

REPORT OF THE  
**TARGET MARKET CONDUCT EXAMINATION**  
FOR THE  
**VERMONT DEPARTMENT OF  
BANKING, INSURANCE, SECURITIES  
& HEALTH CARE ADMINISTRATION**



OF

**NORTHBROOK LIFE INSURANCE COMPANY**

PHOENIX, ARIZONA

AS OF AUGUST 31, 2002

**HUFF THOMAS**

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**SALUTATION**

January 15, 2003

Honorable John P. Crowley  
State of Vermont  
Commissioner of Banking, Insurance, Securities  
And Health Care Administration  
89 Main Street, Drawer 20  
Montpelier, VT 05620-3101

Dear Commissioner Crowley:

Pursuant to your authority delegated under the provisions of Title 8 V.S.A. §§ 3564 and 3573 and in accordance with your instructions, a target market conduct examination of the business practices and affairs has been conducted on:

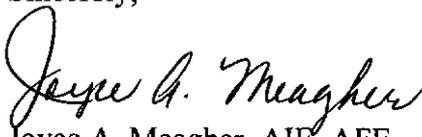
**Northbrook Life Insurance Company**

Statutory Home Office:  
5343 North 16<sup>th</sup> Street, Suite 300  
Phoenix, Arizona 85016

Administrative Office:  
3100 Sanders Road  
Northbrook, Illinois 60062-7154

hereinafter referred to as "Northbrook" or the "Company." The examination was conducted offsite at the office of Huff, Thomas & Company, 4700 Belleview, Suite 208, Kansas City, Missouri 64112. The report on examination is herewith respectfully submitted.

Sincerely,



Joyce A. Meagher, AIE, AFE  
Examiner

## **FORWARD**

This report of examination is confined to comments on exceptions that involve departures from laws, regulations or bulletins and questionable business practices or patterns that are determined to be contrary or detrimental to the best interests of the insurance buying public and require special explanation or description. The failure to identify or criticize certain practices does not constitute acceptance by the examiners.

## **SCOPE OF EXAMINATION**

This target market conduct examination commenced on October 15, 2002, and covered the period beginning January 1, 1999 and ending August 31, 2002. Representatives from Huff, Thomas & Company as Examiners for the Vermont Department of Banking, Insurance, Securities & Health Care Administration (Department) conducted this examination.

This examination was conducted pursuant to the provisions of Title 8 V.S.A. §§ 3564, 3573, and in accordance with procedures and guidelines outlined in the Market Conduct Examiners Handbook as adopted by the National Association of Insurance Commissioners (NAIC) and/or consistent with the predetermined market conduct program presented to and approved by the Department.

The purpose of this target market conduct examination was to determine the Company's ability to fulfill and the manner of fulfillment of its obligation, the nature of its operations, whether it has given proper treatment to policyholders and its compliance with specified sections of the Vermont statutes and Administrative Rules and Regulations.

This examination included a review of the applicable records and files pertaining to the phases listed below. The Company responded to a series of questions and written inquiries regarding the results of the files being examined.

This examination was comprised of the following two phases:

**Complaint Handling**

**Marketing and Sales**

## **PROFILE**

### **HISTORY**

Northbrook Life Insurance Company was incorporated as a stock life insurance company under the laws of the State of Illinois on December 20, 1978 and commenced business on December 29, 1978. The Company was organized by Allstate Insurance Company (AIC), an Illinois property and casualty insurer.

A Plan and Agreement of Merger (Plan), dated January 4, 1980, was entered into by and between Northbrook Life Insurance Company of Texas (NLICTX), a Texas corporation (formerly known as Cross Country Life Insurance Company and wholly owned by AIC and the Company. According to the Plan, NLICTX was merged into the Company and dissolved. The Company was the surviving entity but assumed the incorporation date of NLICTX (December 16, 1959) for the purposes of complying with requirements of laws relating to the age of the Company.

Ownership of the Company was transferred from AIC to Allstate Life Insurance Company in December 1983. The Company redomesticated to the State of Arizona on December 28, 1998.

The Company is currently authorized to write disability insurance, life insurance, variable annuities and variable life insurance products.

The Company is a member of an insurance holding company system. The "ultimate controlling person" is the Allstate Corporation; a publicly owned diversified holding company with its principal interests in insurance and financial services, including asset management and broker-dealer operations.

The Company is authorized to transact business in all states, with the exception of New York, as well as the District of Columbia.

### **OPERATIONS**

The Company has strategic alliance with Morgan Stanley, to develop, market and distribute proprietary annuity and life insurance products exclusively through Morgan Stanley Financial Advisors. The relationship started during the early 1980's when Sears owned both the Allstate Insurance Group (Allstate) and Dean Witter Reynolds (DWR), and continued subsequent to Sears' divestiture of Allstate and DWR.

As of December 31, 2001, there were over 1,600 licensed agents, who are Morgan Stanley broker-dealers, producing business for the Company. At December 31, 2001 the Company had over 140,000 life insurance and annuity contracts in force with Morgan Stanley clients.

Based upon the demographics of the Morgan Stanley clients, the Company has focused on providing investment-oriented products. The Company currently offers variable annuities, single premium deferred annuities, market value adjusted annuities and single premium immediate annuities. The Company also offers interest-sensitive life insurance, including single premium variable life.

## EXECUTIVE SUMMARY

This target exam was focused on compliance with specific sections of Vermont Statutes and Regulations that the Department has found to be problematic with life and annuity insurance companies. The Department's experience has shown that Vermont Consumers are especially vulnerable to potential abuses of replacement sales and suitability issues. Therefore the exam was structured to determine if key provisions of the regulations concerning replacement sales and suitability issues were being complied with.

In addition, the exam looked at compliance with complaint reporting issues because the Department wanted to verify that the information they were receiving was complete.

The major finding of the exam is that the Company is not following the mandates of the Vermont replacement regulation and they have not taken responsibility to verify that its appointed agents are selling suitable policies.

## PERTINENT FACTUAL FINDINGS

### COMPLAINTS

***Complaint Handling Standard #1 - The Company's maintains a complaint record as required by Vermont Regulation 76-1 §§3 and 4.***

A comparison was made of Vermont's required minimum record complaint content (Regulation 76-1 §4) with the content maintained by the Company in its complaint handling system. Upon review it was found the Company reason codes did not include the "Refusal to Insure" reason code as required by the regulation.

It is recommended the Company add the reason code "Refusal to Insure" to its complaint handling system and provide proof to the Department that this has been accomplished.

***Complaint Handling Standard #2 - The Company files annually with the Vermont Department of Banking, Insurance, Securities and Health Care Administration a summary sheet of its complaint record as required by Vermont Regulation 76-1 §5.***

The Company was asked to provide copies of the annual complaint reports, as required of Regulation 76-1 §5, filed during the examination period. The Company advised it had not, during the period of examination, filed a summary of its complaint record with the Department, as required by the regulation.

It is recommended the Company immediately develop and maintain procedures for filing a summary of its complaint record and provide written evidence to the Department that this procedure has been completed.

## MARKETING AND SALES

*Marketing and Sales Standard #1 – The Company informed its producers of the requirements of the new replacement regulation and incorporated the requirements into all relevant producer training materials prepared by the insurer as required by Vermont Regulation I-2001-03 §4(A)(1).*

Documentation was provided that indicated the Company did communicate the requirements of Vermont's new replacement regulation to the contracted financial services firms with whom the Company has selling agreements. However, the Company could not confirm that the individual producers had or had not been informed of the new regulations.

The appointed producers are employees of financial services firms with whom the Company has agreements to sell its products. According to the Company, training materials developed to inform the producers of changes in Vermont statutes and regulations are required, pursuant to the selling agreement, to be prepared and provided by the financial services firms. Northbrook did not have copies of any training materials developed and used by the financial service firms. It is the opinion of the examiner, that without a system to monitor what training materials are being used by the financial services firms, the Company has no way to insure that their statutory obligations are being met. Although the company can contract out the activity mandated by the Statutes and Regulations, it is still responsible to see that these activities are performed.

It is recommended the Company develop guidelines and establish a monitoring system to assure that all producers are being informed of changes in Vermont statutes and regulations and have received adequate training to assure compliance with all requirements.

*Marketing and Sales Standard #2 – The Company provides to each producer a written statement of its position with respect to the acceptability of replacements providing guidance to its producer as to the appropriateness of these transactions as required by Vermont Regulation I-2001-03 §4(A)(2).*

Northbrook did provide evidence of a written statement with respect to the acceptability of replacements, which they have incorporated into the selling agreement with the

various financial services firms. The Company did not provide its appointed producers, who are employees of the contracted financial services firms, with a written statement of its replacement position as required by Regulation I-2001-03 §4(A)(2).

It is recommended the Company establish a procedure and a monitoring system to assure each appointed producer is provided a written statement of its position as to the acceptability of replacements and the appropriateness of such transactions.

***Marketing and Sales Standard #3 – The Company has procedures in place to confirm that the requirements of the replacement regulation have been met as required by Vermont Regulation I-2001-03 §4(A)(4).***

A request was sent to the Company to ascertain what procedures the Company has developed to assure the requirements of the new replacement regulation are being met. In response, the Company advised that the new replacement requirements were communicated to its New Business Team. The New Business team is a unit within the Company that processes new applications for annuity contracts. It is the New Business team's responsibility to insure that appropriate "point of sale" forms are present and properly executed. There were no written procedures for this process. There were no procedures that were provided to confirm that the requirements of this regulation have been met.

To assure the requirements of Reg. I-2001-03 are being met it is recommended the Company establish written procedures for the New Business Team as required by Reg. I-2003-03 §4(A)(4).

***Marketing and Sales Standard #4 – The Company has procedures to detect transactions that are replacements of existing policies or contracts by the existing insurer, but that have not been reported as such by the applicant or producer as required by Vermont Regulation I-2003-03 §4(A)(5).***

A request was sent to the Company to ascertain if the Company has a process in place to track unreported replacements of existing policies or contracts not reported by the applicant or producer. The Company advised that they do have a process to track unreported replacements as required by the new replacement regulation, Reg. I-2001-03 § 4(A)(5). In non-replacement situations a confirmation letter accompanies the issued contract, which asks the owner to certify that the policy was not issued as the result of a replacement of an existing contract.

***Marketing and Sales Standard #5 – The Company requires with or as a part of each application for life insurance or an annuity a signed statement by both the applicant and the producer as to whether the applicant has existing policies or contracts as required by Vermont Regulation I-2001-03 §(4)(C).***

To test this Standard all 33 annuity policies sold to Vermont residents after March 1, 2002 were reviewed. Only five of the policies involved replacement. All 33 of the files were reviewed to ascertain if there was a statement signed by both the applicant and the producer regarding existing policies or contracts. There was no statement in any of the 33 files reviewed.

It is recommended the Company incorporate the statement required by Regulation I-2001-03 §(4)(C) into its Northbrook applications and provide proof to the Department that this has been accomplished.

***Marketing and Sales Standard #6 –The Company shall require with each application for life insurance or an annuity that indicates an existing policy or contract a completed notice regard replacements as specified by Vermont Regulation I-2001-03 §(4)(D).***

To meet the requirement of Regulation I-2001-03 §(4)(D) the Company created Form NLR739-1. To test this Standard all 33 annuity policies sold to Vermont residents after March 1, 2002 were reviewed. Only five of the policies involved replacement. All five replacement policies were reviewed to determine if a properly executed Form NLR739-1 was in the file. Only one of the five replacement policy files included the required form.

It is recommended the Company develop and implement procedures to insure that when an existing policy or contract is being replaced that all producers present the required notice regarding replacements to the applicant as required of Vermont Regulation I-2001-03 §(4)(D).

***Marketing and Sales Standard #7 – When the applicant has existing policies or contracts, the Company shall be able to produce copies of any sales material, the basic illustration and any supplemental illustrations related to the specific policy or contract that was purchased as required by Vermont Regulation I-2001-03 §(4)(E).***

To test this Standard all 33 annuity policies sold to Vermont residents after March 1, 2002 were reviewed. Only five of the policies involved replacement.

In the five replacement files there were no producer statements in the files that identified any preprinted or electronically company approved sales materials used in the presentation as required by Regulation I-2001-03 §(4)(E). There were no copies of any individualized sales materials, including any illustrations related to the specific policy or contract purchased as required by Regulation I-2001-03 §(4)(E).

It is recommended the Company develop and implement procedures to insure that all documents required by Regulation I-2001-03 §3 are submitted to the insurer with the application and that producers include a statement identifying sales materials used and provide copies of any individualized sales materials, including illustrations, used in the transaction.

***Marketing & Sales Standard #8 – The Company has suitability standards for its products as required by Vermont Regulation I-88-3, Article III, §3.***

To determine if the company was in compliance with suitability requirements of the State of Vermont, the company was asked to answer a list of questions regarding its suitability practices. (See appendix 1). Vermont Regulation I-88-3 Article III, §3 states, "Every insurer seeking approval to enter into the variable life insurance business shall establish and maintain a written statement specifying the Standards of Suitability to be used by the insurer. Such Standards of Suitability shall specify that no recommendation shall be made to an applicant to purchase a variable life insurance policy and that no variable life insurance policy shall be issued in the absence of reasonable grounds to believe that the purchase of such policy is not unsuitable for such applicant concerning the applicant's insurance and investment objectives, financial situation and needs, and any other information known to the insurer or to the agent making the recommendation."

Although Northbrook did state that they had a suitability statement in its 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.

It is the opinion of the examiner that without any method 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 employees of the contracted financial services firms, they are still appointed by the company. Vermont statute, 8 V.S.A. Chapter 131 §48131(b) states that appointed producer acts as an agent of the insurer. Vermont statute 8 V.S.A. §4813(c) states 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 who they are employed by.

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

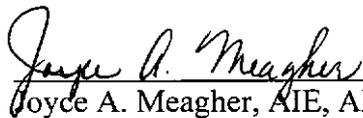
## SUMMARY OF RECOMMENDATIONS

1. It is recommended the Company add the reason code "Refusal to Insure" to its complaint handling system and provide proof to the Department that this has been accomplished. *(Page 4)*
2. It is recommended the Company immediately develop and implement procedures for filing a summary of its complaint record and provide written evidence to the Department that this procedure has been completed. *(Page 5)*
3. It is recommended the Company develop guidelines and establish a monitoring system to assure that all producers are being informed of changes in Vermont statutes and regulations and have received adequate training to assure compliance with all requirements. *(Page 5)*
4. It is recommended the Company establish a procedure and a monitoring system to assure each appointed producer is provided a written statement of its position as to the acceptability of replacements and the appropriateness of such transactions. *(Page 6)*
5. To assure the requirements of Reg. I-2001-03 are being met it is recommended the Company establish written procedures for use by the New Business team. *(Page 6)*
6. It is recommended the Company incorporate the statement required by Regulation I-2001-03 §(4)(C) into its Northbrook applications and provide proof to the Department that this has been accomplished. *(Page 7)*
7. It is recommended the Company develop and implement procedures to insure that when an existing policy or contract is being replaced that all producers present the required notice regarding replacement to the applicant as required of Vermont Regulation I-2001-03 §(4)(D). *(Page 7)*
8. It is recommended the Company develop and implement procedures to insure that all documents required by Regulation I-2001-03 §3 are submitted to the insurer with the application and that producers include a statement identifying sales materials used and provide copies of any individualized sales materials, including illustrations, used in the transaction. *(Page 7)*
9. It is recommended the Company establish suitability guidelines and procedures for the contracted financial services firms and establish a monitoring system to assure all appointed producers are following these guidelines. *(Page 8)*

## ACKNOWLEDGEMENT

In addition to the undersigned, Cecil W. Thomas, CIE, CFE participated in this examination of Northbrook Life Insurance Company.

Respectfully submitted.



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Joyce A. Meagher, AIE, AFE

Examiner

For the State of Vermont

Department of Banking, Insurance, Securities  
and Health Care Administration



AFFIDAVIT

STATE OF MISSOURI }
} ss
COUNTY OF JACKSON }

Joyce A. Meagher, being duly sworn, upon her oath deposes and says:

That she is an examiner appointed by the Commissioner of Banking, Insurance, Securities, and Health Care Administration for the State of Vermont;

That a target market conduct examination was made of complaints and marketing and sales of Northbrook Life Insurance Company for the period from January 1, 1999 through August 31, 2002;

That the foregoing 10 pages constitute the report to the Commissioner of Banking, Insurance, Securities, and Health Care Administration of the State of Vermont; and

That the statements, exhibits, and data therein contained are true and correct to the best of her knowledge and belief.

Joyce A. Meagher (signature)
Joyce A. Meagher, AIE, AFE
Examiner
For the State of Vermont
Department of Banking, Insurance, Securities and Health Care Administration

Subscribed and sworn to before me on the 18 day of December, 2003.

Jennifer A. Roe (signature)
Notary Public for the State of
My Commission Expires 09/24/06



JENNIFER A. ROE
Jackson County
My Commission Expires
September 24, 2006

**APPENDIX - COMPANY RESPONSE TO SUITABILITY GUIDELINES**



# Allstate.

November 5, 2002

Ms. Joyce Meagher  
Examiner-In-Charge  
Huff, Thomas & Co.  
4700 Belleview, Suite 208  
Kansas City, MO 64112

**RE: Target Market Conduct Examination  
Northbrook Life Insurance Company  
MEMORANDUM - REQUEST # 9**

Dear Ms. Meagher,

This is in response to your request for additional information – Memorandum – Request #9.

- 1. Does the Company have an individual or section that is responsible for compliance with established guidelines for suitability?*

**No. As previously detailed, while producers of Northbrook products are appointed agents of Northbrook, they are employed and supervised by non-affiliated financial services firms with whom we have selling agreements. Pursuant to such selling agreements, it is the responsibility of the financial services firms to ensure that recommended products are suitable to the needs and circumstances of their customers.**

- 2. Does the Company provide each producer with written guidelines and procedures as to what relevant information should be obtained from a consumer prior to making recommendations to a consumer?*

**No. As indicated in #1 above, it is the responsibility of the selling broker dealer to assure that relevant information is obtained from a consumer prior to making recommendations. The Northbrook General Agency agreement contains a provision (which was previously provided with the original request for information-Item Marketing and Sales #7) describing Northbrook's requirement that agents covered under the agreement recommend Northbrook policies**



# Allstate.

only to those applicants for which the policy is suitable to the applicant's insurance and investment objectives, financial situation and needs.

3. *Does the Company have any training programs or materials available to producers that include information regarding the analysis of consumer insurable needs and financial objectives?*

**Yes.** Northbrook has in the past participated in a bi-weekly publication, 'Selling Points', for producer use, which describes specific sales oriented situations and the specific application of a product(s) features.

4. *Is there a monitoring system in place to reasonably assure that the Company or its producers enter into transactions that assist a consumer in meeting his or her insurable needs or financial objectives?*

**No.** As indicated in #1 above it is the responsibility of the selling broker dealer to assure that its producers enter into transactions that assist a consumer in meeting his or her insurable needs or financial objectives.

5. *Do supervisors take appropriate actions when producers practice unfair trade practices? If so, please identify the types of action to be taken.*

Each selling agreement that Northbrook enters into with non-affiliated firms contains a termination clause that Northbrook can exercise should it be determined that the selling broker dealer or its producers have engaged in unfair trade practices or failed to comply with Northbrook's ethical market conduct as described in the exhibit to the selling agreement. Engaging in unfair trade practices or failure to comply with Northbrook's ethical market conduct can result in a producer's termination of his/her appointment with Northbrook.

Sincerely,

Sales Miller  
Senior Manager