the affixing of "electronic signatures" by the Company to replacement documents would fulfill the "signature requirements" of Vermont Regulation 2001-3.

10.

Page 15

The Company should revise its present "Remote Policy Entry" procedures to bring them into compliance with Vermont Regulation 2001-3.

11.

Page 16

It is suggested that the Vermont Department's legal counsel may wish to review the Company's stated grounds for denial of examiners' request for copies of their compliance audit reports.

12.

Page 18

The examiners recommend that the Company revise its procedures to insure that the actual net cost of its policy loans do not exceed 8%.

APPENDIX I

Claim

774792027

774792102

774794046

774794551

774795074

774796355 (involved two claims-same claim #)

774799057

774799316

774801615

774804339

774804668

774804755

774805652

774807711

774808860

774809602

APPENDIX II

Replacements

Sample I Putnam/Allstate

Policy/Contract #	Comments
PA00078893 PA00076983 PA00075892	There are existing policies/contracts- however, no replacement form was completed
PA00076793	IRA transfer-no replacement form provided
PA 00076220	No signed statement as to whether or not there are existing contracts/policies
PA00022061	No signed statement as to whether or not this is a replacement
PA00069664	This is a replacement, however, no form was provided

Allstate Life Ins. Replacements

Policy/Contract #	Comments
712204737 709315121 709321715P	Used old replacement forms

Allstate Annuity Replacements

Policy/Contract #	Comments
795918452	Treated as though it was not a replacement