examiners note that the Company is responsible to ensure its products are not sold when unsuitable, even if sold by Dealers (the Company's appointed producers). The examiners recommend that the Company establish suitability guidelines and standards or utilize SmartMatch suitability standards for products sold by Dealers and implement a monitoring system to ensure that such guidelines are being followed. (Recommendation No. 9, Report at page 24.)

In response, the Company argues that the Dealers are subject to an extensive regulatory structure imposed by securities laws and as such should not be subject to the insurance laws. In turn, the Company asserts that if the Department were to require the Company to monitor that its product (sold through the Dealers) be only sold when suitable, such a requirement would be a break from existing law and must be vetted through the formal rule making process or the Company's due process rights will be violated.

The undersigned expressly rejects the Company's argument that application of the securities suitability laws eliminates the application of insurance laws. Bulletin 129, referred to by the Company in support of its argument, expressly states that variable products are subject to both the securities and insurance laws. As such, requiring the Company to assure that variable products are sold in compliance with insurance laws and securities laws is not a change in the law, it is application of the law referenced in Bulletin 129 and expressed in the statutes.

The examiners are correct that although the Company may rely on the Dealers to sell its product, it is still responsible to make sure the product is only sold when suitable. Pursuant to 8 V.S.A. § 4813c, the Company is responsible for its appointed producers.

Pursuant to 8 V.S.A. § 4724, the Company must not sell unsuitable products. Bulletin 129 emphasizes the dual nature of the regulations applicable to variable products and highlights the fact that the sale of such products are subject to both insurance and securities regulations. If the Company fails to have any means to monitor the suitability of its variable sales through the Dealers, the Company cannot ensure compliance with the law.

That said, the Company appears to assume that application of the insurance laws to variable products sold by the Dealers would be incredibly onerous. However, the insurance suitability requirements are not inconsistent with the applicable securities laws and the Company could simply implement guidelines which complement the existing securities framework. These guidelines do not need to be as elaborate as that employed by the SmartMatch program. Further, having a monitoring system in place to ensure that Dealers are selling products in a suitable fashion does not need to be unduly burdensome.

In order for the Company to ensure that its products are not sold in violation of the Vermont Insurance Practices Act it must have the ability to monitor those sales. This could be through random spot checks, monthly reviews, complaint reviews, all of the above or some other reasonable method. Monitoring the Dealers does not require that the implicated variable products be subjected to SmartMatch review.

No later than December 15, 2005 the Company shall confirm, in writing, to the Department that it has taken steps to monitor that its variable products are only being sold in compliance with applicable insurance laws, even when sold by Dealers. Because the examiners did not identify unsuitable sales through the Dealers and the Department has

no evidence of problems with Company products being sold in violation of the Insurance Trade Practices Act, no penalty is warranted under these circumstances.

14. In the **(XII) SALES AND MARKETING - (B) SUITABILITY – (iii) Rectifying Unsuitable Applications** section of the Report (pages 19 - 20), the examiners discuss perceived problems with applications that have been placed on "pend" status by SmartMatch. The examiners report that when there is a discrepancy between an investor's stated investment objective and investment choices, the Company changes the investment objective so that the application passes the SmartMatch analysis. The examiners conclude that this undermines the effectiveness of the SmartMatch program and results in the Company using the product to dictate the need, as opposed to using the need to dictate the product, as required by law.

Further, the examiners note that by changing the investment objective stated on the application, the Company is making a material change to the application. As such, the examiners recommend the issue be referred to the Securities Division to determine whether or not the applications should be amended and signed by the applicant when the investment objective is changed to match the applicant's premium allocation. (Recommendation No. 10; Report at page 24.)

The Company disagrees with the examiners' characterization of how pended applications are handled. The Company explains that applications which have a pend status are referred to a NASD Series 6 or 7 reviewer for manual review. The Company notes that "a discussion with the registered representative and/or customer must occur in order to resolve the pend condition."[10] (Response at page 7.) As a result of that

[10] Although this sentence is somewhat ambiguous, the Company has indicated that the reviewer must discuss the matter with either the registered representative that sold the policy or the customer.

discussion, the customer's investor profile will be changed and the application approved or the application will be denied. The Company further explains that Company procedures allow the customer to change either the premium allocation (to match the objective) or the profile. In addition, the reviewer must confirm that any changes to the objective are consistent with the risk tolerance; changes to the investment objectives are confirmed in writing and the customer is informed they should call a toll free number if they object to the changes. A procedure is in place to handle investor profile change disputes. Company registered representatives can be subject to disciplinary action if it is determined that they knowingly provided incorrect information to resolve the pend.

Finally, the Company disputes the examiners recommendation that a change in the investment profile is a material change to the application and must be signed by the applicant, but agrees to defer to the determination of the Securities Division.

Upon consideration, the undersigned adopts this portion of the Report, but expressly notes that the procedures in place as described by the Company appear to address the pend applications substantively.

As recommended by the examiners, the Insurance Division consulted with the Securities Division regarding the appropriate resolution of a pended application through changing the stated investment objectives to match investment decisions. The Securities Division recommended that such changes be confirmed with an amended application signed by the customer. However, upon discussions with the Company, it appears that the operative document designating the investment objective is not the application, but the investor profile and the Company has requested that, if a customer signature is required to confirm the change, it be included on the document specifying the investment

objective. Such a request appears reasonable, subject to the requirement that the Company retain the document in its records in the same manner required for applications and other policy records. The Company shall change its procedures to be consistent with the recommendation, subject to the modification noted. No later than December 15, 2005, the Company shall submit to the Insurance Division for review a copy of the "confirmation letter" notifying the insured of the change to his or her investment objectives, the meaning of such change and the method for disputing the change (as referred to in the Company's Response at page 7) and confirm that procedures which require a customer to proactively sign off on any change to his or her investment objective has been implemented consistent with this Order. No administrative penalty appears warranted under these circumstances.

15. In the **(XIII) VARIABLE UNIVERSAL LIFE – REPORTS TO POLICYHOLDERS** section of the Report (pages 21 and 22), the examiners discuss two violations of Regulation 88-3. Regulation 88-3 §, Art. IX, § (1) requires that reports to policyholders show both projected cash value and cash surrender value as of one year from the period covered by the report. The examiners note that they discovered 68 policy reports which reported "N/A" in the portion of the report which was supposed to provide these values.

The examiners also report that Regulation 88-3, Art. IX, § (1)(iii) requires that if the projected value is less than zero a warning message must be included "which states that the policy may be in danger of terminating without value in the next twelve (12) months unless additional premium is paid." The examiners note that the Company's warning does not comply with the Regulation and recommend appropriate amendments. (Recommendation No. 11, Report at page 25.)

During the course of the exam, the Company explained that the "N/A" notation on certain policyholder reports was a function of some premium payments not clearing prior to the statement date, thus causing the N/A reference. However, during the exam, the Company indicated to the examiners that revisions to the statement generating system would be made to address the problem and N/A would no longer appear on the statements.

In its Response (page 8), the Company disputes the examiners' assertion that the warnings provided to the policyholders fail to comply with the Regulation. Specifically, they Company notes that in addition to the warning referenced by the examiners, policy statements that are in danger of terminating include the following warning "Based on these assumptions your policy may be in danger of terminating without value in the next 12 months unless additional premiums are paid." (Response at page 8.) As such, the Company asks that the third and sixth paragraphs of the Report not be adopted.

Upon consideration, the undersigned adopts this portion of the Report, but does not adopt the third and fifth paragraphs of this section (Report pages 21 and 22) as requested by the Company. It appears that the policy statements do, in fact, comply with Regulation 88-3, Art. IX, § (1)(iii). No administrative penalty appears warranted under these circumstances.

## ORDER

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

17. As discussed more fully in Paragraph 7 above, discussing the **(V) CLAIMS PROCEDURES AND PROCESSING – (A) Claims Practices and Procedures Not in**

**Compliance With 8 V.S.A. § 3665** section of the Report, the Company shall conduct an audit and report to the Department no later than December 15, 2005. As discussed above, upon approval of the report, the Company shall undertake a remediation program paying withheld interest that exceeds $25.00 per policy.

18. As more fully discussed in Paragraph 10 above, discussing the **(X) LIFE INSURANCE ILLUSTRATIONS** section of the Report, the Company shall pay an administrative penalty of $1,000 for the noted violations of Regulation 99-1 § 10. Such payment should occur no later than ten days from the expiration date of the appeal deadline of this Order.

19. As more fully discussed in Paragraph 11 above, discussing the **(XII) SALES AND MARKETING – (A) INCOMPLETE/INCORRECT APPLICATIONS** section of the Report, reference to Policy 46624317 shall not be considered part of the Report because it does not involve the Company.

20. As discussed in Paragraph 11 above, addressing the **(XII) SALES AND MARKETING – (A) INCOMPLETE/INCORRECT APPLICATIONS** section of the Report, the Company shall pay a $1,500 administrative penalty for the application errors noted by the examiners.

21. As discussed more fully in Paragraph 13 above, addressing the **(XII) SALES AND MARKETING – (B) SUITABILITY – (i) MainStay Variable Annuities** section of the Report, no later than December 15, 2005, the Company shall confirm, in writing, that it has implemented methods to allow it to monitor sales made through Dealers in order to ensure compliance with applicable insurance laws.

22. As discussed more fully in Paragraph 14 above, discussing the **(XII) SALES AND MARKETING – (B) SUITABILITY – (iii) Rectifying Unsuitable Applications** section of the Report, the Company shall implement procedures requiring a customer signature to amend the investment objective if the objective is changed to match the chosen premium allocation. The Company shall submit, no later than December 15, 2005, written confirmation to the Department indicating that such a procedure has been implemented. The Company shall also submit to the Department, for its approval, the confirmation letter used to notify insureds that the investment objective has been modified. Such confirmation shall be submitted no later than December 15, 2005.

23. 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 COMMISSIONER.**

Dated at Montpelier, Vermont this 23rd day of August, 2005.

Department of Banking, Insurance,
Securities and Health Care Administration

By: _____

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