

**[IN ACCORDANCE WITH CALIFORNIA INSURANCE CODE SECTION 12938,
THIS REPORT WILL BE MADE PUBLIC AND BE PUBLISHED ON THE
CALIFORNIA DEPARTMENT OF INSURANCE (CDI) WEBSITE]**

**WEBSITE PUBLISHED REPORT OF THE
TARGET COMPLIANCE EXAMINATION OF THE
RATING AND UNDERWRITING PRACTICES OF THE
AMERICAN EQUITY INVESTMENT LIFE INSURANCE
COMPANY
(NAIC #92738, CDI #2509-8)**

AS OF JULY 31, 2005

ADOPTED ON JUNE 15, 2012

STATE OF CALIFORNIA



**DEPARTMENT OF INSURANCE
MARKET CONDUCT DIVISION
FIELD RATING AND UNDERWRITING BUREAU**

NOTICE

The provisions of Section 735.5(a), (b), and (c) of the California Insurance Code describe the Commissioner's authority and exercise of discretion in the use and/or publication of any final or preliminary examination report or other associated documents. The following examination report is a report that is made public pursuant to California Insurance Code Section 12938(b)(1) which requires the publication of every report on an examination of unfair or deceptive practices in the business of insurance as defined in Section 790.03 that is adopted as filed, or as modified or corrected, by the Commissioner pursuant to Section 734.1.

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DEPARTMENT OF INSURANCE

CONSUMER SERVICES AND MARKET CONDUCT BRANCH
FIELD RATING & UNDERWRITING BUREAU
45 Fremont Street
San Francisco, California 94105



June 15, 2012

The Honorable Dave Jones
Insurance Commissioner
State of California
300 Capitol Mall
Sacramento, California 95814

Honorable Commissioner:

Pursuant to instructions, and under the authority granted under the California Insurance Code Part 2, Chapter 1, Article 4, Sections 730, 733, and 736 and Article 6.5, Section 790.04, an examination was made of the rating and underwriting practices and procedures in California of the

AMERICAN EQUITY INVESTMENT LIFE INSURANCE COMPANY
(NAIC #92738, CDI #2509-8)

hereinafter referred to as American Equity or the Company. The California Department of Insurance will be referred to as the Department.

This report is made available for public inspection and is published on the California Department of Insurance website (www.insurance.ca.gov) pursuant to California Insurance Code Section 12938(b)(1)..

FOREWORD

This examination covered the rating and underwriting practices of the aforementioned Companies during the period from January 1, 2004 through July 31, 2005. The examination was made to discover, in general, if these and other operating procedures of the Company conform to provisions of the California Insurance Code (CIC), the California Code of Regulations (CCR), and other applicable insurance law.

This report contains only alleged violations of CIC § 790.03 and its implementing regulations. A separate report pertains to laws other than CIC § 790.03.

This report is written in a “report by exception” format. This report does not present a comprehensive overview of the subject insurer’s practices. The report contains only a summary of pertinent information about the lines of business examined and of the non-compliant or problematic activities or results that were discovered during the course of the examination, along with the insurer’s proposals for correcting the deficiencies. All unacceptable or non-compliant activities may not have been discovered. Failure to identify, comment upon, or criticize non-compliant activities in this state or other jurisdictions does not constitute acceptance of such practices.

Alleged violations identified in this report, any criticisms of practices, and the Companies' responses, if any, have not undergone a formal administrative or judicial process.

SCOPE OF THE EXAMINATION

To accomplish the foregoing, the examination included:

1. A review of the rates, rating plans, forms, and underwriting rules made or adopted by the Companies for use in California, including a review of records of data, statistics, or information maintained by the Companies in support of or relating to such rates, forms, and rules.
2. A review of the application of such rates, forms, and rules by means of an examination of policy files and related records.
3. A review of the Company's advertising materials.
4. A review of any consumer complaints and inquiries received by the Department about the Company in the year prior to the start of the examination, a review of prior market conduct examination reports on the Company, and a review of any prior enforcement actions by the Department regarding the Company.

The examination was conducted principally at the Department's offices in Valencia, California and Los Angeles, California.

EXECUTIVE SUMMARY

This examination focused on American Equity's annuity business and was limited to the insurer's sale of policies to senior citizens (age 65 and older) during the period from January 1, 2004 through July 31, 2005, referred to as the "review period." The examination included a review of 99 annuity replacement policy files. The 99 policies reviewed represent the 99 oldest people who purchased a replacement policy from American Equity during the review period. The age range for these individuals was age 82 through age 90. Within the scope of this report, one general practice was alleged to be in violation of CIC § 790.03. American Equity failed to provide the Department with a copy of the procedures that it stated were in place to determine whether a replacement was appropriate for the insured. Additionally, the 99 files reviewed contained no evidence that procedures existed or were followed in determining that a replacement sale was not unnecessary and that the replacement contract would confer a substantial financial benefit to the purchaser over the life of the contract.

To date, no premium has been returned to consumers as a result of this examination.

METHOD OF DOING BUSINESS

American Equity Investment Life Insurance Company is a wholly-owned subsidiary of American Equity Investment Life Holding Company. The Company's business consists primarily of the sale of indexed and fixed rate annuities. The Company operates solely in the life insurance business.

American Equity markets its products through a variable cost brokerage distribution network of national marketing organizations and independent agents. These organizations typically recruit agents for American Equity by advertising the Company's products and commission structure, through direct mail advertising, or through seminars for insurance agents and brokers. These organizations bear most of the cost incurred in marketing the Company's products. American Equity compensates the marketing organizations by paying them a percentage of the commissions earned on new annuity policy sales generated by the agents recruited in such organizations. American Equity also conducts incentive programs for marketing organizations and agents from time to time, including equity-based programs for the Company's leading national marketers. American Equity generally does not enter into exclusive arrangements with these marketing organizations.

AUTHORIZED CLASSES OF BUSINESS

American Equity is authorized to transact the following classes of business in California:

Class No.	<u>Class Of Insurance</u>
1.	Life
6.	Disability

LIFE INSURANCE PREMIUMS AND ANNUITY CONSIDERATIONS

The following table shows American Equity’s California life insurance premiums and annuity considerations for calendar year 2005 based on data from the Annual Statements filed with the California Department of Insurance.

AMERICAN EQUITY INVESTMENT LIFE INSURANCE COMPANY
California Life Insurance Premiums and Annuity Considerations for Calendar Year 2005

Description	Premiums and Annuities
Life Insurance Ordinary Group	\$ 7,579 0
Annuity Considerations Ordinary Group	289,572,729 0
TOTAL	\$ 289,580,308

ANNUITY CONTRACTS MARKETED AND SOLD TO SENIORS

During the examination period American Equity marketed and sold 33 different annuity products to seniors age 65 and older. The 33 products were comprised of 30 Flexible Premium Deferred Annuities (FPDA), 2 Single Premium Deferred Annuities (SPDA) and 1 Single Premium Immediate Annuity (SPIA).

During the review period of January 1, 2004 through July 31, 2005 American Equity sold annuity policies to 3,656 individuals age 65 and over. The most popular policies sold were the IDX-26 7.5, the INDEX-28, the INDEX-1-05, and the FPDA7 2.25. These four products accounted for 80% of American Equity annuity policies sold to senior citizens in California during the review period. The IDX-26 7.5, INDEX-28, INDEX-1-05, and the FPDA7 2.25 annuities were sold to 30%, 24%, 15% and 11% of the population, respectively.

IDX-26 7.5 is a flexible premium equity indexed deferred annuity contract with a 7.5% premium bonus on the total initial premium and five interest crediting options (four indexed values and one fixed value). Interest credited to the Averaged Value is based on the monthly average of annual gains in the Standard & Poor's (S&P) 500 Index. Interest credited to the Point-to-Point value is based on annual gains in the S&P 500 Index. Interest credited to the Monthly Point-to-Point Value is based on the sum of monthly gains in the S&P 500 Index. Interest credited to the Bond Value is based on annual gains in the Lehman Brothers U.S. Treasury Index (Lehman Brothers Bond Index was discontinued after Lehman Brothers filed bankruptcy. The substitute bond index is the 10-Year United States Treasury Bond Index). Participation, Cap, and Asset Fee rates apply to the indexed value options. For policyholders age 0-80 at the time of issuance, the IDX-26 7.5 has a declining surrender charge period of 16 years. The highest surrender percentage is 17.5% in the first year. For policyholders age 81-85 the surrender charge period is 9 years with the highest percentage being 9% in the first year.

INDEX-28 is a flexible premium equity indexed deferred annuity contract with five interest crediting options (four indexed values and one fixed value). Interest credited to the Averaged Value is based on the monthly average of annual gains in the S&P 500 Index. Interest credited to the Point-to-Point value is based on annual gains in the S&P 500 Index. Interest credited to the Monthly Point-to-Point Value is based on the sum of monthly gains in the S&P 500 Index. Interest credited to the Bond Value is based on annual gains in the Lehman Brothers U.S. Aggregate Index (discontinued with the collapse of Lehman Brothers). Cap and Asset Fee rates apply to the indexed value options. For policyholders age 0-80 at the time of issuance, the INDEX-28 has a declining surrender charge period of 12 years. The highest surrender percentage is 15% in the first year. For policyholders age 81-85 at issuance, the surrender charge period is 9 years with the highest percentage being 9% in the first year.

INDEX-1-05 is a flexible premium equity indexed deferred annuity contract with a 10% premium bonus on the initial premium and seven interest crediting options, of which six are indexed values and one is a fixed value. Interest credited to the Averaged Values is based on the monthly average of annual gains in the S&P 500 Index and the Dow Jones Industrial Average (DJIA) Index. Interest credited to the Point-to-Point Values is based on annual gains in the S&P 500 Index and DJIA Index. Interest credited to the Monthly Point-to-Point Value is based on the sum of monthly gains in the S&P 500 Index. Interest credited to the Bond Value is based on annual gains in the Lehman Brothers U.S. Aggregate Index (discontinued due to collapse of Lehman Brothers). Caps and Asset Fee rates apply to the indexed value options). For policyholders age 0-80 at the time of issuance, the INDEX-1-05 has a declining surrender charge period of 17 years. The highest surrender percentage is 20% in the first year. For policyholders age 81-85 at issuance, the surrender charge period is 9 years with the highest percentage being 9% in the first year.

FPDA7 2.25 is a flexible premium deferred annuity with a market value adjustment provision. The annuity offers a guaranteed initial interest rate of 5.25% payable for the first contract year only. The FPDA7 2.25 has a declining surrender charge period of 12 years; the highest surrender percentage is 14% during the first two years.

Regarding the surrender periods and associated surrender charges on annuity contracts sold by American Equity, the product with the longest and highest surrender period for policyholders age 0-80 is the INDEX-1-05, followed by the IDX-26 7.75 and the INDEX-24. These three products, along with seven others (for a total of ten) provide a reduced surrender period of 9 years and reduced surrender charges that begin at 9% for policyholders who are age 81-85 at the time of purchase. There are two products that offer the same reduced surrender period and charge for policyholders who are age 78-85 at the time of purchase.

All of the contracts sold by American Equity provide a Nursing Care Rider and a Terminal Illness Rider to policyholders under age 75 at issuance with the exception of SPDA-6 and SPDA-6-3 which do not provide either of the riders, FPDA-1 which does not provide the nursing care rider, and FPDA-3 which does not provide the terminal illness rider.

The Nursing Care Rider (Form NCR-2) is automatically added to the policy at no cost for Annuitants under age 75 at issue. Annuitants age 75 and older at the time of purchase are not eligible for the rider. The benefit provided under the Nursing Care Rider increases the penalty-free withdrawal amount allowed under the base contract from 10% to 20% provided that the annuitant stays in a qualified nursing care center for 90 consecutive days, the stay begins after the first contract year ends, and American Equity receives proof of stay. FPDA-4 is the only annuity contract that was sold during the review period that offered Nursing Care Rider (Form NCR-4) which allowed for a 50% penalty free withdrawal if after two full contract years the annuitant stayed in a qualified skilled nursing facility for 60 consecutive days. American Equity

no longer sells the FPDA-4 product.

The Terminal Illness Rider (Form TIR-1) is automatically added to the policy at no cost for Annuitants under age 75 at issue. Annuitants age 75 and older at the time of purchase are not eligible for the rider. The benefit provided under the Terminal Illness Rider allows for a one-time penalty-free withdrawal of up to 75% of the contract value provided that a qualified physician provides notice that he or she has diagnosed the annuitant as having a terminal illness which is expected to result in death within one year, and the diagnosis and notice occur after the first contract year ends.

In regard to the death benefit provision in the American Equity annuity contracts, the beneficiaries receive the full contract value at death and American Equity does not assess a surrender charge. According to the Company, the only exception is the FPDA-4 annuity contract where for annuitants age 71 and older on the contract issue date, the death benefit equals the cash surrender value if a lump sum is elected. If the death benefit is payable to the beneficiaries over at least 5 years, proceeds equal the contract value. As stated previously, American Equity no longer offers the FPDA-4 product.

SUMMARY OF RELEVANT LAWS

The table below identifies the provision of CIC § 790.03 and/or its implementing regulations for which violations were alleged during the examination. Each law listed on the following table may be due to a general practice which affects many policyholders. One practice can also violate multiple laws or occur across multiple companies within an insurer group.

	Code Citation	Description of Law
1.	CIC § 790.03(a)	The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance. (a) Making, issuing, circulating, or causing to be made, issued or circulated, any estimate, illustration, circular or statement misrepresenting the terms of any policy issued or to be issued or the benefits or advantages promised thereby or the dividends or share of the surplus to be received thereon, or making any false or misleading statement as to the dividends or share of surplus previously paid on similar policies, or making any misleading representation or any misrepresentation as to the financial condition of any insurer, or as to the legal reserve system upon which any life insurer operates, or using any name or title of any policy or class of policies misrepresenting the true nature thereof, or making any misrepresentation to any policyholder insured in any company for the purpose of inducing or tending to induce the policyholder to lapse, forfeit, or surrender his or her insurance.

SUMMARY OF EXAMINATION RESULTS

During the American Equity examination, and within the scope of this report, one general practice was alleged to be in violation of CIC § 790.03 and its implementing regulations. In response to each of the Department's allegations of non-compliance, the Company is required to identify remedial or corrective action that was or will be taken to correct the deficiency.

Regardless of actions taken or proposed by the insurer in this report, it is the insurer's obligation to ensure that compliance with California law is maintained continuously. Any non-compliant practice identified in this report may extend to other jurisdictions. The Company was asked if it intends to take corrective action in all jurisdictions where applicable. The Company has not yet indicated whether it intends to implement corrective actions in all jurisdictions.

To date, no premium was returned to consumers as a result of the issue described in this report. American Equity's implementation of corrective actions based on this examination will continue to be reviewed by the Field Rating and Underwriting Bureau.

- 1) American Equity did not have a procedure in place to determine if its replacement annuity sales are considered unnecessary as defined by CIC Section 10509.8(b). Due to the lack of supporting evidence in the files provided, it appears that American Equity placed all responsibility for the evaluation of replacement applications on the agent. It is the Department's position that the Company is responsible for the actions of its agents. Regardless of whether a company delegates such decisions, it still retains responsibility for the final results and the agent's recommendation for replacement becomes the company's recommendation. Additionally, the individual policy files that were reviewed did not show any evidence that suitability was considered by the agent or the insurer at the time of the sale, as the Company did not have any formal suitability procedures or requirements in place during the review period. The failure of the insurer to monitor for unnecessary replacements and/or suitability can create an unfair advantage in the marketplace. There was no evidence of whether an analysis was made to determine if the replacement contract would confer a substantial financial benefit to the insured over the life of the contract. Convincing consumers to make unnecessary replacements is considered an unfair practice.
CIC Section 790.03(a)

Insurer Response: The Department alleges that the Company did not have a procedure in place to determine if its replacement annuity sales were "unnecessary" pursuant to CIC section 10509.8 and that this is a violation of CIC section 790.03(a). However, section 790.03(a), in relevant part, prohibits an insurer or its agents from "misrepresenting the terms

of any policy issued or to be issued or the benefits or advantages promised thereby...or making any misrepresentation to any policyholder insured in any company for the purpose of inducing or tending to induce the policyholder to...surrender his or her insurance.” CIC § 790.03(a). The Department did not identify or allege that it found any instances of misrepresentation on the part of the Company or its agents during the course of the examination. The Department disagrees with the Company that the replacement annuities at issue conferred a substantial financial benefit over the life of the policy to the purchaser; however, this does not mean the Company or its agents actively misrepresented the terms of the annuities to prospective insureds. Absent findings of misrepresentation on the part of the Company or its agents the Department can not allege a violation of CIC section 790.03(a).

The Company also disagrees with the Department’s allegation that it did not have a procedure in place to determine if its replacement annuity sales were “unnecessary” as defined by CIC section 10509.8. The statute defines “unnecessary replacement” as the sale of an annuity to replace an existing annuity that requires the insured to pay a surrender charge for the annuity that is being replaced and that does not confer a substantial financial benefit over the life of the policy to the purchaser so that a reasonable person would believe that the purchase is unnecessary. Since a definition of “substantial financial benefit” is not provided, it is unclear what this term means. Nor is the term “over the life of the policy” defined – it could mean during the term of the surrender charge period, during the accumulation phase, or only up to the death of the policyholder. Since these are subjective terms, the Company must look at each individual case to make an assessment of financial benefit to the policyholder. While the files the Department examined may not contain what the Department considers to be sufficient documentation of replacement reviews, during the examination period the Company had processes in place to review replacement sales by considering the following factors: any surrender charges being paid, any bonus being paid by the Company, current and guaranteed interest rates, opportunity for interest crediting above current rates being paid, death benefit payment, annuitization rates, and issuing company reputation.

The Company also disagrees with the Department’s determination that the contracts identified in this report were unnecessary replacements. Specifically, the Company disagrees with the Department’s evaluation and comparisons of the contracts. The Department relied mainly on the minimum guarantee rate in its analysis rather than the actual credited rate which varies by product and strategy and did not take into consideration factors such as death benefit payouts and opportunity for higher interest crediting rates. In many of the contracts, the Company believes that with respect to the replaced policy the policyholder’s beneficiary may not have received the full contract value as a death benefit in the event of the policyholder’s untimely death. This is a significant factor to take into account in determining whether a there exists a substantial financial benefit, one which the Department has not identified in its examination.

The Company takes exception to the Department’s discussion of suitability and the presence or lack of evidence that suitability was a consideration. California did not have any statutes or regulations formalizing suitability requirements during the time period of the examination; in fact, California only enacted suitability standards effective January 1, 2012, eight years after the beginning of the exam period. The Company believes it is not appropriate to discuss the topic of suitability in this report and that the mention of the Company’s lack of a

formal suitability review process during the examination period is prejudicial as it implies non-compliance with California law, when in fact California law did not require a suitability review at the time.

The Company acknowledges that under our current replacement standards and guidelines some of the contracts examined would not have been issued based on the age of the individuals. In addition, the Company's current procedures would require additional information and documentation specific to suitability and replacement before making the decision to issue the contract. The Company has provided the Department with additional points of analysis relating to the contracts the Department examined and believes that in many of the situations, when reviewing the transaction in its entirety, the policy owner was provided a substantial financial benefit over the life of the policy.

The Company acknowledges that its processes involving replacements, particularly documentation of those processes, have changed significantly since the examination review period. When looking at whether a replacement will confer a substantial financial benefit over the life of the policy a number of factors must be weighed on a case-by-case basis, including the following:

- Is the customer currently in a variable or fixed annuity?
- Does the fixed annuity have indexing strategies?
- Does the customer receive all the proceeds of the contract value when the term is up or do they have to annuitize?
- Do the customer's heirs have unrestricted access to the money at death?
- What is the renewal rate history of the company?
- What is the current rate of interest crediting?
- Will the customer earn a bonus?
- Does the product have a market value adjustment?

The Company has incorporated a review of these issues into its replacement review process. This is not an exhaustive list of potential questions for the customer and producer to consider. Every annuity purchase and replacement must be evaluated on its own to determine if that particular transaction is appropriate.

The Company also stated that it is a leader in market conduct and that it has taken steps to comply with current suitability standards in all jurisdictions. In December 2005, the Company began requiring a suitability acknowledgement form for prospective insureds in California over the age of 65. In May 2006, the Company extended this requirement to all prospective insureds, regardless of age, in California even though California had not adopted NAIC Model Act. This was done in response to the California exam, among other factors. In 2010, the NAIC adopted a revised Suitability in Annuity Transactions Model Regulation, which was adopted in the Company's domiciliary state effective 1/1/2011. The Company has chosen to implement the provisions of the revised Suitability Model Regulation nationwide, whether or not a particular state has adopted the revised Model.

Replacements are reviewed as part of the Company's suitability program, and replacements, in combination with other suitability threshold factors generally trigger a higher level in the review process. Post-sale the Company monitors early withdrawals during the first two years to help determine if the consumer is accessing the cash value early on in the contract period

and paying a surrender charge to do so. All first year withdrawal requests are thoroughly reviewed and action may be taken to modify the annuity contract based on the circumstances.

The Company also monitors replacements by agents, complaints and full surrenders later in the contract term. In the event that an inappropriate sale is detected, corrective action will be taken in the form of discussions with the agent, additional training, or termination, depending on the severity of the situation.

In recent years the Company has taken several steps to demonstrate its commitment to compliance and a culture of compliance including the following:

- Restricting sales to consumers over the age of 80;
- Not accepting funds from a home equity transaction;
- Restricting sales to consumers residing in full care nursing homes;
- Making sure the consumer has adequate liquid resources; and
- Working to ensure the consumer has the financial attributes to suggest the proposed annuity is suitable.

The above steps were implemented on a voluntary basis after working on state examinations, including the exam in California. It is important to the Company that producers understand consumers' needs and that they make appropriate recommendations to policy owners. The Company believes the Department's comments during the exam have helped it place better controls over this process.

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