INSURANCE
DIVISION OF INSURANCE

Actuarial Services
Standards for Contracts on a Variable Basis

Standards for Individual Market Value Adjusted Annuities

Unfair Discrimination

Persistency Bonus

Proposed Repeals: N.J.A.C. 11:4-44.5 and 48.4

Proposed Amendments: N.J.A.C. 11:4-44.2 and 48.2

Authorized by: Holly C. Bakke, Commissioner, Department of Banking and Insurance.

Authority: N.J.S.A. 17:1-8.1, 17:1-15e, 17B:30-1 et seq., 17B:25-18, 17B:25-18.1, 17B:25-18.2.

Calendar Reference: See Summary below for explanation of exception to calendar requirement.

Proposal Number: PRN 2002-333

Submit comments by November 15, 2002 to:

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Summary

P.L. 1995, c. 73, the Life and Health Insurance and Health Maintenance Organization Form Approval Reform Act (the "Act"), enacted on April 10, 1995, was intended to facilitate the internal restructuring of the New Jersey Department of Banking and Insurance ("Department") to improve the approval process for life insurance and health insurance policy and contract forms. The Act included a provision requiring all life and health insurance policies or contracts, annuities, or variable contracts delivered or issued for delivery in this State, including any application, rider or endorsement that is made a part of that policy or contract, to be filed with the Commissioner of the Department for approval. The Act required the Department to propose rules addressing any actuarial or form requirements for all types of life, health and annuity forms. The Department subsequently adopted various rules that establish procedures for insurers to obtain the Commissioner's approval prior to use of all life, health and annuity forms, that set forth general standards related to all forms for which the Commissioner's approval is sought, and that establish specific standards related to specific types of forms (see N.J.A.C. 11:4-40 through 48).

The Department has made certain modifications to the forms approval process since its initial adoption to further enhance its efficiency, and has recently determined that further modifications would be appropriate. The Department has recognized that certain product features that were once considered new and innovative have become the industry norm, and no longer require a heightened level of regulation. Additionally, the Department has not been made aware that these product features have resulted in any perceived or actual harm to consumers. Moreover, certain National Association of Insurance Commissioners ("NAIC") speed-to-market and other initiatives (for example, the Coordinated Advertising Rate and Form Review Authority "CARFRA") have been set in place to establish uniformity among the states in their statutory interpretations and standards related to certain products. Accordingly, the Department is hereby proposing the repeal of two rules that apply to standards and procedures for the approval of life insurance and annuity forms.

The Department is proposing to repeal N.J.A.C. 11:4-44.5, Standards for individual market value adjusted annuities (MVAs). MVAs are annuity contracts that credit guaranteed and non-guaranteed interest, but that, upon surrender, adjust the surrender value to reflect current interest rate levels for fixed-income securities. N.J.A.C. 11:4-44.5 requires these annuities to be classified as variable contracts pursuant to N.J.S.A. 17B:28-1 et seq., and to have their underlying funds held in a separate account. At the time it established these criteria, the Department believed that these annuities could be considered variable contracts pursuant to N.J.S.A. 17B:28-1.a because (1) the cash surrender value of the contract varied based on the market value of fixed income assets backing the contract; and (2) adjustment of the cash surrender value to reflect current interest rates potentially violated the standard nonforfeiture law for deferred annuities at N.J.S.A. 17B:25-20. Variable contracts, however, are not subject to N.J.S.A. 17B:25-20.

On May 9, 2002, the Department issued Bulletin 02-10, which notified insurers of its intention to repeal the requirement at N.J.A.C. 11:4-44.5 requiring that MVAs be issued as variable contracts using a separate account. Accordingly, the Department is proposing repeal of N.J.A.C. 11:4-44.5, and will no longer consider MVAs to be variable contracts based solely on a market value adjustment to the cash surrender that reflects current interest rates. The Department is also proposing to repeal the definition of "market value adjusted annuity" at N.J.A.C. 11:4-44.2.

The Department is also proposing to repeal a section in its unfair discrimination rules at N.J.A.C. 11:4-48 applicable to persistency bonuses. Persistency bonus provisions permit carriers to reduce the cost or enhance the value of a life insurance policy at some duration as an incentive for policyholders to keep a policy inforce. The Department's rules, at N.J.A.C. 11:4-48.4, permit the use of persistency bonuses in life insurance policy forms if certain conditions are met. The Department has determined, however, that its requirements specifically applicable to persistency bonuses are no longer necessary because other statutes and rules effectively address this feature. For example, N.J.S.A. 17B:25-5 would require a persistency bonus feature, like any other benefit, to be stated in the contract. Moreover, non-guaranteed charges, including those incorporating a bonus feature, are regulated by N.J.A.C. 11:4-47. Additionally, the standard nonforfeiture law for life insurance at N.J.S.A. 17B:25-19 establishes standards intended to provide equity to surrendering policyholders. Accordingly, the Department is proposing repeal of N.J.A.C. 11:4-48.4 and the definition of "persistency bonus" at N.J.A.C. 11:4-48.2.

As the Department has provided a 60-day comment period on this notice of proposal, this notice is excepted from the rulemaking calendar requirement pursuant to N.J.A.C. 1:30-3.3(a)5.

Social Impact

The Department's proposed repeals and amendments will have a favorable impact on insurers by alleviating some of the administrative burden placed on them in complying with New Jersey specific requirements. The repeals will also favorably impact policyholders in that a more streamlined forms approval process will enable insurers to place their products on the market more quickly. Moreover, these proposed repeals will not result in any deviation from the Department's current appropriate standards of review.

Economic Impact

The Department believes that these proposed repeals and amendments will have an indirect favorable economic impact on insurers by enabling certain products to reach the market more readily. The Department does not believe that these repeals will have any economic impact on policyholders. The Department's cost of reviewing the life, health and annuity forms submissions may decrease slightly as a result of proposed repeals because there will be slightly less paperwork to review as part of the form approval process.

Federal Standards Statement

A Federal standards analysis is not required because the Department's proposed amendments and repeals do not exceed any Federal requirements or standards.

Jobs Impact

The Department does not anticipate that the proposed repeals and amendments will result in the generation or loss of jobs.

Regulatory Flexibility Statement

The Department does not believe a regulatory flexibility analysis is necessary because these proposed repeals and amendments do not impose any additional reporting, recordkeeping or other compliance requirements on any "small businesses" as that term is defined in the Regulatory Flexibility Act at N.J.S.A. 52:14B-16 et seq. In fact, these proposed repeals will reduce the current reporting and recordkeeping requirements placed on insurers subject to these rules.

Smart Growth Impact

The proposed repeals and amendments have no impact on the achievement of smart growth and the implementation of the State Development and Redevelopment Plan.

Full text of the proposal follows (additions indicated in boldface **thus**; deletions indicated in brackets [thus]):

SUBCHAPTER 44. STANDARDS FOR CONTRACTS ON A VARIABLE BASIS

11:4-44.2 Definitions

The following words and terms, when used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise.

. . .

[“Market value adjusted annuity” means a deferred annuity containing a long-term substantial interest rate guarantee which provides for adjustment of the cash value prior to the maturity of the guarantee to reflect the market value of the guarantee. The market value of the guarantee is generally the present value of the guaranteed rate using the current interest rate being credited on similar contracts with similar maturities.**]**

. . .

[11:4-44.5 Standards for individual market value adjusted annuities

(a) All individual market value adjusted annuities shall comply with the following standards:

1. The contract shall be identified and issued as a variable contract pursuant to N.J.S.A. 17B:28-1 et seq.;
2. The funds backing the contract shall be held in a separate account; and
3. The maturity value and cash value guarantees shall be obligations of the general account.**]**

SUBCHAPTER 48. UNFAIR DISCRIMINATION

11:4-48.2 Definitions

The following words and terms, when used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise

. . .

[“Persistency bonus” means any credit to an explicit or implicit accumulation account which varies by duration in a manner which encourages or rewards persistency, and which includes:

1. A retroactive refund of past mortality or expense charges at some duration;
2. A retroactive increase in past interest credits at some duration;
3. A percentage increase in the accumulation amount at some duration; and
4. Factor enhancement bonuses which provide for the crediting of a higher interest rate or the charging of a lower expense or mortality charge commencing at some duration.]

. . .

[11:4-48.4 Persistency bonus

(a) The Department shall approve life insurance policy forms that provide non-guaranteed bonuses which either credit a higher interest rate or charge a lower expense or mortality charge commencing at some duration if all of the following conditions are met:

1. The intention to pay bonus interest or reduce mortality or expense charges shall be stated in the contract or in an endorsement thereto which has been filed by the Department prior to use. Such contract wording or endorsement shall not constitute a guarantee of the payment of the bonus. An example of acceptable language is as follows: The company may credit interest at a rate in excess of the

guaranteed rate. Additional interest at a rate of not more than may be credited to policies in force at least 10 years, as well as for policies in force more than 20 years. The additional excess interest is the result of a reduction in the interest margin for profit and expenses. The guaranteed interest rate will not be increased by the additional excess interest rate.

2. The insurer shall include in its submission to the Department an actuarial certification that the nonguaranteed bonus does not unfairly discriminate between persons who lapse or surrender their policies before the policy year of crediting the bonus and those who continue their policy in force, as prohibited by N.J.S.A. 17B:30-12(c). The submission shall include an explanation of the reason for and source of the bonus which focuses on the completion of amortization expenses and the release of interest margins. Higher investment yields on long term assets or hypothetically better mortality of persisting policyholders will not provide sufficient justification for a bonus.

3. The insurer shall notify the Department in writing at least 60 days prior to implementing any changes in bonus interest rate levels or methodology and any reduction or elimination of bonus provisions. No such changes or reductions shall be implemented without the Department's prior approval. The Department may require the elimination or reduction of the bonus as a condition of approval of some future change in interest rates.

(b) All persistency bonuses other than those described in (a) above shall be prohibited in life insurance policy forms.**]**

(No change in text.

Recodify existing N.J.A.C. 11:4-48.5 through 48.10 as **48.4 through 48.9**.

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