

STATE OF ARIZONA  
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DEPT. OF INSURANCE

**REPORT OF TARGETED EXAMINATION**  
**OF**  
**NATIONAL WESTERN LIFE INSURANCE COMPANY**

**NAIC# 66850**

**AS OF**

**MARCH 31, 2005**

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**CHRISTINA URIAS**  
Director of Insurance

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Honorable Christina Urias  
Director of Insurance  
State of Arizona  
2910 North 44<sup>th</sup> Street, Suite 210  
Phoenix, Arizona 85108-7269

Dear Director Urias:

Pursuant to your instructions and in conformity with the provisions of the Insurance Laws and Rules of the State of Arizona, a targeted examination has been made of the market affairs of:

**NATIONAL WESTERN LIFE INSURANCE COMPANY**

**NAIC # 66850**

The above examination was conducted by James R. Dargavel, FLMI, CIE, Examiner-in-Charge, Jerry Paugh, AIE, Senior Market Examiner and Helene I. Tomme, CPCU, CIE, Examinations Analyst.

The examination covered the period of October 1, 2004 through March 31, 2005.

As a result of that examination, the following Report of Examination is respectfully submitted.

Sincerely yours,


A handwritten signature in cursive script that reads "Paul J. Hogan".

Paul J. Hogan, JD, FLMI, ALHC, CIE  
Market Oversight Administrator  
Market Oversight Division

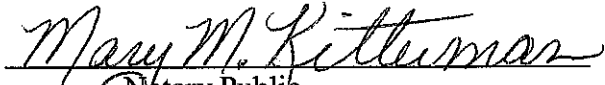
**AFFIDAVIT**

STATE OF ARIZONA                    )  
  )    ss.  
County of Maricopa                 )

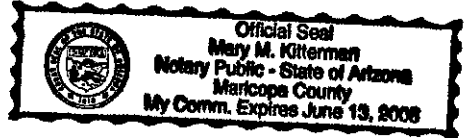
I, James R. Dargavel, FLMI, CIE, being first duly sworn state that I am a duly appointed Market Examinations Examiner-in-Charge for the Arizona Department of Insurance. That under my direction and with my participation and the participation of Jerry Paugh, AIE, Senior Market Examiner and Helene I. Tomme, CPCU, CIE, Examinations Analyst, the Examination of National Western Life Insurance Company, hereinafter referred to as the "Company." was performed at the offices of the Arizona Department of Insurance. A teleconference meeting with appropriate Company officials was held to discuss this Report, but a copy was not provided to management, as the Examination was not finalized. The information contained in this Report, consisting of the following pages, is true and correct to the best of my knowledge and belief and that any conclusions and recommendations contained in and made a part of this Report are such as may be reasonably warranted from the facts disclosed in the Examination Report.

  
James R. Dargavel, FLMI, CIE  
Market Examinations Examiner-in-Charge

Subscribed and sworn to before me this 17<sup>TH</sup> day of August, 2006.

  
Notary Public

My Commission Expires June 13, 2008



## **FORWARD**

This targeted market examination of National Western Life Insurance Company (“Company” or “National Western”), was prepared by employees of the Arizona Department of Insurance (“Department”) as well as independent examiners contracting with the Department. A targeted market examination is conducted for the purpose of auditing certain business practices of insurers licensed to conduct the business of insurance in the State of Arizona. The Examiners conducted the examination of the Company in accordance with Arizona Revised Statutes (A.R.S. §§20-142, 20-156, 20-157, 20-158, and 20-159. The findings in this report, including all work products developed in the production of this report, are the sole property of the Department.

The examination consisted of a review of the following components of the Company’s life and annuity business:

1. Provide a proper “free look period” for annuity contracts.
2. Communicate all of the required disclosures relative to annuity contracts.
3. Use of proper replacement practices.

## **SCOPE AND METHODOLOGY**

The examination of the Company was conducted in accordance with the standards and procedures established by the National Association of Insurance Commissioners (NAIC) and the Department. The targeted market examination of the Company covered the period from October 1, 2004 through March 31, 2005 for the business reviewed. The purpose of the examination was to determine: (1) if the Company uses annuity applications and contracts that contain the appropriate notice regarding Free Look and premium refund requirements; (2) if the Company utilizes annuity replacement procedures and practices, and provides training to its producers that complies with the applicable statutes; (3) if the Company uses compliant procedures for processing annuity refunds requested during the Free Look and 30 day option period; and (4) if the Company provides the required disclosure documents, buyer’s guide and annual reports on all annuity applications in compliance with the applicable statutes. This examination targeted the top 75% of the Arizona individual life and annuity insurance market.

The Examiners utilized both examinations by test and examination by sample. Examination by test involves review of all records within the population, while examination by sample involves the review of a selected number of records from within the population. Due to

the small size of some populations examined, examination by test and by sample were completed without the need to utilize computer software.

File sampling was based on a review of annuity new business files that were systematically selected by using Audit Command Language (ACL) software and computer data files provided by the Company's Representative, Rey Perez, Corporate Counsel. Samples are tested for compliance with standards established by the National Association of Insurance Commissioners and the Department. The tests applied to sample data will result in an exception ratio, which determines whether or not a standard is met. If the exception ratio found in the sample is, generally less than 5%, the standard will be considered as "met". The standard in the areas of procedures, forms and policy forms use will not be met if any exception is identified.

### **EXECUTIVE SUMMARY**

This examination was completed by applying tests to each examination standard to determine compliance with the standard. Each standard applied during the examination is stated in this report and the results are reported beginning on page seven.

The Company failed Standard No. 1 by using two annuity application form and seven annuity contract forms that failed to contain a Free Look Notice prominently printed on or attached to the first page of the application or contract that included:

1. A statement to the effect that contract holders age 65 or older have 30 days to return the annuity contract for a full refund of all monies paid, or
2. A statement notifying contract holders that, upon written request, the insurer is required to provide within reasonable time reasonable factual information regarding the benefits and provisions of the annuity contract to the contract holder.

The Company failed Standard No. 3 because:

1. It failed on 10 annuity policy summaries to provide information relative to the current death benefit and information relative to the amount of outstanding loans.
2. It failed to maintain a system on eight annuity new business replacement files to review the appropriateness of each replacement transaction for compliance with the Company's stated replacement policy.
3. It failed on 48 applications to require a statement signed by the applicant and insurance producer as to whether or not the applicant had an existing policy or contract.

4. It failed on six applications to require, with the application, the replacement notice prescribed by section 20-1241.03, subsections C and D or a replacement notice in a form approved by the Director.
5. It failed on 47 applications, which failed to meet the requirements of the article, to notify the producer and applicant and fulfill the outstanding requirements.
6. It failed to notify three existing insurers that may be affected by the proposed replacement within five business days of receipt of a completed application indicating replacement.
7. It failed on 10 applications to require, with the application, a statement signed by the producer stating that the producer used only sales material which had been approved by the Company.
8. It failed on 63 annuity replacement new business files to notify the applicant within ten days of the issuance of the contract or policy that the producer made a representation about using only sales materials that had been approved by the Company and that copies had been provided to the applicant.

The Company passed Standards Nos. 2, 4 and 5.

### STANDARD 1

**The following Life Insurance and Annuity Replacement and Disclosure Standard Failed:**

#	STANDARD	Regulatory Authority
1	Company annuity application and policy forms contain compliant notices concerning the policyholder's right to request benefit and contract provision information and the right to return the contract for a refund of premium.	A.R.S. § 20-1233(A), (B) & (C)

The Examiners reviewed National Western's annuity application and policy forms to determine if those forms contained notices that state the policyholder's right to request information regarding benefit and contract provisions, and the right to return the contract for a refund of premium.

**Procedures Performed:**

During the Phase I Examination, the Examiners reviewed one annuity application form, seven annuity contact forms and a random sample of 29 of 180 National Western annuity new business application files. During the Phase II Examination, the Examiners reviewed an

additional 52 annuity new business issued and 52 annuity new business external replacement files selected randomly from the above listed population.

**Finding:**

The Examiners issued a preliminary finding on one annuity application form and seven annuity contract forms that failed Standard 1. These forms failed to contain a Free Look Notice prominently printed on or attached to the first page of the application or contract that included:

1. A statement to the effect that contract holders age 65 or older have 30 days to return the annuity contract for a full refund of all monies paid, or
2. A statement notifying contract holders that, upon written request, the insurer is required to provide within a reasonable time reasonable factual information regarding the benefits and provisions of the annuity contract to the contract holder.

During the Phase II review of the 104 annuity files the Examiners identified one additional annuity application forms that failed Standard 1 because the application either failed to contain a Free Look notice, or contained a Free Look notice that failed to included a statement stating that, on written request, an insurer is required to provide within a reasonable time reasonable factual information regarding the benefits and provisions of the annuity contract to the contract holder and notifying contract holders age 65 years or older on the date of the application that they had 30 days after delivery in which to return the annuity contract for a full refund of all monies paid.

Form Number	Form Number
01-1114CA-98-AZ	01-1126C-02
01-1117C-99	01-1114-CB-98-AZ
01-1128C-02	01-1132C-03
01-1129C-03	01-9046-95
01-9046A-95	

**ANNUITY CONTRACTS AND APPLICATION FORMS**

Number of Exceptions	Population Reviewed	Percentage	Applicable Statute
9	Application and Contract forms	N/A	A.R.S. §20-1233(A)



**Recommendation No. 1**

Within 90 days of the filed date of this report, provide documentation that procedures and controls are in place to ensure that the Company uses annuity contract forms that contain a compliant Free Look notice.

**STANDARD 3**

**The following Life Insurance and Annuity Replacement and Disclosure Standard Failed:**

#	STANDARD	Regulatory Authority
3	Company rules pertaining to producer and company replacement requirements are in compliance with applicable statutes, rules and regulations.	A.R.S. § 20-1241.02; 20-1241.04, 20-1241.05, 20-1241.06, and 1241.07.

The Examiners reviewed National Western's procedures pertaining to producer and Company requirements in connection with replacement of annuity contracts.

**Procedures Performed:**

During the Phase I Examination, the Examiners reviewed the information provided by the Company in response to the Coordinator's Handbook Attachments A and B, Interrogatories, and follow-up requests.

The Examiners reviewed a random sample of 21 of 180 National Western annuity new business application files selected from the issued new business and internal replacement and external replacement new business populations.

A Phase II examination review was conducted to determine if additional annuity new business replacement files were improperly processed. The Examiners reviewed an additional 52 annuity new business issued files and 52 annuity external replacement files selected from the above listed populations.

**Finding:**

Ten of 10 (100.0%) annuity policy summaries failed Standard 3 because the policy summaries failed to contain information relative to the current death benefit and information relative to the amount of outstanding loans.

Form Number	Policy Number
01-1114CA-98-AZ	0100892921
01-1117C-99	0100901878
01-1128C-02	0100848614 (FQA60B)
01-1129C-03	

Form Number	Policy Number
01-1126C-02	
01-1114-CB-98-AZ	
01-1132C-03	

Eight of 63 (12.7%) annuity internal and external replacement files failed Standard 3 because the Company failed to maintain a system to review the appropriateness of each annuity replacement transaction for compliance with the Company's stated replacement policy.

Forty-eight of 125 (38.4%) annuity new business issued, internal and external replacement files failed Standard 3 because the Company failed to require a statement signed by the applicant and insurance producer as to whether or not the applicant had an existing policy or contract.

Six of 62 (9.7%) annuity external replacement files failed Standard 3 because the Company failed to require, with the application, the replacement notice prescribed by section 20-1241.03, subsections C and D or a replacement notice in a form approved by the Director.

Forty-seven of 125 (37.6%) annuity new business issued, internal and external replacement files failed Standard 3 because the Company because the applications failed to meet the requirements of the article but the Company failed to notify the producer and applicant and fulfill the outstanding requirements.

Three of 62 (4.8%) annuity external replacement files failed Standard 3 because the Company failed to notify existing insurers of the proposed replacement within five business days of receipt of a completed application indicating replacement.

Ten of 63 (15.9%) annuity internal and external replacement files failed Standard 3 because the Company prohibits the use of sales materials that have not been approved by the Company and the Company failed to require, with the application, a statement signed by the producer stating that the producer used only sales material which had been approved by the Company.

Sixty-three of 63 (100.0%) annuity internal and external replacement files failed Standard 3 because the Company failed to notify the applicant within ten days of the issuance of the contract:

a) That the producer made a representation that only approved sales materials were used during the sales presentation and that copies were left with the applicant.

b) To provide the applicant with a toll free number to contact insurer personnel responsible for regulatory compliance if the insurance producer did not leave sales materials..

c) To advise the applicant that it is important to retain copies of the sales material for future reference.

**COMPANY AND PRODUCER REQUIREMENTS REGARDING REPLACEMENT**

**PHASE I and PHASE II**

Number of Exceptions	Population Reviewed	Percentage	Applicable Statute
10	Forms	N/A	A.R.S. § 20-1241.02(B)
8	63	12.7%	A.R.S. § 20-1241.04(B)(3)
48	125	38.4%	A.R.S. § 20-1241.04(D)
6	62	9.7%	A.R.S. § 20-1241.04(E)
47	125	37.6%	A.R.S. § 20-1241.04(H)
3	62	4.8%	A.R.S. § 20-1241.05(C)
10	63	15.9%	A.R.S. § 20-1241.05(G)(1)
63	63	100.0%	A.R.S. § 20-1241.05(G)(2)

**An error ratio greater than 5% does not meet standards; therefore recommendations are warranted.**

**Recommendation No. 2**

Within 90 days of the filed date of this report, provide documentation that procedures and controls are in place to ensure that the Company: a) provides complete and compliant policy summaries to contract owners; b) adheres to its system to review the appropriateness of each annuity replacement transaction; c) requires with the application, a statement signed by the applicant and insurance producer as to whether or not the applicant had an existing policy or contract; d) requires with replacement applications the replacement notice prescribed by section 20-1241.03, subsections C and D and in a form approved by the Director; e) notifies the producer and applicant and fulfills outstanding requirements when applications fail to meet the requirements of the article; f) requires, with the application, a statement signed by the producer stating that the producer used only sales material which had been approved by the Company; and g) provides a complete and compliant advisory notice to applicants within 10 days after the issuance of the contract.

### SUMMARY OF STANDARDS

#	STANDARD	PASS	FAIL
1	Company annuity application and policy forms contain compliant notices concerning the policyholder's right to request benefit and contract provision information and the right to return the contract for a refund of premium.		X
2	Company producer training procedures and materials regarding replacement of existing coverage are in compliance with applicable statutes, rules and regulations.	X	
3	Company rules pertaining to producer and company replacement requirements are in compliance with applicable statutes, rules and regulations.		X
4	Company procedures for processing refunds under the "Free Look" option, or the 30 day option, if the application involved replacement of existing coverage, are in compliance with applicable statutes, rules and regulations.	X	
5	Company procedures that require disclosure documents, buyer's guides and annual reports be provided to contract owners are in compliance with applicable statutes, rules and regulations.	X	