

3. On December 19, 2003, a final market conduct examination report was issued by examiners Robbie L. Kriplean and James Montgomery entitled 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 (the "Report").

4. In accordance with the requirements of 8 V.S.A. § 3574(b), the Report was transmitted to the Company and the Company was afforded a reasonable period of time to submit a formal written response to the findings of the Report. The Company submitted a formal response (the "Response") dated January 23, 2004 addressing the issues raised the Report, discussed issues with the Department and provided additional information as requested by the Department.

5. Pursuant to 8 V.S.A. § 3574(c), the undersigned Commissioner has fully considered the Report, the Response and additional information provided.

CONCLUSIONS OF LAW

6. In the **CLAIMS PROCEDURES AND PROCESSING** section of the Report (pages 8 – 9), the examiners note that the Company appears to have failed to pay statutory interest as required by 8 V.S.A. § 3665. Specifically, Company policy was to not pay any interest on death benefits unless the claim was not settled within 30 days of receipt of proof of loss. This violates 8 V.S.A. § 3665(c)(2) which requires that interest be paid from the date of the death of the insured at six percent per annum. Further, the examiners note that the Company did not pay 12% interest for claims which were not settled in a timely manner, pursuant to 8 V.S.A § 3665(d).

In light of the their findings, the examiners recommend the Company revise its procedures to ensure interest shall be paid on life insurance benefits in the future. (Recommendation No. 2, Report at page 20.) Further, the examiners recommend four corrective actions for the Company. (Report at pages 8-9; Recommendations No. 2.A through D, Report at page 20.) The examiners recommend that the Company “[g]o back as far as sufficient records are available” and calculate proper amounts due. (Report at page 8; Recommendation No. 2.A, Report at page 20.) For those periods when records are not available, the examiners recommend the Company calculate an estimated aggregate amount based on annual statement figures. The examiners then recommend the Company mail the appropriate interest to beneficiaries and escheat unclaimed funds to the Abandoned Property Division of the Treasurer’s Office pursuant to 27 V.S.A. § 1208 *et seq.*

In response, the Company notes 8 V.S.A. § 3665 is “somewhat ambiguous” (Response at page 1), but the Company has revised its procedures accordingly. Further, the Company indicates it is in the process of taking the steps required to implement the corrective action recommended by the examiners.¹ (Response at page 2.)

Upon consideration, the undersigned adopts this portion of the Report and the examiners’ recommendation. It appears the Company has taken significant steps to comply with the examiners’ recommendations. No later than March 14, 2005, the Company shall provide the Department with a spreadsheet detailing the payments made for the Department’s review. Upon approval of the Company’s calculations, the

¹ The Company requests that the examiners’ reference to the Company not paying interest on claims for 47 years should be removed from the Report because 8 V.S.A. § 3665 was not enacted until 1987. The Report does not refer to 47 years, so it’s unclear to what the Company is referring and it appears the Report complies with the Company’s request. In any event, the Company would not be required to comply with 8 V.S.A. § 3665 until that statute was enacted.

Company shall promptly make the payments as detailed and provide the Department with written confirmation that such payments have been made. Upon completion of the payments (including escheating those funds which cannot be refunded), the Company shall have satisfied the examiners' recommendations.

In light of the Company's proactive approach to the problem upon the examiners' discovery, the undersigned concludes administrative penalties are not warranted in this situation.

7. In the **SALES AND MARKETING – SUITABILITY** section of the Report, the examiners note that although the Company contractually obligates its producers to only sell suitable products, the Company does not have a monitoring system in place to ensure that the Company's appointed producers are complying with Company suitability standards. (Report at page 10.) The examiners recommend 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 the guidelines. (Report at page 10; Recommendation No. 3, Report at page 20.)

In response, the Company disputes that it is legally obligated to monitor its producers in light of the fact the producers are contractually obligated to comply with the law (Response at page 3). Nonetheless, the Company indicates it intends to take several steps to monitor producer compliance more closely. For example, the Company indicates that beginning March 2004, it shall use customer surveys which specifically ask if the customer was asked about his or her current financial situation. Further, the Company indicates that it will be "conducting analyses using freelook and complaint reports in an

effort to identify any trends that may reflect the contracted financial services firms are not following compliance requirements.” *Id.*

Upon consideration, the undersigned adopts this portion of the Report and the examiners’ recommendation. The undersigned notes that the Company is mistaken that it has no legal obligation to ensure its producers’ compliance with Vermont’s suitability guidelines. As an appointed producer selling the Company’s products, the Company must ensure that those Company products are only sold when suitable.² Nonetheless, it appears that the Company is taking, or plans on taking, proactive steps to ensure compliance going forward. To that end, the Company is instructed to more fully expand on the explanation provided in its Response for Department approval. For example, the Company should provide the Department with a sample of the revised customer survey and written confirmation that such survey is being utilized and results are being actively reviewed by Company personnel. Similarly, the Company shall expand on what it means by “using freelook and complaint reports” to monitor producer suitability compliance. Such explanation and confirmation shall be provided to the Department, in writing, no later than March 14, 2005.

8. In the **DIRECT RESPONSE** section of the Report (pages 11 – 12), the examiners discuss various problems with the Company’s Direct Response program. The Direct Response program markets individual five-year term life insurance policies that are issued to credit cardholders of specific card issuing companies. The examiners note the policies are sold by unlicensed telemarketers in violation of 8 V.S.A. § 4793(a). The

² Whether the Company would have a contractual action for indemnification against its own producer for the sale of unsuitable products is a matter of contract law and outside the scope of this exam. However, the existence of such a potential cause of action does not insulate the Company from compliance with the laws in the state in which its products are sold.

examiners note the coverage is offered with no cost to the customer for the first two months and that the credit card company, which is not a party to the insurance contract, pays the first two months of coverage in violation of the statutory prohibition on rebating. 8 V.S.A. § 4724(8). The examiners note that no effort is made by the telemarketers to establish whether such a sale is a replacement sale and the telemarketers selling the term life insurance do not otherwise comply with Vermont's replacement regulation, Regulation I-2001-03. Finally, the examiners note the telemarketers ask a question pertaining to HIV testing which violates 8 V.S.A. § 4724(20).

In response, the Company generally disputes that the activities noted by the examiners violate the applicable laws. The Company asserts the telemarketers "do not hold themselves out to be an insurance broker or agent" and as such, no violation of 8 V.S.A. § 4793³ has taken place. With little elaboration, the Company denies it violated the statutory prohibition on rebating contained in 8 V.S.A. § 4724(8). (Response at page 4.) Regarding failure to comply with the replacement regulation, the Company notes its procedures were amended in December 22, 2003. Regarding its violation of 8 V.S.A. § 4724(20),⁴ the Company indicates it revised the question to ask not about previous HIV tests, but whether or not the prospect had been diagnosed with AIDS. However, ultimately the Company notes that Direct Response made the business decision to cease marketing and selling all Company products in the state of Vermont effective January 1, 2004.

³ Title 8, Chapter 131 was substantially amended in 2002. For the purposes of this discussion, the changes to the law are irrelevant to the legality of the Company's activities. For simplicity, the statutory citations are to the laws presently in effect, unless specifically noted to the contrary.

⁴ 8 V.S.A. § 4724(20) was amended in 2002. Such amendments are not relevant to the examiners' findings.

The undersigned rejects the Company's assertions that its Direct Response program, specifically its practice of utilizing unlicensed telemarketers to sell life insurance without complying with Vermont law, did not constitute a violation of Vermont law. The undersigned adopts this portion of the Report. However, in light of the fact these products are no longer being marketed in Vermont, remedial measures appear unwarranted. As such, the undersigned does not adopt the examiners' recommendations. However, to the extent the Company intends to market this type of product in Vermont in the future, the Company shall note that its legal assertions put forth in the section of its Response (pages 3 – 4) are expressly rejected.

The undersigned finds this matter appropriate for the imposition of a \$5,000 administrative penalty. This penalty is supported by the findings of the examiners that the Company's Direct Response program used unlicensed individuals to sell Company products, offered improper rebates, failed to comply with Regulation I-2001-03 and violated 8 V.S.A. § 4724(20) in the sale of Company products.

9. In the **REPLACEMENTS – SAMPLE I PUTNAM/ALLSTATE** and **REPLACEMENTS RECORDED** sections of the Report (pages 13 – 14), the examiners discuss their review of compliance with Vermont's replacement regulations.⁵ In the Putnam/Allstate section (page 13), the examiners discuss a random sample of 50 variable annuity policies (from a population of 100) which were reviewed for compliance with Vermont's replacement regulations. The examiners note that in seven contract files, the examiners discovered 37 total violations. In the Replacements Recorded section (page 14) the examiners identify four contracts which contained various violations. The examiners note, however, that

⁵ Vermont adopted Régulation I-2001-03, effective March 1, 2002. The examiners reviewed policies for compliance with the replacement regulation which was in effect at the time the policy was sold.

most violations of I-2001-03 discovered occurred shortly after the initial implementation of the statute. Nonetheless, the examiners recommend that the Company review its procedures to insure that the replacement regulation is being followed.

(Recommendation No. 13, Report at page 20.)

In response, the Company notes that it is in the process of reviewing its procedures to assess what changes may be necessary to help ensure that replacement requirements are satisfied. (Response at page 5.) The Company notes specifically that it has “enhanced certain replacement procedures such as the handling of new business paper applications received from the contracted financial services firms” and is pursuing other options. *Id.* The Company does object, however, to the examiners’ use of applying the number of violations (typically constituting more than one violation per policy) to the number of policies when calculating the percentage error. The Company argues if each policy constitutes eight possible violations of the replacement regulation, then the total sample number (i.e. the denominator) should also be increased for the purpose of establishing the percentage of violations.

Upon consideration, the undersigned adopts this portion of the Report and the examiners’ recommendations subject to the exceptions noted below. The Company’s argument that the manner in which the examiners calculated the multiple violations per policy to increase the percentage violations is well founded. Although it is not improper to note more than one violation per file, it is true to establish the percentage of violations, the total number should reflect the possibility of multiple violations. When the examiners discovered replacement regulation violations, they found many for those policies that had violations. It unfairly inflates the total percentage of error to apply that

multiple number to the number of sample policies. As such, this portion of the report (the paragraph following the chart contained on page 13) is not adopted.

It further appears that the Company has taken significant steps to address the examiners' recommendations. No later than March 14, 2005, the Company shall provide a written description for the Department's review of the steps it has taken to ensure Company compliance with the Regulation I-2001-03.

The undersigned concludes the replacement regulation violations discovered by the examiners warrant the imposition of a \$2,000 administrative penalty. In light of the Company's proactive response to the examiners' findings and the fact it appears the primary failure was a result of failing to implement the new requirements in a timely fashion, the full administrative penalty which could be imposed for these violations is not warranted.

10. In the **REPLACEMENTS – Electronic Signature Requirements** section of the Report (pages 14), the examiners note that the Company employed a procedure whereby an "e-app" was used in applying for life insurance. In this process, an electronic signature was taken from the producer and the customer and then affixed on the appropriate forms by the Company. The examiners question whether such procedure complies with I-2001-03 and recommends that Department counsel determine whether this procedure is sufficient. (Recommendation No. 9 at Report page 21.) However, the examiners note the Company has discontinued its practice of accepting electronic applications.

The Company does not respond to this section of the Report

Upon consideration, the undersigned concludes under the present regulatory structure, based on the examiners' description of the electronic application procedure, it would appear the Company was in violation of I-2001-03. The undersigned adopts this portion of the Report. However, in light of the evolving nature of this area of the law⁶ and the Company's voluntary decision to cease using this procedure, no administrative penalties appear warranted under these facts.

11. In the **REPLACEMENTS – Remote Policy Entry** section of the Report (page 15), the examiners discuss the Company's Remote Policy Entry procedure which is utilized when some contracts are issued through Allstate/Putnam broker dealers. All information required to issue a contract is included in the electronic record transmitted to the Company's Service Center. However, the examiners note that this fails to comply with I-2001-03 § 4C which requires that every life insurance or annuity application contains a signed statement from both the applicant and the producer as to whether the applicant had existing policies or contracts. The examiners recommend the Company should revise its present "Remote Policy Entry" procedures to bring them into compliance with Vermont Regulation I-2001-03. (Recommendation No. 10, Report at page 21.)

In response, the Company notes that its procedures are under review and some enhancements have already been made. (Response at page 5.)

Upon consideration, the undersigned adopts this portion of the Report. Although the undersigned recognizes the Company's desire to utilize electronic applications to improve efficiencies, nothing in the Report indicates that steps are being taken to address the requirements of Regulation I-2001-03. Furthermore, it is possible to electronically

⁶ See the Uniform Electronic Transactions Act, 9 V.S.A. § 270 *et seq.*, effective January 1, 2004.

transmit forms with signatures. The Company shall provide the Department with a description of how it has revised its Remote Policy Entry application processing procedures to address the requirements of I-2001-03. Such report shall be provided to the Department no later than March 14, 2005.

12. In the **INTERNAL AUDITS** portion of the Report (page 16), the examiners note that although the Company provided them with a list of all internal audits conducted by the Company, the Company declined to provide the actual audit results. The Company based this refusal on the work product doctrine, the attorney-client privilege and the “insurance compliance self-evaluative privilege.” (Report at page 16.) The examiners recommend Department counsel review the Company’s stated grounds for refusal.

The Company does not respond to this portion of the Report.

Upon consideration, the undersigned adopts this portion of the Report. The undersigned also notes that additional facts other than those provided in the Report would be needed to support the Company’s assertion that such audits are not subject to review.⁷ As the Company must be aware, the work product doctrine only prevents the disclosure of documents prepared in anticipation of litigation. Further, the attorney client privilege does not apply in all situations where an action has been advised by counsel. Finally, as of yet there is no such thing as the “insurance compliance self-evaluative privilege” in Vermont. Nonetheless, the Department has no interest in discouraging efforts taken by insurers to candidly assess compliance with the law. To that end, the undersigned does not request additional information. Presumably, the examiners reviewed the list of self

⁷ It is possible such additional information was provided to the examiners who note “The Company also included a more detailed discussion of their position as summarized above.” (Report at page 16.)

audits and nothing contained on that list appeared sufficiently relevant to the examiners to press the issue with the Company. It should be noted for future reference that the examiners and the Department have the authority to treat such documents as confidential and exempt from public disclosure. *See, e.g.*, 8 V.S.A. §3574(d)(4).

13. In the **FINES, PENALTIES & FORFEITURES** section of the Report, the examiners note the Company failed to comply with Bulletin 30 for the years 1999, 2000 and 2001.

The Company notes it now has a procedure in place to comply with Bulletin 30.

The undersigned adopts this portion of the Report and no additional action by the Company is necessary.

14. In the **POLICY LOAN INTEREST** section of the Report (page 18), the examiners note the Company's use of an 8% interest rate on policy loans, coupled with decreased accumulation interest rates on loaned portions of the policy, exceed the 8% maximum that can be charged under 8 V.S.A. § 3731. The examiners recommend that the Company revise its procedures to insure the actual net cost of its policy loans do not exceed 8%. (Recommendation No. 12, Report page 21.)

The Company disputes that 8 V.S.A. § 3731 applies to anything but the interest rate directly charged on the loaned portion of the policy. "This statute only pertains to policy loan interest, and not to interest that is 'credited back' on loaned cash values." (Response at page 6.)

Upon consideration, the undersigned rejects the Company's argument, but nonetheless does not adopt the examiners' recommendation. The fact that 8 V.S.A. § 3731 does not explicitly regulate the interest rate credited on the loaned portion of

accounts does not alter the fact that the Company is effectively exceeding the interest rate allowed by 8 V.S.A. § 3731(7)(B) by imposing additional costs on the loan beyond the maximum allowable interest rate.

Although the Company's position is not persuasive, the undersigned has reservations about applying the examiners' interpretation of the law in this instance. In this situation the law is complex and there is room for competing reasonable interpretations. As such, the undersigned concludes a market conduct exam is not the appropriate forum for resolution of this issue.

The undersigned adopts this portion of the report, but does not adopt the examiners' recommendation. As such, no further action by the Company is necessary on this issue. The Department may examine this issue further in the future and require the withdrawal of the Company's forms, but not at this juncture.

ORDER

15. The Report is adopted in its entirety without modification unless expressly stated to the contrary herein.

16. As discussed more fully in Paragraph 6 above, the Company shall provide the Department with a spreadsheet detailing the payments proposed to satisfy the examiner's recommendations regarding interest payments required under 8 V.S.A. § 3665. Such detailed payment verification shall be provided no later than March 14, 2005. Upon approval of the proposed payments, the Company shall make such payments and verify payment to the Department in writing as directed. Unclaimed funds shall be escheated to the State.

17. As more fully discussed in Paragraph 7 above, the Company shall provide the Department with an expanded explanation of how it intends to ensure its appointed

producers' compliance with Vermont's suitability laws and the Company's own suitability guidelines. Such explanation shall be provided to the Department for review no later than March 14, 2005.

18. As more fully discussed in Paragraph 8 above, the examiners' recommendations contained in **DIRECT RESPONSE** section of the Report are not adopted because the subject program is no longer utilized in Vermont. However, if the Company shall sell its products in a similar fashion in the future, it shall not do so without complying with Vermont law as discussed above.

19. As discussed in Paragraph 8 above, the undersigned finds the Company's sale of its products through the Direct Response program warrants the imposition of a \$5,000 administrative penalty.

20. As discussed in Paragraph 9 above, addressing the **REPLACEMENTS – SAMPLE I PUTNAM/ALLSTATE** and **REPLACEMENTS RECORDED** section of the Report, the Company shall provide the Department with a written description of the steps the Company has taken to ensure compliance with Regulation I-2001-03. Such description shall be provided no later than March 14, 2005. As noted, the paragraph following the chart on page 13 of the Report is not adopted.

21. As discussed in Paragraph 9 above, the Company's violations of the Replacement regulation warrant the imposition of a \$2,000 administrative penalty.

22. As discussed in Paragraph 11 above, the Company shall provide the Department with a written description of the steps being taken to address the requirements of Regulation I-2001-03. Such description shall be provided for Department review no later than March 14, 2005.

23. As discussed above in Paragraph 14, the examiners' recommendations contained in the **POLICY LOAN INTEREST** portion of the Report (Recommendation No. 12, Report page 21) are not adopted. However, this portion of the Report other than the recommendations (Report page 18) is adopted.

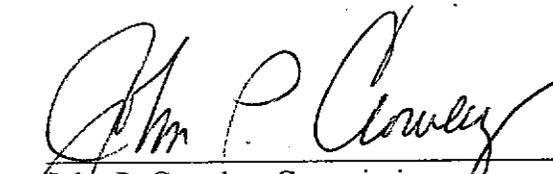
24. All penalties described above shall be paid to the Department no later than 10 days after the expiration of the appeal deadline of this Order, or other administrative or judicial order as appropriate.

PURSUANT TO 8 V.S.A. § 3574(c), THIS ORDER AND REMEDIAL ACTION SET FORTH HEREIN MAY BE APPEALED TO THE COMMISSIONER BY FILING AN ADMINISTRATIVE APPEAL WITHIN THIRTY (30) DAYS OF THE DATE SET FORTH BELOW. FURTHER REMEDIAL ACTIONS AND PENALTIES ORDERED UPON RECEIPT OF INFORMATION ORDERED HEREIN MAY BE APPEALED WITHIN THIRTY (30) DAYS OF SUBSEQUENT DECISIONS BY THE UNDERSIGNED.

Dated at Montpelier, Vermont this 12th day of December, 2004.

Department of Banking, Insurance,
Securities and Health Care Administration

By:



John P. Crowley, Commissioner
Department of Banking, Insurance, Securities and
Health Care Administration