TARGETED MARKET CONDUCT EXAMINATION OF

NATIONAL WESTERN LIFE INSURANCE COMPANY
NAIC #66850

As Of

December 31, 2009
Honorable Mary Taylor
Lt. Governor/Director
Ohio Department of Insurance
50 West Town Street Suite 300
Columbus, Ohio 43215

Director:

Pursuant to your instructions and in accordance with the powers vested under Title 39 of the Ohio Revised Code, a targeted market conduct examination was conducted on the Ohio business of the following:

National Western Life Insurance Company NAIC# 66850

The examination and risk assessment was conducted at the Company’s statutory home office at:

850 East Anderson Lane
Austin, Texas 78752-1602

A report of the examination is enclosed.

Respectfully submitted,

Lynette Baker
Chief, Market Conduct Division

Date 10/3/11
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FOREWORD
This examination and risk assessment was conducted under authority provided under Ohio Revised Code (“R.C.”) 3901.011.

SCOPE OF EXAMINATION
On January 8, 2010, the Market Conduct Division, Ohio Department of Insurance (“Department”), opened an examination into the business practices of National Western Life Insurance Company (“Company”) by sending a call letter. The on-site portion of the examination began May 3, 2010, and concluded May 7, 2010. The examination reviewed the Company’s annuity suitability oversight and compliance. Records of annuity transactions from January 1, 2003, through December 31, 2009, were reviewed. Annuity files and life insurance policy loans were sampled from the period March 1, 2007, through December 31, 2009.

The basic business areas included as part of the examination included:

A. Compliance
B. New Business and Replacements
C. Miscellaneous
D. Surrenders
E. Agent Terminations
F. Suitability and Disclosure Forms

Each business area has standards that were measured during the examination. Some of the standards have specific statutory guidance; others have specific company guidelines or contractual guidelines.

The focus of the examination was on the procedures and methods used by the Company to achieve compliance with applicable Ohio statutes and rules involving the issuance of fixed, individual annuity products. This included an analysis of how the Company communicates its instructions and philosophy with its employees, agency force, and national marketing organizations.

This examination report is a report by test, rather than a report by exception, and all standards and tests are described and the findings indicated.

METHODOLOGY
Only Ohio policyholders’ files were reviewed. A series of tests were designed and applied to these files to determine the Company’s level of compliance with Ohio’s insurance statutes and rules. These tests are described and the results noted in this report.

The examiners used the NAIC’s standard of 10% error ratio on files other than claims (90% compliance rate) to determine whether an apparent pattern or practice of non-compliance existed for any given test. The results of each test applied to a sample are reported separately. Each test is expressed as a “yes/no” question. A “yes” response indicates compliance and a “no” response...
indicates a failure to comply. A “no” response may be referred to in this report as an “exception.”

In any instance where errors were noted, the examiners described the apparent error and asked the Company for an explanation. The Company responded to the examiners and either:

- Concurred with the findings;
- Had additional information for the examiners to consider; and/or
- Proposed remedial action(s) to correct the apparent deficiency.

The examiners’ recommendations are included in this report.

This examination is based on the standards and tests for a market conduct examination of a life and annuity insurer found in Chapters XVI and XIX of the NAIC Market Regulation Handbook and on applicable Ohio statutes and rules.

**COMPANY OPERATIONS**

National Western Life Insurance Company is a life insurance and annuity company, chartered in the state of Colorado in 1956, and currently doing business in 49 states, the District of Columbia and four U.S. territories or possessions. Moody National Life Insurance Company acquired Austin Life Insurance Company and National Western in 1958. The three companies were consolidated by merger into National Western Life Insurance Company in 1963.

<table>
<thead>
<tr>
<th>2009 Annuity Considerations</th>
<th>Ohio Ordinary</th>
<th>Ohio Group</th>
<th>Ohio Total</th>
<th>National Ordinary</th>
<th>National Group</th>
<th>National Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$55,695,667</td>
<td>$21,555,412</td>
<td>$77,251,079</td>
<td>$517,672,211</td>
<td>$296,605,202</td>
<td>$814,277,413</td>
</tr>
</tbody>
</table>

**COMPLIANCE**

Compliance is handled within the Legal Department. The chief responsibility of the department is the identification of new statutes, assuring compliance with the various statutes and rules, and advising all necessary parties of any changes in the statutes and rules. This is accomplished through issuance of compliance bulletins that contain any statute changes and advises agents of the Company’s procedures on suitability.

The Company does not oversee the suitability of each transaction. The responsibility for compliance to suitability requirements is left with the agents. Any audits performed by the Company address form completeness, not the suitability of the transaction. The Company does not perform what the Department considers to be adequate trend analysis of new business sales, replacement activity, nor surrender activity. The Company also does not have what the Department considers to be adequate conservation procedures in place as duties of the existing insurer to attempt to prevent any unsuitable replacements as required by Ohio Administrative Code 3901-1-6-05 (G). The Company does perform audits on the effectiveness of the system to supervise annuity activity through an annual review of the New Business, Marketing, Client Services section, or other departments within the Company. Again, these audits are on form
completeness and availability rather than on transactional suitability. Forms reviews are done to assure they are accurate, up-to-date and being used properly.

The procedure manuals developed by the Company for application submission, replacement handling, and handling of surrenders were thorough and provided state specific details and requirements. They offered step-by-step instructions of what an agent would need to know to submit an application or for internal handling of the applications submitted. Even though the manuals are thorough with respect to requirements and procedures, they do not address the issue of the suitability of the transactions, only the completeness of the form. Also, the Company’s data records do not have an electronic identifier to determine whether a replacement is internal or external. This would aid in trend analysis for both replacements and suitability.

AGENT TRAINING

The National Marketing Organizations (“NMO’S”) provide training to the agency force on how to sell a product. Any training involving the Company’s products and annuity suitability is handled by the Company directly with the agency force. The training includes a compliance section that is thorough and lists ‘red flags’ for agents to watch for when discussing suitability with a potential client and the required forms needed for submission of applications. The training includes an Ethics training manual for use by the agents. Also, included in the training are issues involving money laundering, senior designations, and privacy concerns that appear to meet statute requirements. The Company does have controls in place to monitor any advertising used by the agent. All material must be approved by the Company before it can be used by the agent.

The Company appears to have adequate procedures and controls in place to guard against issuance of any policy if an agent is not on the company system as being licensed and appointed.

NEW BUSINESS AND REPLACEMENTS

Examination Methodology:

The findings are based on applicable Ohio statutes and rules, including OAC 3901-6-13 and 3901-6-14. The examiners followed guidelines set forth in Chapter XIX of the NAIC Market Regulation Handbook.

Some of the standards were measured using a single type of review, while others used a combination or all types of review. The types of review used in this examination fall into two general categories: Generic and Sample.

A “Generic” review indicates that a standard was tested through analysis of general data gathered by the examiners, or provided by the Company in response to interrogatories or personnel interviews conducted by the examiners.

A “Sample” review indicates that a standard was tested through direct review of a random sample of files selected using automated sampling software.
“Sample” Review

“Sample” Methodology: The examiners reviewed a sample of all Ohio new business fixed annuity contracts, including replacements, falling within the scope of OAC 3901-6-13 and issued during the examination period on individuals over age 65.

Standard: The Company has suitability standards for its products as required by applicable statutes, rules, and regulations.

Test: Does the Company have suitability standards established for assuring compliance with OAC 3901-6-13(G) (1) and (2) and does the file documentation adequately support the suitability decision in compliance with OAC 3901-6-13 (J) (1) and (2)?

Findings:

<table>
<thead>
<tr>
<th>Population</th>
<th>Sample</th>
<th>Yes</th>
<th>No</th>
<th>Standard</th>
<th>Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,400</td>
<td>100</td>
<td>97</td>
<td>3</td>
<td>90%</td>
<td>97%</td>
</tr>
</tbody>
</table>

The standard for compliance is 90%. The Company’s performance is above this standard.

Examiner Comments:
Surrender charge information from the prior company was not consistently provided. In addition to the three files determined to be unsuitable, four files did not contain information on the surrender charges. While the available information did not clearly indicate unsuitability, there cannot be an adequate determination of suitability without that information. Those four were not indicated as exceptions, because the Company has asserted that the surrender charges did not exceed the bonus on the policy.

Examiner Recommendations:
The Company should revise its procedure to require that surrender charge information be documented in the file. Surrender charges are a major factor in determining suitability. If this information is not provided, the Company and agent are not in a position to assert the suitability of an annuity purchase.

“Generic” Review

“Generic” Methodology: The examiners reviewed compliance procedure manuals and interviewed Company personnel to determine how new business and replacements were reviewed and processed.

<table>
<thead>
<tr>
<th>Standard 5: Marketing and Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>The insurer has suitability standards for its products as required by OAC 3901-6-13 (5), (7), and (8).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Standard 3: Marketing and Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>The insurer’s rules pertaining to insurer requirements in connections with replacements are in compliance with OAC 3901-6-05.</td>
</tr>
</tbody>
</table>
Examiner Findings:
The examiners reviewed the Company’s compliance procedure manuals and interviewed Company personnel to determine how the review of annuity suitability is conducted. The Company currently does not have an adequate system in place to review recommendations from the agency force that are reasonably designed to achieve compliance. Also, they do not conduct periodic audits to review the suitability determinations of their third parties. The only review that is conducted involves the completeness of the suitability form and application and whether the suitability form accompanies each transaction. However, during file reviews there were inconsistencies noted in the applicability of suitability determination.

During the review, acts by the agents that would generate concern were noted. These acts included:
- Blank suitability forms,
- Unreported replacements,
- Form letters signed by the annuitant to prevent the company from trying to conserve the business,
- Frequent movement of funds from one company to the next and then back again, and
- Questionable signatures.

There is also no conservation program in place to attempt to prevent any individual from making an unsuitable decision to replace their current annuity. Unsuitable surrenders could be prevented with an effective conservation program.

Examiner Recommendations:
Without increased oversight, National Western makes itself a target for agents moving business that may be unsuitable in nature. The Company needs to establish and maintain a system to supervise all compliance with Ohio statutes and rules concerning suitability of annuity purchases. This system should include, but is not limited to:
- Determination of suitability independently of the agent,
- Periodic reviews of new business and agent activity to identify trends,
- Periodic review of selected agents to determine whether the agents are performing the required functions to comply with not only the suitability statute, but also the replacement oversight requirements of OAC 3901-6-05 (E). The analysis should enable the Company to proactively identify agents that may be involved in unsuitable sales practices. Corrective action plans can then be established for preventing the occurrence of unsuitable transactions in the future,

MISCELLANEOUS

Longevity of In-Force Business (policy age in years):
The Company told the examiners that the annuities issued were good products for anyone, especially individuals over age 65. Individuals over age 65 appear to be a target market of the agency force. The Company also told the examiners that any surrender charge that may have occurred at another company could be offset by offering premium bonuses and other contract
features that benefit older individuals (ex. death benefit, terminal illness waiver). However, an
analysis of the duration of the Company’s block of business does not support that assertion. The
average duration for the entire population of the Company’s Ohio in force annuity contracts as of
May 31, 2010, was less than 6 years. About 40% of the contracts in force were less than 4 years
old. This weakens the Company’s argument that surrender charges are offset with bonuses. The
bonuses are applied to first year premiums paid and, in some contracts, years 2-5 would receive a
bonus on additional premiums paid. Therefore, the individuals are not staying around long
enough for any bonus to have much positive effect. Of the 7,437 policies in force, 3,369 (45%) were
in force only 0-5 years; 2,758 (37%) were in force 6-10 years. Only 1,310 policies (18%) were
in force longer than 11 years. Of the 3369 policies in force in the 0-5 year range, 58% were
on persons over age 65, 31% were over age 75; of the 6-10 range, the percentage was 59% over
65 years of age and, 20% over age 75. As these statistics indicate, any replacement or surrender
of a policy would generate some type of surrender charge and bring in to question the suitability
of the transaction.

It was also noted that a large percentage of annuity contracts issued to replace another
company’s annuity were contracts coming from a limited number of annuity carriers. The
surrendered files indicate that these same annuity carriers were also replacing the Company’s
contracts. The majority of this movement in both directions was done within the surrender
charge period.

This issue is explored more fully in the separate review of surrenders below. Examiner
recommendations are included there.

**New business issued over the maximum allowable age**
The Company has procedures that provide for a maximum allowable age limit on each product
type. This information is available on the Company website. Based on the information provided
by the Company the examiners identified 20 occurrences where the policy was issued on
individuals over the age limit.

**Examiner Recommendation:**
New business underwriting should identify and decline those applicants that exceed the
maximum allowable age.

**Complaint handling**
A review was performed on all 31 internal complaints received in 2008 and 2009 to assure that
the Company is responding in a timely manner and analyzing them for any trends that might be
occurring. 88% of the complaints fell into one of three categories:

- Annuitants not being given all information on product features (surrender charges, free
  look period),
- Annuitant not fully understanding what they were purchasing, and
- Alleged misrepresentations of product details.

There were several instances where the complaint was not handled on a timely basis. Although
the complaints are logged, there does not appear to be any trending or analysis of the complaints
that would assist the Company in determining any improvements needed and the agent activities
that are currently occurring. The Company added a person in 2010 whose duties are to perform
periodic reviews of complaints and begin trending for issues. Therefore, the examiners make no additional recommendations.

**Unreported replacements**
The examiners identified several instances of replacements that had not been included on the Company’s replacement register. The Company provided another copy of the register that did show that these replacements were included on the register.

**Examiner Recommendations:**
The Company should maintain one register and assure that procedures and controls are in place as required by OAC 3901-6-05(G) (1).

**SURRENDERS**

**Examination Methodology:**
The examiners reviewed 76 policies that were in force during the experience period, which had a partial or total surrender occurring during the examination period. The review was conducted to assure that the Company had appropriate controls and procedures in place to protect annuitants from fraudulent or dishonest practices by an agent. The sample was derived from a list of surrenders during the examination period in which the proceeds went to another insurance company.

<table>
<thead>
<tr>
<th>Standard 1: Marketing and Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>The insurer has procedures and practices in place to monitor insurance agents/producers activities and to prevent unfair and deceptive practices or intentional misrepresentation in regards to all sales of annuity products in compliance with ORC 3901.21(A) and 3905.14(B).</td>
</tr>
</tbody>
</table>

**Examiner Observations:**
The major purpose of this review was to identify instances of excessive premium movement. The review identified instances of agents selling an annuity or annuities to senior clients, then after a short period the agent then surrendered these same policies to another company as new business. The policyholder realized significant surrender charges and ended up with a new surrender period. Historically, the Company appears to have a high number of surrenders as compared to contracts issued: in 2007, there were 375 policies issued and 284 surrenders; in 2008, there were 354 policies issued and 175 policies surrendered; and in 2009 there were 956 contracts issued and 140 surrenders.

- During the review of the 76 surrendered annuities, the examiners found 50 instances (68%) of excessive premium movement. Many of these reflected moves between three companies in an apparently short time frame. Surrender charges would have occurred during both exchanges. It was also noted that there was a pattern of agents withdrawing and moving money amounts that are below the amount where surrender charges apply. Even though this type of withdrawal is allowed on an annuity, and the consumer does not pay a surrender charge, the movement could cause the annuitant not to receive the total amount of interest they are due as well as triggering new surrender charge periods. The agent earns a higher, new commission rate for these moves, but the annuitant appears not
to achieve any significant benefit. The Company currently has no system in place to monitor surrenders, nor is there a conservation program in place in which to attempt to stop any potentially unsuitable transaction. An example of activity that was noted from the file review:

- One agent had clients that had annuities with three or four different companies besides National Western. Within a three year span, amounts under the 10% penalty free withdrawal, were moved from the other companies to National Western, back to the other companies, back to National Western, but to a different annuity, all with the following explanation: “Want to diversify my assets.” A few months later, full surrenders of all the annuities were done to move the annuity to a new company and a new surrender charge of 14-19% was applied.

- The same agent also had the annuitant sign a form letter to National Western instructing them not to contact the annuitant and just to follow the surrender request immediately. This did not allow any opportunity for the Company to conserve the business.

- Further analysis of the 50 files with apparent excessive premium movement indicated that 49 of the 50 (98%) involved transactions between more than one company with 38 of those (78%) involving more than three companies and six of the files (12%) indicated money movements between more than five different companies. Twenty-seven of the 50 files (54%) had indications of excessive money movements (many transactions and 10% free withdrawals moving back and forth between companies). Another six had many of the 10% free withdrawals taken as “cash”, but no further information on where the money went. In addition, 37 of the files (74%) had at least one 10% free withdrawal taken with 11 of those files showing policies with more than five.

- The following data were obtained from the entire population of surrenders that occurred during the examination period:

**Policy Longevity** {the length of time current policies have been with the Company}:

**In Force policies** (Figures are as of 5-31-2010)

<table>
<thead>
<tr>
<th>Age in Years</th>
<th>Policy count</th>
<th>% of Total</th>
<th>Age 0-54</th>
<th>55 to 64</th>
<th>65 to 74</th>
<th>Over 75</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 5</td>
<td>3,369</td>
<td>45.3%</td>
<td>614</td>
<td>790</td>
<td>928</td>
<td>1,037</td>
<td>3,369</td>
</tr>
<tr>
<td>6 to 10</td>
<td>2,758</td>
<td>37.1%</td>
<td>517</td>
<td>603</td>
<td>1,094</td>
<td>544</td>
<td>2,758</td>
</tr>
<tr>
<td>11 to 15</td>
<td>667</td>
<td>9.0%</td>
<td>124</td>
<td>142</td>
<td>311</td>
<td>90</td>
<td>667</td>
</tr>
<tr>
<td>16 to 20</td>
<td>144</td>
<td>1.9%</td>
<td>126</td>
<td>12</td>
<td>6</td>
<td>0</td>
<td>144</td>
</tr>
<tr>
<td>21 to 25</td>
<td>323</td>
<td>4.3%</td>
<td>317</td>
<td>4</td>
<td>2</td>
<td>0</td>
<td>323</td>
</tr>
<tr>
<td>26 to 30</td>
<td>154</td>
<td>2.1%</td>
<td>150</td>
<td>4</td>
<td>0</td>
<td>0</td>
<td>154</td>
</tr>
<tr>
<td>Over 30</td>
<td>22</td>
<td>0.3%</td>
<td>22</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>22</td>
</tr>
<tr>
<td>Totals</td>
<td>7,437</td>
<td>100.0%</td>
<td>1,870</td>
<td>1,555</td>
<td>2,341</td>
<td>1,671</td>
<td>7,437</td>
</tr>
</tbody>
</table>

*Only 17.6% of the current annuities have been in force over 10 years. The annuities do not have a high longevity with the Company.*
### Surrenders (Figures are as of 5-31-2010)

<table>
<thead>
<tr>
<th>Age in Years</th>
<th>Policy count</th>
<th>% of Total</th>
<th>Age 0-54</th>
<th>55 to 64</th>
<th>65 to 74</th>
<th>Over 75</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 5</td>
<td>145</td>
<td>45.0%</td>
<td>29</td>
<td>44</td>
<td>33</td>
<td>39</td>
<td>145</td>
</tr>
<tr>
<td>6 to 10</td>
<td>133</td>
<td>41.3%</td>
<td>34</td>
<td>21</td>
<td>49</td>
<td>29</td>
<td>133</td>
</tr>
<tr>
<td>11 to 15</td>
<td>25</td>
<td>7.8%</td>
<td>4</td>
<td>3</td>
<td>17</td>
<td>1</td>
<td>25</td>
</tr>
<tr>
<td>16 to 20</td>
<td>12</td>
<td>3.7%</td>
<td>12</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>21 to 25</td>
<td>5</td>
<td>1.6%</td>
<td>5</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>26 to 30</td>
<td>2</td>
<td>0.6%</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Over 30</td>
<td>0</td>
<td>0.0%</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Totals</td>
<td>322</td>
<td>100.0%</td>
<td>86</td>
<td>68</td>
<td>99</td>
<td>69</td>
<td>322</td>
</tr>
</tbody>
</table>

*86.3% of the annuities were surrendered within 10 years of purchase, 45% within 5 years of purchase, both of which contain high surrender charge percentages.

### Surrenders because they were replaced by another company (Figures are as of 5-31-2010)

<table>
<thead>
<tr>
<th>Age in Years</th>
<th>Policy count</th>
<th>% of Total</th>
<th>Age 0-54</th>
<th>55 to 64</th>
<th>65 to 74</th>
<th>Over 75</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 5</td>
<td>56</td>
<td>43.4%</td>
<td>14</td>
<td>17</td>
<td>14</td>
<td>11</td>
<td>56</td>
</tr>
<tr>
<td>6 to 10</td>
<td>58</td>
<td>45.0%</td>
<td>13</td>
<td>23</td>
<td>19</td>
<td>3</td>
<td>58</td>
</tr>
<tr>
<td>11 to 15</td>
<td>12</td>
<td>9.3%</td>
<td>1</td>
<td>2</td>
<td>9</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>16 to 20</td>
<td>2</td>
<td>1.6%</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>21 to 25</td>
<td>1</td>
<td>0.8%</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>26 to 30</td>
<td>0</td>
<td>0.0%</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Over 30</td>
<td>0</td>
<td>0.0%</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Totals</td>
<td>129</td>
<td>100.0%</td>
<td>31</td>
<td>42</td>
<td>14</td>
<td>14</td>
<td>129</td>
</tr>
</tbody>
</table>

- The sample reflected that the average age of contract holder at surrender: age 50-59=20% of the surrenders, 60-69=25%, 70-79 = 38% and 80-89=17%. In sum, 61 or 80% of the 76 files reviewed were over age 60, 42 of 76 were over age 70.
- Several files indicated that questionable annuitant signatures had occurred. Also, the Company allowed use of copies of suitability forms that had been signed by annuitant previously and was reused by the agent for a new transaction.
- Two files had a Disclosure statement with product name crossed out and another written in. This is a deceptive practice since the features of the existing disclosure did not match the product name written in.
- Overall file documentation was lacking as surrender charges from prior companies were not present in the file. Also, several files did not have documentation of surrender charges that occurred at the time of the full surrender, even though the policy was still in the surrender period. The Company needs to make sure that the file documentation reflects any surrender charge that occurs whether on the surrender of the National Western policy or on replacements coming to National Western. The charges should be part of the evaluation process in determining if the surrender is suitable.
Examiner Recommendations:

- The Company should conduct regular audits of surrender files to determine whether unsuitable transactions may be occurring. Any trends and/or unusual agent activity should be identified and investigated. Corrective action should be taken as required.
- The Company should establish a conservation program to prevent unsuitable surrenders from occurring. Every surrender should be reviewed, and if questionable, a move to conserve the National Western Life policy should be undertaken in order to protect their policyowners from unsuitable surrenders.

AGENT TERMINATIONS

<table>
<thead>
<tr>
<th>Standard: Producer Licensing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Termination of producers/agents complies with Ohio Revised Code (“R.C.”) 3905.21 (A)-(C) and 3905.14 (B) regarding notification to the producer/agent and notification to the state.</td>
</tr>
</tbody>
</table>

The examiners determined that the Company has adequate procedures in place to notify the Ohio Department of Insurance (“Department”) when any agent is terminated “for cause” as defined by R.C. 3905.14. The Company has an established procedure that all agent terminations are coded “not for cause” until sufficient investigation warrants supports a “for cause” designation. Once “for cause” is indicated, the Company notifies the Department and updates its records accordingly.

The file documentation was sufficient and supported the agent termination.

The agent review recommended by the Examiners under the generic review of new business and replacements addresses the Examiners concerns about agent oversight and no additional recommendations are included here, except that the analysis should include, but not necessarily be limited to, complaints received, surrenders, replacements, and new business applications.

SUITABILITY AND DISCLOSURE FORMS

The examiners reviewed the sales and marketing materials used by the Company in marketing annuities and monitoring suitability of annuity purchases.

<table>
<thead>
<tr>
<th>Standard: Marketing and Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>The insurer has suitability standards for its products as required by Ohio Administrative Code (“OAC”) 3901-6-13.</td>
</tr>
</tbody>
</table>

Annuity Suitability Questionnaire (ex. DM-1081. Rev.7.08)

The first section of the Company’s suitability form is a check box and statement that says “I have chosen not to provide my agent with all the information requested and/or have decided to enter into an insurance transaction that my agent did not recommend. I acknowledge that this decision will prevent my agent from certifying to the suitability of the product for which I am applying”. Specifically, 19 of the 100 new business and replacement files reviewed had this box marked.
During the file review it was determined that several agents had all of their applicants check this box.

The placement of this question at the beginning of the form implies that not giving the information is not harmful. In fact, providing the information is intended to protect the applicant from unsuitable annuity purchases.

The form does not contain adequate information to determine suitability. There are no questions on annual income, risk tolerance, sources of funds, if applicant can afford to purchase the annuity, liquidity needs, time horizon, financial experience, potential impact of the purchase, prior company information (i.e. surrender charges), etc. When a replacement is involved, there is no information about the policy being replaced that can be used to determine to determine if the replacement is a suitable transaction.

The Company’s procedures lack appropriate oversight and review of the suitability process. The Company’s procedures only make sure that the suitability form is sent in with the application, but not whether the form is complete. In one annuity file, the Company requested the suitability form be sent in since it was not attached to the application. The Company accepted the form when it was sent in even though the only thing on the form was the applicant’s signature.

Examiners recommendations:

- The Company should require completion of the suitability form on all applications. Without this information, the Company cannot protect itself from potential abuses by agents.
- If the Company continues its policy of allowing applicants to decline to provide suitability information, the form should be revised so that the “opt out” choice is at the end of the form where it would have less prominence. Another option would be to eliminate the question entirely as many other companies have chosen to do.
- The Company should include appropriate questions on the suitability form so that the suitability of the purchase is clearly documented. This would include, but not be limited to, age, annual income, net worth, liquidity needs, risk tolerance, risk objectives, sources of funds, and surrender charges.
- Procedures, controls, and audits should be implemented to assure receipt, completion, and review of suitability forms with all annuity applications.

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Standard 1: Marketing and Sales
Sales materials are not unfair and deceptive as defined by Ohio Revised Code 3901.21. Disclosures are compliant with Ohio Administrative Code 3901-6-14.

The Disclosure form used by the Company is not a separate form. It is attached to the end of a ten page Consumer Information Summary. The applicant is given a one half page “tear off”. The Disclosure form by itself does not meet the requirements of OAC 3901-6-14 (E) (4). The Company has taken the position that the information provided in the Consumer Information Summary satisfies that rule’s requirements.
Combining the Disclosure form with the lengthy Consumer Information Summary causes fewer applicants to be given true disclosure, because applicants are much less likely to read and study a ten page brochure than a simple two page disclosure. A two page Disclosure is suggested by most industry groups such as the American Council of Life Insurers.

It was noted that there were Consumer Information Summary/Disclosures where the agent crossed out the name of the product and typed in the name of a different product. This is clearly inappropriate and should not be permitted by the Company.

The Liberty policy types (Classic, Challenge, and Champion) have three surrender period choices that the annuitant can choose from. However, the same brochure is used for all three products thus the Disclosure specifies neither the interest rate nor specific surrender period chosen. The Company intentionally designed the brochure in this manner to assure the brochure was more clear and understandable to the annuitant.

Examiners recommendations:

- The Company should create a two page Disclosure document consistent with the Disclosure forms suggested by industry groups. The two page document will provide greater disclosure to applicants than the current ten page format since the longer format discourages review by the applicants.
- The Disclosure needs to include surrender charges, interest rates, participation rates, fees, and other specific information that will allow applicant to know what is going to occur with the annuity purchase.

This concludes the report of the annuity suitability review of National Western Life Insurance Company. The Examiners, Don Layson, John Pollock, Laura Price, and Robert Stroup would like to acknowledge the assistance and cooperation provided by the management and the employees of the Company.

Don Layson  
Examiner in Charge

10/3/11  
Date
May 16, 2011

The Honorable Mary Taylor
Lieutenant Governor/Director
The Ohio Department of Insurance
50 West Town Street
Third Floor - Suite 300
Columbus, Ohio 43215

Re: Response of National Western Life Insurance Company to the Targeted Market Conduct Examination Report of the Ohio Department of Insurance as of December 31, 2009

Dear Ms. Taylor:

The National Western Life Insurance Company (the “Company”) would like to thank the Ohio Department of Insurance (“Department”) staff for its professionalism throughout the market conduct examination process, both in Austin and in the meetings held in Ohio. While the Department’s final market conduct examination report (the “Report”) did not cite any statutory or regulatory violations by the Company, the Department did make numerous recommendations and conclusions based on what the Department considers to be best practices, and not the law that was applicable during the examination process. The Report also contains numerous factual and legal errors. These errors, as well as the use of the Department’s best practices standard throughout the examination process and the public nature of the Report, compel the Company to provide this response to ensure that the public record is complete and accurate. Because of the number of errors and misstatements contained in the Report, as well as the lack of additional information regarding some of the Department’s determinations, the Company is unable to respond to each and every one of the Department’s statements and is only responding to certain sections of the Report. The Company’s decision not to respond to every contested statement in the Report should not be considered as the Company’s consent to the Department’s positions or the Company’s waiver of its objections thereto.

To assist the reader in comparing the Department’s positions with the Company’s response, this letter uses the same section headings as the Report.

**COMPLIANCE**

The Report indicates that the Company does not perform what the Department considers to be adequate “trend analysis” of new business sales, replacement activity, or surrender activity. In fact, the Company, as part of the routine management of its business, does review on a regular basis its new business sales, replacement activity, and surrender activity.
The Honorable Mary Taylor
Lieutenant Governor/Director
The Ohio Department of Insurance
May 16, 2011
Page 2

Apparently, this review does not satisfy the Department’s unpublished standard for trend analysis. The Company is unaware of any statute or regulation that requires an insurance company to perform these trend analyses, nor has the Department cited one. Given that no applicable statute or regulation exists, the Department cannot fairly criticize the Company for not abiding by the Department’s unpublished position on trend analysis.

The Company also disagrees with the suggestion made by the Department throughout the Report that if the Company had a “conservation program” in place it would prevent unsuitable surrenders. In the Company’s prior experience, performing such activities does not prevent surrenders. Furthermore, the Department appears to be suggesting that through the adoption and implementation of a “conservation program,” the Company should endeavor to prevent its customers from surrendering their contracts. However, every customer has the contractual right to surrender his or her contract and the freedom to enter into other contractual/business relationships as they see fit. The Company is unaware of any legal authority by which it can stop its customers from exercising their contractual rights. In fact, the Company could face potential legal liability if it interfered with its customers’ desire to pursue other contractual/business relationships.

The Department’s Report states that the Company does not have what the Department considers to be an adequate conservation program as required by OAC Section 3901-6-05(G). OAC Section 3901-6-05(G) requires the retention of replacement notifications and the mailing of certain written notices to replacing policy or contract owners. There is no requirement for verbal notification by telephone. Despite the clear language of this regulation, the Department advised the Company that its conservation program was inadequate in only one respect: the failure of Company personnel to personally contact by telephone each customer who was considering a replacement. This alleged deficiency was not set forth in the Report, but was explained to the Company during several meetings held to discuss the market conduct examination. The Company objects; as noted above, this requirement is not currently set forth in Ohio law. If the Department feels strongly about the need for such a telephonic “conservation program,” then the Department should adopt an appropriate regulation in order to place all affected parties on notice of their respective obligations. Having not taken this step, the Department cannot fairly criticize the Company for following the currently enacted statutes and regulations and for not adopting a telephonic “conservation program” as envisioned by the Department.

The Report also states that the Company’s data records do not have an electronic identifier to determine whether a replacement is internal or external. The Department believes this identifier would aid in trend analysis for both replacements and suitability. Once again the Department is criticizing the Company for not having in place a requirement that is not actually found in the regulations or statutes. This criticism is inappropriate given the fact that although the Company’s records do not comport with the Department’s unpublished position on how its
records should be maintained, the Company does have all replacement documentation in its files and maintains those records in the format the Company finds most useful.

NEW BUSINESS AND REPLACEMENT

While the Company is pleased with its ninety-seven percent (97%) compliance rate, the Company believes that the Department’s position regarding the three contracts that did not meet the Department’s standards should be revised. The Company has corrected factual errors made by the Department and provided additional information regarding the three contracts in order to address the issues the Department identified, and the Company believes that the compliance rate should have been one hundred percent (100%).

The Report states that the Company did not consistently obtain surrender charge information about the annuity being replaced and that there cannot be an adequate determination of suitability without the receipt of this surrender charge information by the Company. Respectfully, the Department’s position on this point does not comport with Ohio law in effect during the time of the examination.

All sales of the Company’s contracts are conducted through licensed insurance agents. Because a licensed insurance agent is involved in all transactions, OAC Section 3901-6-13(G)(1) is not applicable to the Company and does not require the Company to conduct an independent suitability determination of each transaction. OAC Section 3901-6-13(G)(1) requires the Company to perform a suitability determination only when no agent is involved in the transaction.

As discussed in previous communications with the Department, OAC 3901-6-13 requires that the licensed insurance agent have reasonable grounds for believing that his/her recommendation is suitable, and that it is therefore the responsibility of the agent, not the Company, to determine suitability. This assignment of responsibility to the agent makes logical sense. These agents are vetted and licensed by the Department and typically enjoy a personal relationship with the individual customer, while the insurer rarely (if ever) communicates directly with the customer at the time of sale.

OAC Section 3901-6-13 also identifies the suitability-related information that the agent must make reasonable efforts to obtain from the consumer: (1) the consumer’s financial status, (2) the consumer’s tax status, (3) the consumer’s investment objectives, and (4) such other information used or considered to be reasonable by the insurance agent in order to determine suitability of a recommendation. Under Ohio law as it existed during the time period of the market conduct exam, a licensed insurance agent was not required to obtain information about surrender charges.

Further, Ohio recently adopted a new suitability regulation (effective July 1, 2011), which specifically adds the requirement that the agent take into consideration whether the
consumer will incur a surrender charge when making a suitability determination. The fact that this language is explicitly added to the new regulation further illustrates the fact that the law in existence during the time period of the market conduct exam did not require that surrender charge information be obtained in order to make a suitability determination.

That being said, and although not required pursuant to OAC Section 3901-6-13, the insurance agent may very well have obtained surrender charge information and factored that into his/her analysis—but in accordance with OAC Section 3901-6-13 (J), the agent is required to maintain records of the information used in making his/her recommendation, not the Company.

The Report also states that the Company does not have an adequate system in place to review recommendations from the agency sales force that is reasonably designed to achieve compliance with the applicable statute and that the Company does not conduct periodic audits to review the suitability determinations of the third parties (i.e., Agents). Yet Ohio law existing at the time of the market conduct examination requires nothing more than what the Company has been doing. See supra. Although the regulations previously promulgated by the Department do not require an insurer to independently review each and every suitability determination made by its licensed agents as part of its system of oversight and supervision, the Company has developed a standardized form for its agents’ use. The form requests all the information which is required by the regulations, and the agent is empowered to request any additional information that the agent (not the Company or the Department) considers necessary to make a suitability determination.

The Department also asserts in the Report that “the only review” that is conducted by the Company involves the completeness of the suitability form and application and whether the suitability form accompanies each transaction and that this review was not completed consistently. The Company’s procedures regarding suitability complied with OAC Section 3901-6-13 as it existed during the time of examination and the Company strenuously disagrees with the Department’s position that it violated its own internal procedures. The Department was provided with the Company’s compliance bulletins, as well as its written procedures and guidelines, all of which explicitly require that before a contract is issued, the application must be accompanied by a signed suitability form. The Company’s written procedures prohibit the issuance of a contract without this review being completed. Although the Company on several occasions requested specific examples of files in which these procedures were purportedly not followed, the Department failed to provide the Company with examples. Therefore, the Company is unable to adequately respond to the Department’s claim that the Company did not follow its own internal procedures.

The Report also states that the following items were found in various files, which raised concerns: (i) blank suitability forms; (ii) “unreported replacements”; (iii) form letters signed by the annuitant to prevent the Company from trying to conserve the business; (iv) “frequent movement” of funds from one company to the next and then back again; and (v)
“questionable” signatures. The allegations cited in items (i) through (iv) are addressed by the Company in other sections of this letter. (See page 4 for item (i), page 6 for item (ii), page 7 for item (iii), and page 6 for item (iv).) With regard to item (v), the Company was only provided with a single example of what the Department deemed to be a “questionable signature.”

With respect to the Department’s statement regarding a “conservation program,” please refer to page 2 of this response.

MISCELLANEOUS

A. Duration of In-Force Business:

The Report states that the Company told examiners that any surrender charges imposed by another company could be offset by the premium bonuses and other contract features offered by the Company’s products. The Report further states that the Department’s analysis of the duration of the Company’s current block of business does not support that assertion. According to the Department, the average duration for the entire population of the Company’s Ohio in-force annuity contracts, as of May 31, 2010, was less than 6 years.

With all due respect, the Company believes that the Department’s analysis does not support its conclusion. An analysis of the contracts the Company currently has in force does not address whether individuals are staying around long enough to offset their surrender charges. By definition, in force contract holders are “staying around.” Next, the premium bonuses paid to consumers are paid immediately and become the property of the consumer regardless of how soon after transferring their contracts they choose to surrender. Focusing on the duration of the current “in-force” contracts only reveals that more contracts are being written in recent years than has historically been the case. The data assembled by the Department illustrates that the Company’s current “mix” of business skews towards recent purchases, rather than historic purchases. The Department’s data cannot indicate that customers are leaving the Company before receiving their premium bonuses because their premium bonuses vest immediately.

Moreover, the numbers calculated by the Department appear to be incorrect. The Company has been unable to reconcile the numbers presented in the Report from the information the Company provided to the Department during the examination. The Department was advised in an earlier meeting with the Company of this possible discrepancy. Until the numbers can be

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1 While the underlying data are seemingly drawn from the Company’s electronic spreadsheet of 7,437 policies in force as of May 31, 2010, the Department’s analysis is inconsistent with those figures. For example, the data show that 3,169 of the in-force policies were issued between June 1, 2005, and May 31, 2010 (a five-year period), while the Department’s analysis puts the figure at 3,369. Thus, the Department’s analysis overstates the newest in-force policies by nearly 7%. Similarly, the data indicate that 34 of the in-force policies were issued before May 31, 1980 (more than 30 years ago), while the Department’s analysis puts the figure at 22. Consequently, the Department’s analysis understates the oldest in-force policies by over 33%. As a result of these significant discrepancies, the accuracy of the Department’s entire analysis is questionable.
reconciled, the Company believes the numbers cited throughout the Report should not be relied upon.

B. Unreported Replacements:

The Company is unaware of what created the differences in the replacement documentation provided to the Department. The Company has always had and continues to maintain a single database for replacement contracts. The replacement documentation provided to the Department staff during the examination was taken from the same database that the Company used in providing a new list of the replacement contracts during their response to the Department’s initial findings. The resulting difference in the information provided was likely due to the fact that the spreadsheets were created at two different points in time.

SURRENDERS

The examiners reviewed 76 contracts that were in force during the examination period, which had a partial or total surrender occurring during the examination period. According to the Report, the major purpose of this review was to identify instances of “excessive premium movement.” The Company is unaware of any existing statutes or regulations that use this term or that provide guidance as to when a customer’s movement among various products rises to the level of “excessive.” The Report asserts that “historically, the Company appears to have a high number of surrenders as compared to [the number of] contracts issued.” The Company respectfully takes exception to that conclusory statement, which takes no account of product issue trends or external economic factors. In addition, the Company would like to point out that it cannot control consumers who choose to surrender their contracts. The responsibility of surrendered contracts lies with the new company accepting the replacement (if a replacement exists), the agent assisting in the surrender transaction (if an agent is involved), or the consumer who chooses to surrender their contract. The Company is merely following the directions of the consumer and is required to process the surrender within six (6) months.

The Department appears to be suggesting that the Company should intervene and prevent its customers from surrendering their contracts or using their available funds by withdrawing amounts under the 10% penalty free withdrawal provision. However, as stated earlier, every customer has the contractual right to surrender his or her contract and the freedom to enter into other contractual/business relationships. The Company is unaware of any legal authority by which it can stop its customers from exercising their contractual rights and using their own money as they deem appropriate. In fact, the Company could face potential legal liability if it interfered with its customers’ desire to pursue other contractual/business relationships or refused to honor the 10% penalty free withdrawal request. Indeed, the Department would likely be the first to challenge the Company’s decisions to prevent a consumer from exercising their contractual rights.
The Department also cites to a situation where an agent had the annuitant sign a form letter that was addressed to the Company and instructed the Company not to contact the annuitant and simply process the surrender request immediately. The Department believes this letter did not allow any time for the Company to conserve the business. The Company objects to the Department’s conclusion based upon the fact that the Company followed all required laws and regulations in processing the surrender request. The Company cannot control the letters and the requests it receives from consumers and agents and therefore cannot be fairly criticized for receiving these requests. The Department may only fairly criticize the Company if it failed to follow Ohio’s laws and regulations regarding surrenders.

With respect to the Department’s statement regarding a “conservation program,” please refer to page 2 of this response.

The Report states that the Company currently has no system in place to monitor surrenders. As stated previously, the Company does monitor surrenders as part of its general business practices. See response to Compliance on pages 1 and 2 of this letter.

The Report also states that “several” of the files indicated that questionable annuitant signatures had occurred and the Company permitted the use of previously signed suitability forms. The Company is not able to adequately address this issue because the Department did not identify all the files to which it was referring.

The Department also contends that the Company’s file documentation lacked surrender charges from prior companies. Apparently, the Department believes that an analysis of possible surrender charges should be part of the evaluation process in determining if the surrenders is suitable. The Company does not understand Ohio law, as it existed during the examination period, to have required such an analysis. See response to New Business and Replacement on pages 3 and 4 of this letter.

SUITABILITY AND DISCLOSURE FORMS

The examiners reviewed the sales and marketing materials used by the Company in marketing annuities and monitoring suitability of annuity purchases. The standard was whether the insurer had suitability standards for its products as required by OAC Section 3901-6-13.

A. Suitability Questionnaire:

The Report states that the Company’s current suitability form does not contain adequate information to determine suitability. The Department believes the form is deficient because it lacks questions on annual income, risk tolerance, sources of funds, if the applicant can afford to purchase the annuity, liquidity needs, time horizon, financial experience, potential impact of the purchase, prior company information (i.e., surrender charges), et cetera. The
Department also believes that when a replacement is involved, there is no information about the contract being replaced that can be used to determine if the replacement is a suitable transaction.

With all due respect, the Company’s suitability form seeks every piece of information that OAC Section 3901-6-13(G)(2) specifically states is necessary in making a suitability determination: (1) the consumer’s financial status, (2) the consumer’s tax status, (3) the consumer’s investments objectives, and (4) such other information used or considered to be reasonable by the insurance agent. If the Department believes further information is necessary for the suitability determination, it should adopt an appropriate regulation so as to place all affected parties on notice of their respective obligations.

With regard to the Department’s comments regarding the Company’s lack of oversight and review of the suitability process see the response provided in the New Business and Replacement Section on pages 3 and 4 of this letter.

B. Disclosure Forms:

The Department recommends that the Company prepare a two-page disclosure form for its products, rather than the ten-page disclosure form and information summary currently in use. While the Company appreciates the recommendation, and will certainly consider it, the Company prides itself on giving consumers all the information they need to make an informed decision. The Company finds the Department’s proposal to be somewhat curious in that it favors a lesser amount of information being given to consumers. Furthermore, the Department’s position that a two-page document provides greater disclosure because the Company’s current 10-page format discourages review, seems counter-intuitive. The Company’s current disclosure forms fully comply with Ohio’s existing laws and the requirements in existence during the time period of the market conduct examination. The Company’s disclosure forms provide consumers with a summary of the terms of the contract they are applying for. The Department favoring the removal of this information in exchange for brevity of the disclosure form will limit the information a consumer receives prior to making their decision to purchase an annuity.

The Company would like to make two additional points of clarification regarding its Disclosure brochures. First, the Department’s focus on the ten pages of the brochure seems to suggest a ten page, single spaced, black and white document with small font. In actuality, the drafting and formatting of the brochure, including the use of charts and pictures, was designed to make the brochure understandable and easy to review. Second, the Consumer Information Summary and Disclosure is one document. The Company requires that the entire document, including the Summary and the “one half page ‘tear off’,” be left with the consumer for further review after the presentation. The other completed “one half page ‘tear off’” is sent to the Company as verification that these requirements were followed.
The Company appreciates the opportunity to respond to the Department’s issues and concerns, and trusts that this information will be of assistance to the Department. We would welcome the opportunity to engage in additional discussions regarding these matters in the future.

Respectfully submitted,

[Signature]

Rachel Rega Paulson

RRP/as