

MARKET CONDUCT EXAMINATION REPORT

ALLIANZ LIFE INSURANCE COMPANY OF NORTH AMERICA

NAIC # 90611
5701 Golden Hills Drive
Minneapolis, MN 55416

MATS # KS-KS182-20

As of

December 31, 2016



KANSAS INSURANCE DEPARTMENT

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The Honorable Ken Selzer
Insurance Commissioner
Kansas Insurance Department
420 SW Ninth Street
Topeka, KS 66612

Dear Commissioner Selzer:

In accordance with your respective authorization, and pursuant to K.S.A. 40-222, a market conduct examination has been conducted on the business affairs of:

Allianz Life Insurance Company of North America
NAIC # 90611
5701 Golden Hills Drive
Minneapolis, MN 55416

hereafter referred to as “Allianz” or the “Company”, the following report of such examination is respectfully submitted,

Tate Flott, AIE, MCM, ALMI, AIRC, ACS
Chief Examiner, Market Regulation
Examiner-in-Charge

PURPOSE AND SCOPE OF REVIEW

A targeted market conduct examination of Allianz Life Insurance Company of North America was conducted pursuant to, but not limited to K.S.A. 40-222.

The Kansas Insurance Department (KID) reviewed the Company's complaint handling as well as marketing and sales, including suitability, specific to individual annuities. After an increase in the Company's consumer complaints, analysis was performed which resulted in the recommendation of a market conduct examination. The review was performed at KID on electronic files provided by the Company and was conducted according to the guidelines and procedures recommended in the 2017 NAIC Market Regulation Handbook (MRH). This examination report is written primarily by exception. Due to the limited scope of the exam, not all NAIC standards were tested. Silence on any NAIC standard or Company practice does not imply KID acceptance or endorsement of such practices. Applicable statutes and regulations cited throughout the report may be found in the Appendix.

The examination included a review of complaints as well as a sample that included both fixed index annuity declined applications and contracts issued during the exam period of January 1, 2014 through December 31, 2016. Interrogatories were submitted to the Company prior to the file review segment of the examination, and written responses were provided. The examination also included, but was not limited to, company operations and management, history and profile, prior market conduct examination reports, fines and penalties, Certificate of Authority, and internal audit procedures.

EXECUTIVE SUMMARY

A targeted market conduct examination of Allianz Life Insurance Company of North America was conducted pursuant to, but not limited to K.S.A. 40-222. The examination period was from January 1, 2014 through December 31, 2016. The exam focused primarily on marketing and sales, including suitability, specific to fixed index annuities.

Recommendations:

OPERATIONS AND MANAGEMENT

1. The Company must develop enhanced procedures to ensure producers are retaining documentation. Additionally, it is recommended that the Company create an audit program with respect to producer files.
2. Overall the Company was responsive and cooperative throughout the examination. However, the Company should consistently ensure that it contacts KID to request an extension prior to the due date.

COMPLAINT HANDLING

1. The Company must ensure all required fields, including dates, are accurately recorded on their complaint register.
2. The Company should ensure that all complaint files are legible and complete.

MARKETING AND SALES

1. The Company must conduct a review of replacement applications received after the exam period to ensure notifications are being sent to existing carriers within required timeframes.
2. The Company should reinforce with producers and contracted third parties the requirements contained within K.A.R. 40-9-118.
3. The Company must review its suitability supervision program including, but not limited to, requiring consistent submissions of company-created worksheets and retention of substantiating documentation from producers.
4. The Company should reinforce with producers its requirements for advertising with regards to free meal offers.

DESK EXAMINATION

OPERATIONS AND MANAGEMENT

[Based on Company response to interrogatories]

North American Casualty was incorporated in Minnesota on April 17, 1896 and commenced business May 8, 1896. North American Casualty merged with North American Life Association in 1912 to become North American Life and Casualty (NALAC). In May 1968, NALAC acquired the assets and business of the Thomas Edison Life Insurance Company, Des Moines, Iowa and its wholly-owned subsidiary, Financial Plans, Inc., a broker/dealer. Subsequently, Thomas Edison Life's operations were fully merged into NALAC.

From late 1971 to 1979, NALAC was controlled (over 98%) by the Mutual Life Insurance Company of New York. In November 1979, Mutual of New York completed the sale of its interest in NALAC to Allianz Minnesota Life Insurance Company, a subsidiary of the Allianz Insurance Group of West Germany. Through its subsidiary companies, Allianz maintains life/health and property/casualty insurance operations on a worldwide basis. On January 1, 1981, NALAC was merged into its parent, Allianz Minnesota Life, which concurrently adopted the name North American Life and Casualty Company.

On March 31, 1993, NALAC changed its name to Allianz Life Insurance Company of North America (Allianz Life). Subsequently, as of May 31, 1993, Allianz Life acquired all the assets and liabilities of Fidelity Union Life Insurance Company of Dallas, Texas. Fidelity Union was under common ownership with Allianz Life. It was also owned by Allianz AG Holding of Munich, Germany.

On May 16, 1999, Allianz Life acquired LifeUSA Insurance Company. LifeUSA and Allianz Life merged on July 1, 2002.

The Company made a decision to exit the affinity/association market to focus its group insurance related product offerings on those products and markets that Allianz Life believed offered the greatest opportunities for long term growth. This market exit was completed by the end of 2003. In 2006, the Company also made the decision to no longer provide healthcare excess of loss products and services. This portion of the business was sold and reinsured to HCC Life effective October 1, 2006. On November 2, 2009, the Company announced plans to stop selling stand-alone long-term care products as of November 13, 2009. While it no longer sells stand alone long term care insurance, the Company continues to consider opportunities for the development of new long term care combination products.

Allianz Life currently offers a portfolio of individual fixed indexed annuities, variable annuities and life insurance products. It distributes fixed indexed annuities and life insurance through Field Marketing Offices. It also distributes fixed indexed annuities and our variable annuities through a broker-dealers channel.

When reviewing the applicable Standards listed in the MRH, the following should be noted from the review of operations and management:

- The Company has an internal audit program. However, there were no audits of third parties doing business in Kansas during the examination period.
- The Kansas Certificate of Authority was reviewed and complies with Kansas law.
- There were 13 instances where the Company submitted responses to examiners beyond the due date.
- Documentation regarding producer disciplinary actions was reviewed. Company procedures regarding the producer watch list were also examined. During the examination period, reviews occurred on 24 producers. Of those, no action was taken in ten cases, seven producers were provided education, five producers were terminated, and two producers were added to the Watch List. Additionally, the Company maintains an agent oversight board and a total of three producers were reviewed during the examination period. Two of those producers were referred to the board multiple times.
- There were 21 instances of the Company being unable to locate the producer file for recommendations in the sample. Based on the sample of 108 policies, this represents an error rate of 19.4%. The Company stated that there was one instance in which the contract was declined due to suitability and two of the contracts were cancelled prior to issue. K.S.A. 40-222 (c) indicates that examiners should have free access to books and papers of companies as well as agents during the course of an examination. Additionally, the Company's *Producer Guide to Annuity Suitability* requires that producers maintain all sales records for at least 10 years. However the Company does not audit the producer records. As a result it does not verify whether the producer is maintaining files as required. It is also unable to confirm the volume of information being retained.

COMPLAINT HANDLING

The examiners reviewed the Company's procedures for handling various types of complaints. Also, a register containing 25 total complaint files was provided for the exam period, which included both complaints received from the Department of Insurance and consumers directly.

When reviewing the applicable Standards listed in the MRH, the following should be noted from the review of complaint handling:

- There was one instance where the log showed a received date of 8/5/14. However the letter was postmarked 7/18/14. The employee traveled frequently; regardless this date should reflect when it is first received by the Company.
- The Company had four files not included on the register. The Company advised that they were re-opened complaints. As such the Company removes the re-opens when a

complaint log is produced. However, when there is a re-opened file disposition dates must be updated on the complaint register.

With the number of inconsistencies in the complaint register, the record is not entirely compliant with K.S.A. 40-2404 (10).

- Three files contained illegible date stamps. The Company should ensure that all complaint files are legible. This is a violation of K.A.R. 40-1-34, (4).

MARKETING AND SALES

Interrogatories specific to marketing and sales were sent to the Company. Separate interrogatories were also sent regarding suitability. Additionally, data was requested for the exam period specific to fixed index annuities. From this data, a sample of 108 policies were selected for review. Applications, suitability paperwork, producer files, and all other documentation related to the sale were requested.

The Company distributes fixed indexed annuities through Field Marketing Offices and broker-dealer channels.

When reviewing some of the applicable Standards listed in the MRH, the following should be noted from the review of marketing and sales:

- There were a total of 599 replacement applications received during the exam period. Of these, 143 replacement notifications were sent to the existing carrier outside of the required timeframe. This includes 10 replacements that were never reported to the other carrier. This represents an error rate of 23.9%. This is a violation of K.A.R. 40-2-12(f)(3).
- Policies in the sample sold through “The Revolution” field marketing organization contained materials offering a “reasonable rate of return” which varied from 3-8%. It does not appear that these claims are based on Allianz product-specific data. All of these files also contain a questionnaire checklist created by the Revolution for agent use. Included within these are graphs which are either printed or drawn by the producer. It appears the graphs are intended to compare the stock market to fixed index annuities. The graphs appear to be fictitious, as there are no dates to validate any of the points. These 32 files represent an error rate of 29.6%. This is in violation of K.A.R. 40-9-118(4)(A).
- For 10 policies in the sample, producers indicated to consumers the Allianz 222 product offered such features as “150% ROR Income,” “150% ROR Income/DB,” “150% ROR Bonus,” “150% Annual Bonus,” and “150% Income ROR Bonus.” In reality the product offers a protected income value interest bonus factor of 150%. This is in violation of K.A.R. 40-9-118(4)(A).

- The *Producer Guide to Annuity Suitability* requires the producer to always complete and maintain Financial Inventory worksheets, along with replacement worksheets when a replacement is involved. However submitting these worksheets with the application is optional. There were 79 files in the sample that contained no Financial Inventory Worksheet; 16 had no Financial Inventory Worksheet or Replacement Worksheet; 5 contained a Replacement Worksheet but no Financial Inventory Worksheet; and 1 contained a Financial Inventory Worksheet but no Replacement Worksheet.

It is the Company's responsibility to verify the producer's opinion that a sale is suitable. K.A.R. 40-2-14a(8)(A) states that "An insurer is responsible for compliance with this Policy and Procedure..." While the Company requires the producer to always complete and maintain Financial Inventory worksheets, along with the replacement worksheets when a replacement is involved, no evidence was presented that any audits occur to ensure this is actually happening. There was significant inconsistency within the sample in terms of recordkeeping. Many of the files included financial worksheets created by producers or third-parties. Without consistent submission of company-created worksheets, along with retention of substantiating documentation, suitability reviews cannot reasonably be conducted. This is a violation of K.A.R. 40-2-14a(9)(A).

- Call-outs occur when a Company contacts a consumer to confirm their understanding of an annuity purchase. The Company utilizes call-outs in two circumstances. One is by the suitability reviewer to gather additional information when completing their analysis. The second circumstance is by the Customer Care team as part of the 75-Plus Call Program. The Customer Service Team (which is a component of the Suitability Team) contacts new fixed annuity owners age 75 and older to review key aspects of the annuity, answer any questions, and assess the customer's understanding of the annuity they are purchasing. The Customer Service Team uses call scripts when contacting customers to review their product. The call-out program utilized by the Company appears to be beneficial for consumer understanding of the purchase. Expanding the program to additional consumers would be a positive addition to the suitability process.
- For applications where the owner is a revocable trust, the living grantor is presumably the owner for technical purposes. However non-individual owners, such as trusts, are not included in the 75+ calling program.
- One producer's website, pinnaclewalker.com, was specific to complimentary dinners. Among other things it did not mention annuities, said no agents/brokers/advisors were permitted and stated that the topic of the seminar was "Worried about a market crash?" One of the topics at the dinner involved the question "Is there a way to lower risk, but still get higher returns?" After bringing this to the Company's attention the website was quickly changed. Given the fact that the target demographic for these types of free dinner seminars is generally older, it is especially important that all advertisements not be misleading. As a result the Company should reinforce with producers its requirements for advertising when free meals are offered.

SUMMARY

This exam was performed due to a dramatic increase in consumer complaints, specifically in 2016 and 2017. Many of these involved either marketing concerns or questions of suitability. The most significant issues uncovered within this review concerned producer oversight, advertising and documentation retention. While written procedures exist in these areas, in practice it does not appear that they are followed on a consistent basis. Without consistent submission of company-created worksheets, along with retention of substantiating documentation, suitability reviews cannot reasonably be conducted. Considerable shortcomings were also noted with respect to replacement notifications to existing carriers. Based upon the findings specific recommendations will be made to the Company.

CONCLUSION

The following examiners from the Office of the Commissioner of Insurance in the State of Kansas participated in the review:

Market Regulation Division

Stacy Rinehart
Assistant Director,
Market Regulation

Tate Flott
Chief Examiner,
Market Regulation

Shannon Lloyd
Senior Examiner,
Market Regulation

Respectfully submitted,



Tate Flott, AIE, MCM, ALMI, AIRC, ACS
Chief Examiner, Market Regulation
Examiner-In-Charge

APPENDIX

Related Kansas Insurance Statutes and Administrative Regulations

K.S.A. 40-222. Examinations

(a) Whenever the commissioner of insurance deems it necessary but at least once every five years, the commissioner may make, or direct to be made, a financial examination of any insurance company in the process of organization, or applying for admission or doing business in this state. In addition, at the commissioner's discretion the commissioner may make, or direct to be made, a market regulation examination of any insurance company doing business in this state.

...

(c) For the purpose of such examination, the commissioner of insurance or the persons appointed by the commissioner, for the purpose of making such examination shall have free access to the books and papers of any such company that relate to its business and to the books and papers kept by any of its agents and may examine under oath, which the commissioner or the persons appointed by the commissioner are empowered to administer, the directors, officers, agents or employees of any such company in relation to its affairs, transactions and condition.

...

(g) The refusal of any company, by its officers, directors, employees or agents, to submit to examination or to comply with any reasonable written request of the examiners shall be grounds for suspension or refusal of, or nonrenewal of any license or authority held by the company to engage in an insurance or other business subject to the commissioner's jurisdiction. Any such proceedings for suspension, revocation or refusal of any license or authority shall be conducted in accordance with the provisions of the Kansas administrative procedures act.

...

K.S.A. 40-2404 Unfair methods of competition and unfair or deceptive acts or practices

...

(10) Failure to maintain complaint handling procedures. Failure of any person, who is an insurer on an insurance policy, to maintain a complete record of all the complaints which it has received since the date of its last examination under K.S.A. 40-222, and amendments thereto; but no such records shall be required for complaints received prior to the effective date of this act. The record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of the complaints, the date each complaint was originally received by the insurer and the date of final disposition of each complaint. For purposes of this subsection, " complaint " means any written communication primarily expressing a grievance related to the acts and practices set out in this section.

...

K.A.R. 40-2-12 Replacement of life insurance and annuities.

...

(f)(3) within three working days, notify each insurer whose insurance is being replaced by another insurer;

...

K.A.R. 40-2-14a. Life insurance and annuities; recommendation standards.

Section 9. Recordkeeping

A. Insurers, general agents, independent agencies and insurance producers shall maintain or be able to make available to the commissioner records of the information collected from the consumer and other information used in making the recommendations that were the basis for insurance transactions for five years after the insurance transaction is completed by the insurer. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

K.A.R. 40-9-118 Life insurance and annuities; advertising.

<http://www.ksinsurance.org/documents/department/regulations-adopted/article-9/40-9-118-attachment.pdf>

...

Section 2. Definitions

For the purpose of this Policy and Procedure:

- A. (1) "Advertisement" means material designed to create public interest in life insurance or annuities or in an insurer or in an insurance producer; or to induce the public to purchase, increase, modify, reinstate, borrow on, surrender, replace or retain a policy including:
 - (a) Printed and published material, audiovisual material and descriptive literature of an insurer or insurance producer used in direct mail, newspapers, magazines, radio and television scripts, telemarketing scripts, billboards and similar displays, the Internet, and social media or any other mass communication media.
 - (b) Descriptive literature and sales aids of all kinds, authored by the insurer, its insurance producers, or third parties, issued, distributed or used by the insurer or insurance producer; including but not limited to circulars, leaflets, booklets, web pages, social media, depictions, illustrations and form letters;
 - (c) Material used for the recruitment, training and education of an insurer's insurance producers which is designed to be used or is used to induce the

- public to purchase, increase, modify, reinstate, borrow on, surrender, replace or retain a policy;
- (d) Prepared sales talks, presentations and materials for use by insurance producers.

...

Section 4. Form and Content of Advertisements

- A. Advertisements shall be truthful and not misleading in fact or by implication. The form and content of an advertisement of a policy shall be sufficiently complete and clear so as to avoid deception. It shall not have the capacity or tendency to mislead or deceive. Whether an advertisement has the capacity or tendency to mislead or deceive shall be determined by the Commissioner of Insurance from the overall impression that the advertisement may be reasonably expected to create upon a person of average education or intelligence within the segment of the public to which it is directed.



**Allianz Life Insurance Company
of North America**
5701 Golden Hills Drive
Minneapolis, MN 55416

Cara St. Martin
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Compliance Department

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September 27, 2018

Tate Flott, AIE, MCM, ALMI, AIRC, ACS
Chief Examiner, Market Regulation
Kansas Insurance Department
Tate.flott@ks.gov

RE: Kansas Market Conduct Exam Draft Report

Dear Mr. Flott:

This is in response to your draft report dated July 31, 2018. The responses below correspond to the Recommendations in the Executive Summary section of the Report. We appreciate the extension of time to respond to this letter as well as the professionalism of the examiners who worked on this exam.

OPERATIONS AND MANAGEMENT

Recommendation #1:

The Company must develop enhanced procedures to ensure producers are retaining documentation. Additionally, it is recommended that the Company create an audit program with respect to producer files.

Allianz Life Response:

Allianz has done a number of things to help educate the field on client file documentation including the financial inventory (or substantially similar document) and other important documents

- The Compliance area has created and delivered training and communications to Field Marketing Organizations (FMOs) on client file content. The objective of the training/communication has been to ensure insurance producers create and maintain sufficiently documented client files. Specifically, the training details

what to keep in the client file. Allianz encourages its FMOs to share this information directly with producers.

- Later this year, Allianz plans on sending out a communication directly to producers reminding them of the importance of this topic and directing them to additional communications.
- There is also suitability training available on the Allianz Life website, which includes a reminder to insurance producers of the importance of maintaining a well-documented client file.

The Company is also meeting with its senior management to discuss the resource needs and viability of creating an audit program of producer client files to ensure required documents are retained.

Recommendation #2:

When receiving communications from the Kansas Insurance Department (KID), timely responses from the Company are expected. If additional time is needed, the Company shall contact KID (prior to the deadline) to request an extension.

Allianz Life Response:

Allianz respectfully requests this Recommendation be removed from the report, as it gives the appearance that Allianz purposely delayed providing information to the Department, which is not the case. Allianz was cooperative and responsive to every request, and it respectfully disagrees with any finding that suggests that its responses were untimely. Allianz worked closely with the Department to ensure timely submissions and to ensure all submissions were responsive and complete. Allianz requested extensions as soon as the need was identified and all were agreed to by the Department. There were a handful of situations in which we received information late in the day. We immediately called the Department, which agreed submission the next business day would be acceptable. Most, but not all, of these extensions were documented. Allianz will ensure future diligence in responding to the KID.

COMPLAINT HANDLING

Recommendation #1:

The Company must ensure all required fields, including dates, are accurately recorded on their complaint register.

Allianz Life Response:

Allianz has updated its complaint procedures to ensure the inclusion of all required fields on the complaint register.

Recommendation #2

The Company should ensure that all complaint files are legible and complete.

Allianz Life Response:

Allianz will be reviewing the legibility of the date stamp as part of its quality assurance process.

MARKETING AND SALES

Recommendation #1:

The Company must conduct a review of replacement applications received after the exam period to ensure notifications are being sent to existing carriers within required timeframes.

Allianz Life Response:

The Company has taken a number of steps to ensure the notice is being sent as required:

- A daily preventive control report was implemented to validate that each replacement notice was sent as required;
- The notice was automated and is generated by the system when an application is submitted electronically for fixed annuity business; and
- An annual review will be conducted by the Compliance department to ensure the notice is sent on time.

Recommendation #2:

The Company should reinforce with producers and contracted third parties the requirements contained within K.A.R. 40-9-118.

Allianz Life Response:

As stated in the response provided on March 30, 2018 to Policy Violation #4, Allianz disagrees with the Department's findings. To summarize our earlier response, the form at issue is not an Allianz form. The form is product and insurance carrier agnostic and does not by itself favor any carrier or product. The form is a worksheet that is used by the producer and client at the time of sale. However, Allianz has reached out to the producer's field marketing organization (FMO), the Revolution, in regards to the worksheet. The Revolution has added the following disclosure to the "line drawing" on the form:

Note that the drawing of the lines is solely meant to be an artist's rendition, in a hypothetical manner, of the concept of the words up and down. It is not a depiction of the market or any product either past, present or future.

As far as the Matt Walker materials, Allianz disagrees with the Department's finding that this is an Allianz advertising violation. As stated in the response of March 30, 2018, the producer's handwritten notes do not appear to meet the definition of advertisement as set forth in K.A.R. 40-9-118

Despite our disagreement with the finding, however, we did agree the Allianz 222 product was described inappropriately by Mr. Walker. The Revolution, Mr. Walker's FMO, met with him to discuss the way in which he was describing the products and educate him on the correct way to do so. In addition, the following actions have taken place, or will take place shortly:

- The Revolution required Mr. Walker to expand his use of a third party compliance oversight company (Summit);

- By the end of September, the Revolution will meet with Mr. Walker to help develop client file protocol;
- The Revolution will conduct an offsite review of the first ten client files created after the meeting above; and
- The Revolution will visit his site quarterly to do a review of client files – this will be a sample.

The Revolution will assess the need to continue the onsite quarterly reviews after two quarters.

In addition, Allianz is working on an enhanced surveillance/monitoring program, but is in the early stages of development.

Recommendation #3:

The Company must review its suitability supervision program including, but not limited to, requiring consistent submissions of company-created worksheets and retention of substantiating documentation from producers.

Allianz Life Response:

The Company is in the process of reviewing this recommendation and meeting with its senior leadership team as explained in response to Recommendation #1.

Recommendation #4:

It is recommended that the Company consider expanding the call-out program.

Allianz Life Response:

The Company respectfully requests this Recommendation be removed from the report – Allianz is unaware of any Kansas regulation requiring the calling of clients. The Company voluntarily conducts the call out program to certain clients. The Company does this to ensure clients understand what they are purchasing and to answer any questions a client may have. Allianz is working with senior management on a possible expansion of this program to include risk-based calls. Staffing and funding will be necessary to implement the program. A decision should be made by year-end.

Recommendation #5:

It is recommended that the Company review suitability procedures with respect to trusts.

Allianz Life Response:

Allianz respectfully requests this Recommendation be removed for the reasons cited in response to #4 above. Allianz does review trusts as part of its suitability program. They are reviewed as if they were individually owned contracts based on the annuitant's age. Trusts are subject to the same rules engine as well. Currently, Allianz does not "call out" on trust-owned accounts as part of the 75+ call program. Allianz is working with senior management on a plan to possibly include trusts in its call out program.

Recommendation #6:

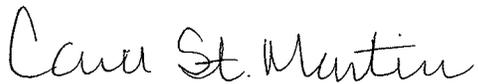
The Company should reinforce with producers its requirements for advertising with regards to free meal offers.

Allianz Life Response:

The Company has updated the Advertising Annual Notice to the field to reinforce the requirement to have all Allianz advertising preapproved. This notice will be sent to the field by the end of the year.

We would like the opportunity to discuss with you and Ms. Rinehart the report findings and our responses. Please let us know an acceptable time and date. Also, please let me know if you have any questions or concerns.

Sincerely,

A handwritten signature in cursive script that reads "Cara St. Martin".

Cara St. Martin

Cc: Stacy Rinehart