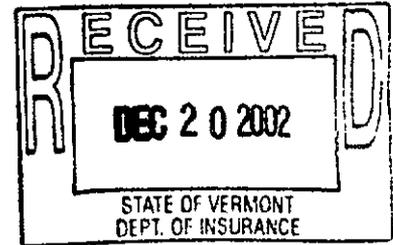



BANKERS
LIFE AND CASUALTY COMPANY
We specialize in seniors



State of Vermont
Dept of Banking, Insurance,
Securities and Health Care Administration
Rebecca C. Heintz
Insurance Division

December 19, 2002

Attn: Rebecca C. Heintz
Insurance Division

Re: Bankers Life and Casualty Market Conduct Exam Report

Dear Ms. Heintz:

It was a pleasure working with examiner Ron Busshart and Market Conduct Chief Charles Piasecki. The Company greatly appreciated the professional manner in which the examination was conducted, especially in the orderly manner in which the examiners requested information and communicated their concerns to us during the course of the examination.

Thank you for extending this opportunity for the Company to comment concerning factual assertions in the draft report. We have tried to limit our comments to the factual assertions. However, due to the format of the report, there were some areas where it was difficult to separate the factual assertions from policies and legal issues.

SALUTATION, Page 4

All areas of the Company were examined. Please delete the word "target" or qualify the market conduct exam language by stating the focus was on a particular line of business or area if that was the case.

FOREWARD, Page 5

Please delete the first sentence. The Company believes the statement is misleading in that it implies a heavy complaint ratio existed during that time frame. There were 2 DOI complaints concerning marketing activities during the winter of 2000/2001 up to the date Vermont joined the examination

on February 21, 2001 and 2 more for the remainder of the winter. There were 515,213 life, 82,807 annuity and 676,210 health policies in force as of 12/31/00. While it is our desire not to have any complaints of this nature, we do not believe the complaint ratio is significant enough to give a reader of the report the impression that there were significantly more complaints.

Please delete the sentence "Because New Hampshire realized that the neighboring states of Vermont and Maine were experiencing similar marketing concerns, a multi-state exam was started." This is conjecture on the part of New Hampshire and their examination has not been finalized.

Please delete the word "Targeted" in the second paragraph.

EXECUTIVE SUMMARY, Page 7

Please delete the word "targeted" from the first paragraph. Please delete the words "...as a result of consumer complaints received by the Vermont Complaint Unit" per the above comments on the complaint ratio.

Please delete the second paragraph. While it does contain some factual statements, it appears to draw conclusions and state opinions which we do not believe have been substantiated.

The Company believes the examiners' concerns regarding suitability were limited to annuity sales, not all lines of business.

The opinion of the examiners doesn't support the facts. As demonstrated by the low percentage of complaints, the Company can and does train its agents to sell suitable products.

We do not believe that Vermont requires written documentation of suitability. Prior to the examination, suitability fact finding was either accomplished verbally through an interview or by use of fact finders which the Company did not require be kept. During the examination period, the Company cooperated fully with the examiners' request that suitability be documented by use of fact finders and completion of a

Suitability Questionnaire. These items are kept at the local office. The "significant" shortcomings the examiner alludes to are questionnaires signed by the applicant and agent, but inadvertently not signed by the field manager. The Company will take appropriate measures to be sure all forms are signed by field managers. However, Vermont regulations do not require this and the complaint ratio does not indicate complaints could have been "greatly" reduced or that there was a suitability training problem.

Please change the first sentence of paragraph three to read "The examiner noted compliance issues with respect to Vermont replacement regulations."

The remainder of the paragraph is misleading, as the reader might conclude the Company was not in compliance with I-2001-03 during the time frame of the examination which began 1/1/99. The regulation applies to life and annuity products only. Please change the second sentence to read "After reviewing the new life and annuity sales client files maintained by the Company, it became clear that neither the agents nor the Company were in full compliance with Vermont Replacement Regulation I-2001-03 which was effective 3/1/02."

Please delete the last sentence, as is repetitious.

Please delete "...and three different company approved sales brochures" from the fourth paragraph. The Company does not believe this statement is factual, as we indicated in correspondence with the examiner during the course of the examination.

The sixth paragraph appears to be a statement of fact by the examiner. The Company doesn't believe it should be included in the Executive Summary until such time as the policy and legal issues have been addressed and the report is finalized.

II. Unfair Trade Practice Violations

Sales aid comparing annuity to mutual funds. Page 9

Please change the fourth sentence in paragraph one to read "The agent in question went on to sell the customer an equity indexed annuity that did not guarantee a 3% return on the entire investment and did have a risk from early withdrawal."

The statement "... and did have less value after the first year compared to the original investment" is not correct because, assuming no withdrawals are made:

The minimum accumulation is 3% each year on 90% of the investment.

The S&P account is never less than the original investment.

The value is the greater of the 3% guaranteed account or the S&P account.

While paragraph two is factual with respect to one (1) file, it is not factual to the way the Company conducts business overall. The way the paragraph is written, the reader may not come to this conclusion. We will comment on this later.

4. Sales brochure - Retirement Activity, page 12
The report is factual in describing brochure #10573(9/97). However, an opinion is inserted stating "Using 3-month CD rates causes the comparison to unfairly favor the annuity and is misleading." Please delete this from the report. We do not believe it is factual. The brochure is clearly marked with an asterisk referencing the 3 month rates.

5. Sales Brochure - The Key to Golden Retirement, page 12
While the facts about the content of brochure 12680(10/96) appear to be correct, we do not agree with the conclusions drawn by the examiner.

6. Sales Brochure - Equity Indexed Annuity, page 13
The Company does not believe the sales presentation material and handout #14405 are in violation. This would be an incorrect factual assertion.

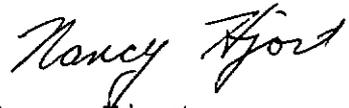
Suitability Training, page 16

Please change the second sentence of paragraph one to read "...since they may no longer have any income producing ability...". Seniors may well have income producing ability, such as rental income, pensions, 401Ks, full or part time employment, etc.

Again, we have tried to limit our comments to factual assertions as you requested. We do however, realize that in some instances we may have gone beyond addressing eh factual

assertions. We look forward to hearing from you and we reserve the right to comment on all aspects of the upcoming report.

Very truly yours,

A handwritten signature in cursive script that reads "Nancy Hjort".

Nancy Hjort
Consumer Relations
312-396-6619

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COMPANY RESPONSE TO THE 2/20/03 VERMONT REPORT

FOREWARD

Report Page 5

Paragraph 1

The Company respectfully requests the words "Because New Hampshire believed that the neighboring states of Vermont and Maine were experiencing similar marketing concerns,..." be deleted from the Report. This remark was based on an incomplete examination by the New Hampshire Insurance Department, the results of which have yet to be determined. To mention this in your Report suggests that the New Hampshire Insurance Department's concerns were justified and with merit. The Company has strongly disagreed with the New Hampshire Insurance Department.

EXECUTIVE SUMMARY

Report Page 7

Paragraph 1

Please change this sentence to read "...concerning *alleged* marketing activities..." The New Hampshire examination is not finalized and the Company strongly disagrees with the New Hampshire Insurance Department's conclusions with respect to our marketing activities.

Paragraph 2

This paragraph draws conclusions, in a general manner, with which we do not agree. For this reason and the reasons set out in the Company's response to pages 15, 16 and 17 of the Report, we would respectfully request the following:

- Please delete the words "the Company's agents were not given specific training in suitability guidelines and"
- Please change "in both of these areas" to "in this area"
- Please delete the sentence "Nonetheless, the examiners review of these changes uncovered significant shortcomings."
- Please delete the word "these" in the last sentence.

Paragraph 4

The Company respectfully requests the words "... and three different company approved sales brochures" be deleted from the report for the reasons set out in the Company's response to pages 12 and 13 of the Report.

Please add the statement "It should be noted that the Company took corrective action regarding the agent designed sales aid and the pre-approach letter during the examination."

Paragraph 5

The Company respectfully requests this paragraph be deleted from the Report for the reasons set out in the Company's response to pages 10 and 11 of the Report.

Paragraph 6

The Company respectfully requests this paragraph be deleted from the Report.

The phrase "...of the number of violations uncovered" is vague and implies something above what may be expected.

The examiner alleged 2 unsuitable sales were made. These were isolated incidents. The examiner did not allege the Company or its agents engaged in the sale of unsuitable products. During the course of the examination, the Company made improvements in the *documentation* of suitability.

PERTINENT FACTS OF THE CURRENT EXAMINATION

I. Replacement Regulation Violations

The Company respectfully requests the following changes be made.

Report Page 8

Paragraph 1

As the paragraph reads, it may lead the reader to conclude that the Company was not complying with any replacement regulations.

Please add the statement "The Company was complying with replacement regulations in effect prior to March 1, 2002."

Paragraph 4

Point 1

As worded, this statement implies that the Company was purposely negligent. Please change "completely" to "inadvertently".

Point 2

Please delete this point. As noted in the Report by the examiner in the above paragraph 3 of this section, the Company did take action on August 21, 2002 to become fully compliant with Regulation I-2001-03. The notification to the field of the Company's procedures is included in the Report as Appendix A.

Point 3

The Company has a full time Compliance/Legal Department. This Department has the responsibility of tracking and reporting regulatory developments. The Department has access to several compliance related databases such as ACLI and HIAA.

It is unfortunate that in this particular case, the Company did not detect the new regulation. However, it should be noted that the Company did have procedures in place to identify and inform applicants who were replacing other coverage of their rights. We believe that the Company has adequate staffing and procedures in place to monitor regulatory developments and ensure compliance with any future Vermont regulations. The Company regrets we inadvertently overlooked this regulation in this one isolated incident.

II Unfair Trade Practice Violations

The Company respectfully requests the following changes be made.

1. Sales aid comparing annuity to mutual funds.

Report page 9

Paragraph 2

Please delete this paragraph for the following reasons.

During the examination, the Company explained that this was an isolated incident. As the Company documented with the examiner, agents are instructed to use only Company approved advertising. Attached are examples of the Company's instructions to agents

regarding unauthorized advertising. This rule is also clearly set out in the agent's contract. A sample contract is attached.

By using only Company approved material, the Company is assured the material has been reviewed and approved by the Home Office prior to use.

Please delete the recommendations for the following reasons.

1. The Company prohibited the use of this unauthorized sales aid during the examination. Attached is the Company's August 9, 2002 memo to the examiner confirming this.
2. As demonstrated to the examiner, the Company has had written procedures for review of advertising since 1988. The procedures are attached.
3. Prior to March 1, 2002, there was no regulation in effect requiring companies to document what material was used at a sales presentation or to keep copies of the sales material used. Also, as stated above, agents are to only use materials approved by the Home Office. The Company now requires documentation of all sales material used during the sale.
4. Subsequent to the examiners' visit to the branch sales office, the branch sales manager agreed to keep individual folders containing sales material used by the agent at the local office.

The Company respectfully requests that the following be added to the Report.

Company Statement:

The Company requires all sales material to be authorized by the Home Office prior to use. The Company regrets one agent used one unauthorized sales aid.

2. Pre-approach sales letter 98-A006

Page 10

Please delete the recommendations for the following reasons.

1. As documented in our response to page 9 of the Report, the Company has procedures in place to ensure sales material is in compliance with Vermont law.

2. The pre-approach letter should have been more clear and should not have been authorized for use.
3. The Company has procedures in place to ensure only compliant sales material is approved for use. The Company strives for 100% accuracy and it was not the intent of the Company by the pre-approach letter to mislead the consumer in any way.

Pages 10 and 11

3. Annuity applications

Please delete paragraph 2 of this section and the last sentence in paragraph 3 for the following reasons.

The original intent of this statement was to convey that the applicant had other assets available for their use. The statement does not violate unfair trade practices. The applicant is advised of withdrawal penalties at the time of sale. The application becomes part of the issued policy. The policy schedule page sets out withdrawal percentages. Guaranteed cash surrender values are set out in the Financial Disclosure page.

Although this statement is not a misrepresentation, Vermont agents have been instructed not to use it in the remarks section of applications. Company underwriters will monitor the remarks section of the applications to assure agents do not include this statement in the application.

4. Sales brochure - Retirement Activity

Page 12

Please delete this section of the Report. The Company does not believe the brochure is misleading for the following reason.

In Retirement Annuity brochure #10573(9/97), the Company used CD rates which were published by the Board of Governors, Federal Reserve System. They do not publish one year rates. A 3 month CD does not earn the interest shown on a quarterly basis. The amounts shown are the average annual yield of a 3 month CD. This is fully disclosed.

The Company is not in violation of 8 V.S.A. ss4724 Unfair Trade Practices.

5. Sales Brochure - The Key to Golden Retirement

Pages 12 and 13

Please delete this section of the Report. The Company does not believe the brochure is misleading for the following reasons.

The Key to Golden Retirement brochure #12680(10/96) is a point of sale brochure and not mailed to consumers. Our agent is present and uses this brochure as part of a sales presentation to the consumer. Whenever a discussion about annuities takes place, there is a discussion of the affect of taxes on the growth of the annuity and how taxes affect any payouts from the annuity. The brochure goes into detail about this on the page titled "Why Consider An Annuity?"

So before the client gets to the back page, they have seen these statements:

"During the accumulation period, interest earnings are tax deferred, accelerating the growth of funds because of the special tax advantages which annuities enjoy under current Federal Tax laws."

"At retirement, under present Federal Tax Laws, a percentage of each monthly payment, from a Non-Qualified annuity, is considered a return of principal and is not taxable income. And, historical trends indicate that your taxation rates could be at a lower rate in later years."

The client is aware there will be tax consequences when money is disbursed.

The purpose of the chart on the back page is to show the growth of both products up to a certain point in time. We do not imply that the taxable account and tax deferred annuity are being cashed out. We are comparing accumulations for 25 years. The differences in the accumulations, which is discussed at length below the chart, is \$35,331. This is true and accurate, not misleading. In bold print, which stands out from surrounding text, we clearly state that no taxes are paid until the interest is taken out.

The Company does not believe this brochure is in violation of 8 V.S.A. ss4724 Unfair Trade Practices. We respectfully ask for your reconsideration of this advertisement with the above understanding. As stated, this comparison is about accumulations, not about the net amount of funds after withdrawal.

6. Sales Brochure - Equity Indexed Annuity

Page 13

Please delete this section of the Report. The Company does not believe the sales material or Illustration handout on Equity Indexed Annuity #14405-inset is misleading for the following reasons.

The chart shows the actual performance of the S&P 500 on the dates shown. While the sample figures are hypothetical, the performance of the S&P 500 shown is not. The purpose of this illustration is not to imply that such growth is likely to happen. It is to show the customer what happens to their money when there are fluctuations in the S&P.

The actual average participation rate for the 9 months the product was available in Vermont in 1999 was 77.78%. The actual average was 75.84% for years 2000 and 2001 and 76.25% for year 2002 to August. For the 41 month period from April 1999 through August 2002, the participation rate was 80% in 26 of the months. The handout clearly states "The participation rate is set by the company on each policy anniversary and is guaranteed for the following year." There is no guarantee of an 80% participation rate and the chart is clearly labeled "Hypothetical Cash Value Accumulation." The Company believes the chart does not misrepresent or fail to adequately disclose the benefits, advantages, conditions, exclusions, limitations or terms of the annuity.

The Company is not in violation of 8 V.S.A. ss4724 Unfair Trade Practices.

7. Unsuitable Sales

Pages 13 and 14

Please delete or change this section for the following reason.

The Company agrees with the examiner's assessment, with the exception of the allegation the sales were in violation of 8 VSA s4724(16). Both selling agents for complaint numbers 20010171 and 20010080 believed, at the time of sale, that the product they presented and sold was suitable for the clients needs.

III Company Improvements

The Company respectfully requests the following changes be made.

Page 15

Please change the first sentence to read "...improvements in the area of documentation of suitability."

Please delete the second paragraph for reasons set out in our response to this section of the Report.

1. Suitability Training

Please delete the last sentence in paragraph 2 referencing the examiner's finding of his review of the Company's fact finder and paragraph 4 for the following reasons.

As mentioned in the Report, the Company does provide excellent suitability training guidelines to its agents. The Company believes that the currently used fact finder does adequately provide a clear picture of an applicant's financial position. The examiner suggests that the fact finder be designed to include the questions that give the total picture of the prospect's situation. The fact finder does have questions designed to elicit responses regarding assets (question 15), liabilities (15), income (14), expenses (15), personal objectives (20), risk tolerance (19), customer's age (page one), investment sophistication (16) and tax issues (19).

Please delete paragraph 5 for the following reason.

As set out above, the Company does determine suitability and uncovers assets and liabilities in the fact finding process. Each prospect's liquidity needs will vary and no set amount would apply to all individuals. The Company's agents are trained in the terms and provisions of the Company's various products and are able to make recommendations for affordable and suitable products based on their fact finding conversations with prospects.

After paragraph 1, please add a statement acknowledging that the Company's annuity products do have provisions allowing for annual 10% penalty free withdrawals and penalties are not imposed on any amounts withdrawn needed to satisfy IRS withdrawal requirements. In addition, the Company offers riders providing for the use of annuity funds penalty free in cases of nursing home admissions or terminal illness.

Please delete paragraph 2 for the following reasons.

As stated above, the Company believes it does provide agent training for determining affordability and suitability. In addition to fact finder training, agents complete the attached Suitability, Replacement and Disclosure course. The Company provides detailed agent training on each of its products. The list is attached.

In the past year, the Company has made additional training available to agents on-line system via the Bankers Learning Network link. A list of courses is attached.

Please delete paragraphs 3, 4 and 5 for the following reasons.

The examiner has made an unsubstantiated assumption that agents do not understand how CDs or other investments work. Furthermore, Vermont life and annuity replacement regulations do not apply to other investments. Vermont replacement regulations refer to an existing life or annuity policy. Insisting that these regulations be applied to other investments is beyond the scope of the insurance replacement regulation.

The Company has the following response to the examiner's recommendations:

1. Please delete this recommendation. Question 21 in the fact finder asks the prospect if they have a financial advisor. Point of sales materials may also advise the prospect to consult an attorney, accountant or tax adviser. Examples are attached. The Company believes that these documents already provide for this recommendation.

2. Please delete this recommendation. Vermont replacement regulations apply to insurance policies and annuities only. Suitability Questionnaire #14818 asks if there are charges or

penalties involved in a replacement sale and how the issuance of the proposed policy is in the best interest of the client.

We are unaware of any specific Vermont Statute or Regulation which specifically defines suitability and/or defines what specific criteria should be used in determining suitability or what specific information is necessary "... to set a complete and accurate picture of the prospect's situation." Lacking such a specific definition or providing implicit guidance on such, makes the entire process for determining suitability very subjective. While we will continue to train our agents in determining suitability and gathering what information is necessary to make such a determination, we do not believe that in the absence of specific direction by the Department to all insurers marketing life and annuity products in Vermont, we should be held to a different standard.

2. Suitability Questionnaires

Page 17

Please delete recommendation 2 for the following reasons.

- a. The attached fact finder is designed to determine a client's need for each of the products featured, Medicare Supplement, Long Term Care, Life and/or Annuities.
- b. The fact finder helps determine the need for the product line. The Company offers a variety of products in each line of business. The agent presents the various options and the client and agent choose the best plan based on the client's needs.
- c. The fact finder asks pointed questions regarding the client's income, living expenses, savings and assets. The Company's agents do determine affordability.
- d. The attached Suitability Questionnaire form #14818 documents any charges or penalties for a replacement sale and documents the reason(s) the replacement is in the best interest of the client.

SUMMARY OF RECOMMENDATIONS

The Company's responses to the Summary of Recommendations are essentially the same as our responses set out in the corresponding sections of the Report. The Company's responses may change depending on the consideration given to these comments and other comments in other areas of the report.

The Company respectfully requests the following changes be made.

Recommendation 1

1. Prior to 8/21/02, the Company was complying with replacement regulations in effect prior to 3/1/02. As noted by the examiner on page 8 of the Report, the Company did take action on August 21, 2002 to become fully compliant with Regulation I-2001-03. The notification to the field of the Company's procedures is included in the Report as Appendix A.

2. As worded, this statement implies that the Company was purposely negligent. Please change the word "completely" to "inadvertently."

3. The Company has a full time Compliance/Legal Department. This department has the responsibility of tracking and reporting regulatory developments. The department does have access to several compliance related databases such as ACLI and HIAA.

It is unfortunate that in this particular case the Company did not detect the new regulation. However, it should be noted that the Company did have procedures in place to identify and inform applicants who were replacing other coverage of their rights. We believe that the Company has adequate staffing and procedures in place to monitor regulatory developments and ensure compliance with any future Vermont regulations. The Company regrets we inadvertently overlooked this regulation in this one isolated incident.

Recommendation 2

1. The Company prohibited the use of this unauthorized sales aid during the examination. Attached is the Company's August 9, 2002 memo to the examiner confirming this. The Company requires all sales material to be authorized by the Home Office prior to use. The Company regrets one agent used one unauthorized sales aid.

2. As demonstrated to the examiner, the Company has had written procedures for review of advertising since 1988. The procedures are attached.

3. Prior to March 1, 2002, there was no regulation in effect requiring companies to document what material was used at an individual sales presentation or to keep copies of the sales material used. The Company now requires documentation of all sales material used by the agent during the sale.

4. Subsequent to the examiners' visit to the branch sales office, the branch sales manager agreed to keep individual folders containing sales material used by the agent at the local office.

Recommendation 3

1. As documented in our response to page 9 of the Report, the Company has procedures in place to ensure sales material is in compliance with Vermont law. The procedures are attached.

2. The Company regrets that due to human error this pre-approach letter was authorized for use.

3. The Company has the attached procedures in place to ensure only compliant sales material is approved for use. The Company strives for 100% accuracy and it was not the intent of the Company by use of this pre-approach letter to mislead the consumer in any way.

Recommendation 4

During the examination period, agents were instructed not to use the phrase "This annuity will cause no harm to the annuitant" in the remarks section of annuity applications. The original intent of this statement was to verify the annuitant had funds available other than those placed in the annuity. Company underwriters will monitor the remarks section of the applications to assure agents do not include this statement on the application.

Recommendation 5

In Retirement Annuity brochure #10573(9/97), the Company used CD rates which were published by the Board of Governors, Federal Reserve System. They do not publish one year rates. A 3 month CD does not earn the interest shown on a quarterly basis. The

amounts shown are the average annual yield of a 3 month CD. This is fully disclosed.

The Company is not in violation of 8 V.S.A. ss4724 Unfair Trade Practices.

Recommendation 6

The Key to Golden Retirement brochure #12680(10/96) is a point of sale brochure and not mailed to consumers. Our agent is present and uses this brochure as part of a sales presentation to the consumer. Whenever a discussion about annuities takes place, there is a discussion of the affect of taxes on the growth of the annuity and how taxes affect any payouts from the annuity. The brochure goes into detail about this on the page titled "Why Consider An Annuity?"

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The client is aware there will be tax consequences when money is disbursed.

The purpose of the chart on the back page is to show the growth of both products up to a certain point in time. We do not imply that the taxable account and tax deferred annuity are being cashed out. We are comparing accumulations for 25 years. The differences in the accumulations, which is discussed at length below the chart, is \$35,331. This is true and accurate, not misleading. In bold print, which stands out from surrounding text, we clearly state that no taxes are paid until the interest is taken out.

The Company does not believe this brochure is in violation of 8 V.S.A. ss4724 Unfair Trade Practices.

Recommendation 7

The Company does not believe the sales material or Illustration handout on Equity Indexed Annuity #14405-inset is misleading for the following reasons.

The chart shows the actual performance of the S&P 500 on the dates shown. While the sample figures are hypothetical, the performance of the S&P 500 shown is not. The purpose of this illustration is not to imply that such growth is likely to happen. It is to show the customer what happens to their money when there are fluctuations in the S&P.

The actual average participation rate for the 9 months the product was available in Vermont in 1999 was 77.78%. The actual average was 75.84% for years 2000 and 2001 and 76.25% for year 2002 to August. For the 41 month period from April 1999 through August 2002, the participation rate was 80% in 26 of the months. The handout clearly states "The participation rate is set by the company on each policy anniversary and is guaranteed for the following year." There is no guarantee of an 80% participation rate and the chart is clearly labeled "Hypothetical Cash Value Accumulation." The Company believes the chart does not misrepresent or fail to adequately disclose the benefits, advantages, conditions, exclusions, limitations or terms of the annuity.

The Company is not in violation of 8 V.S.A. ss4724 Unfair Trade Practices.

Recommendation 8

As mentioned in the Report, the Company does provide excellent suitability training guidelines to its agents. The Company believes that the currently used fact finder does adequately provide a clear picture of an applicant's financial position. The fact finder does have questions designed to elicit responses regarding assets (question 15), liabilities (15), income (14), expenses (15), personal objectives (20), risk tolerance (19), customer's age (page one), investment sophistication (16) and tax issues (19).

Recommendation 9

The Company does determine suitability and uncovers assets and liabilities in the fact finding process. Each prospect's liquidity needs will vary and no set amount would apply to all