

(IX) UNDERWRITING

HIV CONSENT FORMS

The review of the Company's issued life sample (sample II), which contained fifty (50) policy files from a population of eight hundred thirty-two (832) records representing issued life policies from NYLIAC and NYLIC, revealed two (2) violations of 8 V.S.A. § 4724 (20) (B).

One of the requirements of 8 V.S.A. § 4724 (20) (B) is that the agent or broker read the printed information form aloud to the applicant at the time of application. There was no evidence in the file that this was done.

The form the Company provided the applicant in these two (2) cases, that is not in compliance with Vermont's statutes, is "Blood/Urine/Oral Fluid Form # 50-PA. HIV Information and Consent form # 20279 VT 11-98 does provide evidentiary notice of compliance with the requirements of 8 V.S.A. § 4724 (20) (B) and should have been used.

The Company should exercise more care so as to prevent further violations of 8 V.S.A. § 4724 (20) by using the proper HIV information and consent forms in all cases.

(X) LIFE INSURANCE ILLUSTRATIONS

Vermont Regulation 98-1 § 10 D reads as follows:

If an adverse change in non-guaranteed elements that could affect the policy has been made by the insurer since the last annual report, the annual report shall contain a notice of that fact and the nature of the change prominently displayed. (Underlining added for emphasis)

Some of the reports contain such notices wherein the nature of such changes are not prominently displayed. One such example is included in this report as appendix III. In the enclosed example an increase in the monthly contract charge is displayed in an inconspicuous footnote which is clearly not prominent.

While the Company does not agree with the examiners' conclusion, they have volunteered to make the information more prominent by increasing the font size.

See Appendix III

(XI) CONSUMER COMPLAINTS

The Company reported receiving only ten (10) consumer complaints during the examination period. The examiners reviewed the files and did not find any particular patterns or any evidence of intentional mistreatment of policyholders.

(XII) SALES AND MARKETING

(A) INCOMPLETE/INCORRECT APPLICATIONS

The examiners observed an irregularity with regard to the companies' issued life sample (Sample II). A sample of fifty (50) files was selected from a listing of eight hundred thirty-two (832) records representing both companies' issued life policies for the examination period.

Four (4) policy files contained incomplete or incorrect information with respect to completion of the application. The application, designed to be used by both companies, contains a space at the top (Part I) for indicating from which company the applicant is seeking coverage. The agents failed to mark either company on three of the four files listed in the following chart. The fourth file was mistakenly marked NYLIC, however, the issuing company was NYLIAC.

The following chart identifies those policy files:

Policy #	Issuing Company	Examiners' Comments
46850092	NYLIC	No company name marked on application-was a NYLIAC conversion to a NYL policy
46624317	NYLIC	No company name marked on application-or indicated on the accompanying HIV form
62841337	NYLIAC	No company name marked on application or policy delivery receipt
62823601	NYLIAC	Application marked NYLIC, however issuing company was NYLIAC

The examiners criticized the company for the apparent failure to disclose to the insured the name of the company for which they were seeking coverage. The Company's response included a statement that the Administrative Manager would reaffirm the necessity of completing all the required answers regarding the completion of the application.

(B) SUITABILITY

(i) SmartMatch

NYLIAC began using its suitability standards system, called SmartMatch, on September 28, 1999. The system was required to be used in the review of all variable life insurance and variable annuity applications dated on or after this date with the exception of the MainStay series of variable annuities, which are discussed in the following sub-section. SmartMatch was developed by the Company as a way to ensure that the variable product being applied for was suitable considering the applicant's insurance and investment objectives, financial situation and needs and any other information known to the insurer or agent.

SmartMatch requires the applicant to complete an investor profile in which the applicant may indicate their risk tolerance out of a choice of four degrees of risk or take a test developed by the Company to determine their risk tolerance. The applicant also indicates their investment objective out of a list of five choices. In addition, the applicant is asked questions about their personal financial situation and experience.

NYLIAC put applications through the SmartMatch review as a part of processing the application. The SmartMatch review determines whether the applicant's risk tolerance and investment objective are consistent with each other and with the applicant's selection of portfolios for the allocation of premiums. If they are deemed to be inconsistent by the predetermined qualifications of SmartMatch, the application is assigned a "pending" status until the inconsistency has been resolved and confirmed by the applicant. Other suitability issues that an application is reviewed for include the applicant's age, time horizon, financial situation of applicant, level of prior investment experience, and existing insurance owned by the applicant.

The SmartMatch system that NYLIAC has created to test for the suitability of its variable products is a comprehensive process. The examiners, however, find the SmartMatch system's qualification for a "moderate" risk tolerance to be problematic. By the Company's own standards an investor is considered "moderate" if they primarily seek potentially safe return with a slight amount of risk. According to the Company's SmartMatch standards, "moderate" risk tolerance is considered to be consistent with a portfolio with 60% or less of the premiums being allocated to high or highest risk investments. Thus, an applicant would be permitted to allocate a majority (up to 60%) of their investments to the "high" or "highest" risk category. The examiners believe that this distribution is weighted too heavily in "high" and "highest" risk portfolios to be deemed "moderate" and therefore is not suitable for an applicant with a "moderate risk" tolerance.

The examiners recommend that the Company consider revising this standard in a manner so as not to allow investments in a "high" or "highest" risk category to exceed those in the "moderate" risk category when the applicant has a "moderate" risk tolerance.

(ii) MainStay Variable Annuities

All variable products sold by the Company's traditional agency sales force are subject to the suitability standards test of the SmartMatch. The Company's variable annuity products sold under the name "MainStay", however, are sold through outside independent broker-dealers ("Dealers") and are not subject to SmartMatch review.

Prior to permitting Dealers to sell NYLIAC products, the Company enters into sales agreements with the Dealers that provide requirements of suitability. The Company informed the examiners that these agreements address the suitability concerns raised in 8 V.S.A. § 4724 and Bulletin 129 with respect to the Company's products sold through independent Dealers. By entering into these sales agreements, independent Dealers represent that they will develop and apply suitability review processes consistent with state and federal regulatory authorities and self-regulatory organizations.

The above notwithstanding, the examiners note that the Company does not have a monitoring system in place to insure that producers (Dealers), which they appoint, are 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 are still 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 regardless of any other employment of such agents.

(iii) Rectifying Unsuitable Applications

Under the SmartMatch system, applications are "pending" when the applicant's chosen investment objective is deemed to be inconsistent with the premium allocation indicated in the application. NYLIAC discusses the inconsistency of the investment objective and premium allocation with the applicant and sends them a letter of confirmation stating the changes made to their records to correct the inconsistency.

When an application is pending, one method that NYLIAC uses to make the policy pass through SmartMatch is to determine what the corresponding investment objective should have been for the premium allocation and to change the investment objective after discussion with the applicant. This procedure uses the premium allocation to determine the investment objective. In other words, it uses the product to determine the need. The Company is simply making sure that, on paper, the investment objective and premium allocation match. The examiners find this procedure to be a mere formality to pass through the SmartMatch system.

The Company should instead be evaluating the need or investment objective and adjusting the product to meet the need. Bulletin 129, *Suitability Requirements for Variable Insurance Products*, states that “some of the factors that should be considered in recommending a variable product are the customer’s age, tax status, financial objectives, need for immediate liquidity or retirement income, and investment sophistication”. This bulletin implies that an applicant’s needs and objectives are considered before a variable product is recommended and not afterward. The examiners recommend that the stated investment objective be used to determine the premium allocation in rectifying the contradiction between the two. This procedure would ensure that the product is suitable for the customer’s needs.

The examiners acknowledge that in some cases, after NYLIAC discusses the inconsistency of the investment objective and premium allocation with the applicant, an applicant may reevaluate their investment objective and wish to change their selection for the investment objective. The examiners consider a change in the applicant’s investment objective to be a material change to the application and therefore recommend that the Insurance Division refer this concern to the Securities Division of the Vermont Department for a determination as to whether the applications should be amended and signed by the applicant in those cases where the Company changes the applicant’s investment objective to correspond with the premium allocation since this is the reverse of the usual procedure.

(iv) Lapse Percentages

One measure of suitability is lapse rates, which can be viewed as a proxy for policy owner satisfaction. Generally, low lapse rates are one indicator that a company is providing products and services that are satisfactory while high lapse rates may reflect policyholder dissatisfaction.

The following chart shows the Lapse Percentages for Ordinary Life as extracted from the Company’s 2002 Annual Financial Statement (Exhibit of Five-Year Historical Data).

Year	2002	2001	2000	1999	1998
Lapse Percent	5.6	5.6	5.5	5.4	6.4

The percentages shown above are low in comparison with those of similar large insurers with ratios ranging from about 5.5 to about 9.5 over the same time period.

(XIII) VARIABLE UNIVERSAL LIFE

REPORTS TO POLICYHOLDERS

Regulation 88-3 § 10 (Article IX) (1) requires that reports to policyholders show both the projected cash value and the cash surrender value as of one (1) year from the period covered by the reports. NYLIAC provides its variable universal life policyholders with reports that have a space provided for such values for the "next 12 months", however, instead of inserting the projected cash values and cash surrender values at the end of the next twelve months, some of the reports state "N/A". The examiners found sixty-eight (68) quarterly statements with projected cash values and cash surrender values, as of one year from the end of the statement ending period, with the designation "N/A" in lieu of the required values.

NYLIAC stated that several scenarios caused the projected values to be "N/A". One cause was when payments, which were normally made by Check-o-Matic (automatic bank account debit) or pre-authorized check method, had been drafted for bank deposit but had not cleared and therefore had not been invested in the policy's investment divisions. NYLIAC explained that this is what happened in a majority of the sixty-eight (68) statements cited by the examiners. NYLIAC asserted that, in a small number of cases, other circumstances unique to the policy prevented a correct calculation of the projected value at the time the statement was produced.

The examiners also questioned NYLIAC as to its compliance with Regulation 88-3 § 10 (Article IX) (1) (iii) which states that "if the projected value is less than zero, a warning message must be included that states that the policy may be in danger of terminating without value in the next twelve (12) months unless additional premium is paid." NYLIAC's response referenced a warning message appearing on some of the statements, with one-year projected cash values and cash surrender values with values of "N/A", which stated "As of the date we prepared this statement, your policy did not have sufficient Cash Surrender Value to pay the Monthly Deduction Charge(s) due. If you have not remitted the amount necessary to cover the charge(s) and/or excess Policy Loan, please contact your Registered Representative or call our 800 number." This warning message addresses situations where the cash surrender value is not sufficient to keep the policy in force. The regulation requires that a warning message appear when the projected value is less than zero and must state that "the policy may be in danger of terminating without value in the next twelve (12) months unless additional premium is paid." NYLIAC's warning statement is not about the projected value as the Regulation requires and does not contain the proper warning message.

NYLIAC stated that the appropriate systems have been adjusted so that numerical values can be provided in the future for the projected cash values and cash surrender values on its quarterly statements.

The examiners recommend that NYLIAC revise its systems to produce a warning message on its quarterly statements, as required by Regulation 88-3 § 10 (Article IX) (1) (iii) "if the projected value is less than zero" and not only when the cash surrender value is not sufficient which is its current practice. In addition, the warning message must include that "the policy may be in danger of terminating without value in the next twelve (12) months unless additional premium is paid."