

**INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
DIVISION OF INSURANCE**

Actuarial Requirements for Flexible-Factor Policy Forms

Proposed Amendments: N.J.A.C. 11:4-47.2, 47.3 and 47.5

Proposed Repeal and New Rule: N.J.A.C. 11:4-47.4

Proposed Repeals: N.J.A.C. 11:4-47.6 and 11:4-47 Appendix

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

Authority: N.J.S.A. 17:1-8.1, 17:1-15e, 17B:25-18, 17B:25-19, 17B:27-25, 17B:28-5 and 17B:30- 1 et seq.

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

Proposal Number: PRN 2003-57

Submit comments by April 4, 2003 to:

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The agency proposal follows:

Summary

Flexible factor products are life insurance products with premiums, values, benefits, credits and/or charges that can be changed by the issuing company. Effective February 5, 1996, the Department of Banking and Insurance (Department) adopted rules setting forth standards for flexible-factor life insurance forms that are required to be filed with the Commissioner prior to issue and delivery in this State (see 28 N.J.R. 1215(a)). The adopted rules at N.J.A.C. 11:4-47 established standards for cash values and nonforfeiture benefits in accordance with N.J.S.A.

17B:25-19 (the “Standard Nonforfeiture Law”), and established methodology for determining and modifying values, benefits and charges based on future emerging experience. The rules required that a form submitted for filing be disapproved if it did not comply with these standards. The rules also required that changes to flexible factors for in-force policies be submitted to the Department for review and approval prior to implementation.

After reviewing these standards and practices in other states, the Department has concluded that these cash value standards, submission requirements and prior notification requirements are essentially unique to New Jersey. In addition, the Department finds that the costs and delays associated with compliance with the present rules are not justified, and is proposing to replace these requirements with substantive standards for flexible factors that will reduce or eliminate prior review and approval.

For example, instead of documentation being submitted each time a flexible factor is modified, the Department proposes that any modifications to the factors for in-force policies be:

1. Consistent with the contract;
2. Subject to a minimum or maximum set forth in the contract;
3. Based on future or emerging experience;
4. Non-discriminatory; and
5. Must not increase the profit factor.

The proposed amendments further revise assumptions used to comply with the Standard Nonforfeiture Law in the development of retrospective cash values to conform to national standards.

Specific changes to Subchapter 47 are as follows:

The proposed amendments to the definition section, N.J.A.C. 11:4-47.2, change some existing definitions, delete definitions no longer needed, and add a new definition to the section. The proposed amendments to the definitions of “experience factors,” “flexible factors” and “flexible-factor forms” conform the definitions to the proposed standards and provide clarification through examples, but do not constitute a change in scope. The definitions of “minimum guarantee premium” and “persistency bonus” are proposed for deletion since they are not used in the proposed standards. A new term, “flexible factor guarantee,” is defined for use in the standards but is a concept implicit in the existing rule.

N.J.A.C. 11:4-47.4, Pricing assumption-actuarial certification is replaced with a new section, N.J.A.C. 11:4-47.4, Modification of flexible factors, which sets forth the minimum standards for modifications to flexible factors.

The proposed amendment to N.J.A.C. 11:4-47.5 removes the requirement that an actuarial memorandum be prepared and signed by a qualified actuary which demonstrates compliance with the Standard Non-forfeiture Law, and removes all the requirements relating to memoranda. The amended rule now requires a certification by a qualified actuary that the filing is either exempt from the Standard Nonforfeiture Law or is in compliance with that law’s provisions. This amendment will not modify the minimum cash and other nonforfeiture values.

A proposed amendment to subsection (c) of N.J.A.C. 11:4-47.5 significantly modifies assumptions for the maximum initial expense allowance in the cash value formulas for policies with cash values determined retrospectively. This may reduce the minimum nonforfeiture values for some products. In addition, the Appendix, consisting of Exhibit 1 which contained instructions for the detection and avoidance of discontinuities in life insurance policies, is repealed in conjunction with the proposed deletion of N.J.A.C. 11:4-47.5(d)1. N.J.A.C. 11:4-

47.5(a)1 and 2 are being amended to clarify the treatment of supplementary term benefits for nonforfeiture compliance.

N.J.A.C. 11:4-47.6 is repealed since the section referred to the retention of the actuarial memoranda. Former N.J.A.C. 11:4-47.7 concerning penalties is being recodified as N.J.A.C.11:4-47.6 and revised to eliminate reference to the disapproval of a form, since the rules will no longer require that the material be included in a form filing.

This rule proposal provides for a comment period of 60 days, and therefore, pursuant to N.J.A.C. 1:30-3.3(a)5, is not subject to the provisions of N.J.A.C. 1:30-3.1 and 3.2 governing rulemaking calendars.

Social Impact

The proposed amendments, repeals and new rule should have a favorable impact on insurers, consumers and the Department. The promulgation of minimum standards (as opposed to requiring preparation of extensive documentation) relieves insurers of time-consuming tasks. Removal of the form filing requirements will result in the product being introduced to the market in a more timely fashion.

While being of benefit to the insurers, the proposed rules continue to adequately afford protection to consumers through the minimum standards included in the rules. The proposed amendments and new rule also continue to allow the Department to fulfill its regulatory duties, and enhance that ability by providing clear and comprehensive guidelines while reducing the administrative expense of reviewing documentation during the form filing process.

Economic Impact

The proposed amendments, repeals and new rule should have a favorable economic impact on insurers, policyholders and the Department. The Department believes that there will be reduction in the cost of compliance for insurers because of the reduction in documentation required to be submitted to the Department. Elimination of the prior notice for modifications to flexible factors will ensure a uniform, national introduction by the insurer and eliminate the possible need for New Jersey specific administration systems. In addition, speed to market will be improved for innovative products.

Policyholders can be assured that flexible factors will not change beyond the limitations specified in their contract. The Department will reduce its costs in monitoring compliance by eliminating the prior review process and relying on established market conduct procedures that monitor contract provisions.

Federal Standards Statement

A Federal standards analysis is not required because the proposed amendments, repeals and new rules are not subject to any Federal standards or requirements.

Jobs Impact

The Department does not anticipate that the proposed amendments, repeals and new rule will result in the generation or loss of jobs. Insurers already employ professional and other staff to establish experience factors, monitor the actuarial experience based on those factors, and request modification of those factors when indicated. The elimination of the documentation

filing requirements for flexible factors should not affect those employed in the foregoing, and the Department believes that while there may be some effect on the clerical staff, it will be minimal. The Department invites commenters to submit any data or studies concerning the jobs impact of the proposed amendments, repeals and new rule together with their written comments on other aspects of this proposal.

Agriculture Industry Impact

The Department does not expect any agriculture industry impact as a result of the proposed amendments, repeals and new rule.

Regulatory Flexibility Analysis

A regulatory flexibility analysis is required because some insurers to whom the proposed amendments, repeals and new rule apply may employ fewer than 100 full-time employees, and therefore are “small businesses” as that term is defined by the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq. The proposed amendments, repeals and new rule implement minimum standards for an existing practice while deleting certain filing requirements. The Department does not believe any increase in professional services will be needed to comply with the minimum standards as stated in the Jobs Impact above. The intent is to reduce the amount of effort required to complete the filing of a flexible factor policy.

There has been no distinction in the flexible factor standards for small businesses, as the standards relate to the Department’s oversight of all life insurers. The Department’s interest in oversight of these insurers applies regardless of the business size. Accordingly, no undue burden would be imposed, and no differentiation in compliance requirements is made based on business size.

Smart Growth Impact

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

Full text of the proposed repeals may be found in the New Jersey Administrative Code at N.J.A.C. 11:4-47.4, 47.6 and 11:4-47 Appendix.

Full text of the proposed amendments and new rule follows (additions indicated in boldface **thus**; deletions indicated in brackets [thus]):

SUBCHAPTER 47. ACTUARIAL REQUIREMENTS FOR FLEXIBLE-FACTOR POLICY
FORMS

11:4-47.2 Definitions

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

...

“Experience factors” means [factors of future anticipated or emerging experience upon which changes to flexible factors could be based] **a factor experienced by the company that is variable in nature and impacts the profitability of the policy. Depending on**

the policy design, experience factors may include, but are not limited to, investment earnings, mortality, persistency, and expenses, because these factors can vary and the profitability of the policy is normally affected. (For example, the price of a pound of gold is not an experience factor because, while variable, most rational policy designs would not be impacted by this.)

“Flexible factors” means premiums, premium factors (**for example, interest credits, mortality charges, or expense[s] charges**) or benefits (**for example, death benefits, cash or [loan] surrender values**) **or benefit charges (for example, surrender charges)** that the insurer reserves the right to modify, **subject to a flexible-factor guarantee**, on the basis of future anticipated or emerging experience. **Flexible factors do not include: interest or investment credits based on an external index, investment increments based on performance of assets in a variable account contract, the mortality and expense risk charge deducted in determining the investment return on a separate account, or dividends based on the principle of distributable surplus.**

“Flexible-factor form” means any life insurance policy, rider or endorsement, whether participating or nonparticipating, where the insurer reserves the right to modify [(upward or downward) premiums, premium factors (interest, mortality, expenses) or benefits (death benefits, cash or loan values) on the basis of future anticipated or emerging experience] **one or more flexible factors as defined in this section. The right to modify is subject to a flexible-factor guarantee and the modification must be based upon future anticipated or emerging experience.**

“Flexible-factor guarantee” means a statement in the contract which guarantees the upper or lower limits of specific flexible factors.

...

["Minimum guarantee premium" means the minimum premium as established by the insurer to maintain coverage in-force and avoid lapse.

"Persistency bonus" means credit either to an explicit or implicit accumulation account which varies by duration in a manner which encourages or rewards persistency.]

...

11:4-47.3 General requirements

(a) [No form to which this subchapter applies may be delivered or issued for delivery in this State unless submitted to the Commissioner for review and filed by the Commissioner pursuant to all applicable law, including, but not limited to, N.J.A.C. 11:4-40.] **All forms with any flexible factors shall include a flexible-factor guarantee.**

(b) (No change.)

11:4-47.4 **Modification of flexible factors**

(a) Any modification to flexible factors on an in-force policy made by an insurer shall be subject to the following requirements:

- 1. The modification shall be made only to flexible factors identified as such in the contract;**

2. The modification shall be based upon future anticipated or emerging experience and on experience factors only as identified in the contract; and

3. The modification shall be made to all individuals of the same class or equal expectation of life in compliance with the requirements of N.J.S.A. 17B:30-12c.

(b) Any modification to flexible factors shall not result in the distribution of prior profits or the recovery of prior losses.

11:4-47.5 Nonforfeiture benefits—actuarial [memorandum] **certification**

(a) Each form submitted for filing shall be accompanied by **a** certification[s] by a qualified actuary that the nonforfeiture benefits provided [under the form(s)] are in compliance with N.J.S.A. 17B:25-19[, and that an actuarial memorandum has been prepared and signed by a qualified actuary which demonstrates such compliance. This memorandum shall be available for review by the Department upon request, and a qualified actuary shall so certify. These certifications shall be provided regardless of whether or not the insurer is asserting that the form(s) submitted for filing] **or** are exempt from providing guaranteed nonforfeiture benefits as described in N.J.S.A. 17B:25-19.

1. Nonforfeiture compliance for **supplementary** term insurance [riders] **benefits** that create a “target” death benefit based upon the combined coverage provided by the base policy forms and **supplementary benefit** [rider] shall be

based upon the total coverage provided by the base plan[/rider] **and**
supplementary benefit combination.

2. All other term insurance [riders] **benefits** shall be tested for nonforfeiture compliance as [if they provide] stand-alone [term] insurance coverage.

(b) (No change)

(c) For policies where cash values are determined retrospectively as an accumulation of gross premiums less expense charges, with interest increments and mortality decrements, the excess of expense charges in the first policy year over renewal expense charges may not be greater than the maximum initial expense allowance as set forth in N.J.S.A. 17B:25-19h(i), [and a qualified actuary shall so certify. For purposes of determining the maximum initial expense allowance, the insurer at its option may adopt the method described in either (c)1 or 2 below. Each form submitted for filing shall be accompanied by a certification from a qualified actuary that specifies which method has been used.

1. The plan of insurance may be considered to be either that which would result from an indefinite continuation of initial interest, mortality, and expense factors (that is, the apparent plan), or by the assumption that maximum guaranteed interest, mortality, and expense factors will apply at all durations (that is, the guaranteed plan). Except as provided in (c)1ii below, it shall be assumed that the premiums will continue to be paid at the initial level and frequency and the amount of death benefit will continue unchanged from the initial amount. The resulting plan of insurance shall be either an endowment to the age at which the cash value equals the initial insurance amount or term insurance to the age at which the cash value is exhausted. The

maximum initial expense allowance shall be the smaller of the amounts so calculated for the apparent or the guaranteed plan of insurance.

i. The standards set forth in (c)1 above limit the excess first year expenses to an amount equal to the lesser of the maximum initial expense allowance for the apparent plan and the maximum initial expense allowance for the guaranteed plan.

ii. For the apparent plan and the guaranteed plan, insurers shall assume that the initial premium and initial death benefit continue unchanged, except that for policies having either a minimum guarantee provision or a minimum premium test provision as defined in N.J.A.C. 11:4-41.2 effective for a period of 11 or more years after issue (16 or more years for last survivor policies), it shall be assumed that the stipulated minimum premium is paid as required to avoid lapse in all years.

iii. For front end loaded policies without surrender charges, in order to satisfy the requirements set forth in (c)1 above, insurers may be required to express the front end load as a percentage of premium rather than as a flat amount. In the alternative, the insurer may be required to set forth a minimum first year premium which is sufficient to mature the policy.

2. The plan of insurance may be assumed to be whole life, subject to the following conditions:

i. A disclosure statement shall be provided to the prospective policyowner at the time of application and shall be printed

prominently (that is, on or in close proximity to the initial schedule page and in bolder or larger type) on the schedule page of the policy form for any policy for which the initial premium is lower than that premium which, when paid in level amounts at the initial frequency, would provide coverage to the earlier of policy maturity or age 100, assuming indefinite continuation of initial interest, mortality and expense factors. For policies having either a minimum guarantee provision or a minimum premium test provision effective for a period of 11 or more years after issue (16 or more years for last survivor policies), the initial premium shall be deemed to be the stipulated minimum premium. The disclosure statement shall be substantially similar in form and content to the following:

Assuming current (Note: insurers to include listing of interest, mortality and expense factors, as such factors are described in the form) continue indefinitely and a premium equal to the initial premium (or minimum premium, if applicable) is paid (insert premium mode selected by owner), this policy will provide coverage for xx years; based on guaranteed (Note: insurers to include listing of interest, mortality and expense factors, as such factors are described in the form), this policy will provide coverage for yy years. Other policy forms designed specifically to provide term insurance may offer similar benefits for such periods at a

lower cost or with higher cash surrender values. You should consider whether this policy or such alternative policy is right for you.

ii. The specimen disclosure statement(s) submitted with the form shall specify or clearly reference the premiums assumed and shall specify the lengths of coverage provided based upon the current and guaranteed assumptions.

iii. Regardless of initial premium, no disclosure statement shall be required for last survivor policies with a face amount greater than or equal to \$500,000 or to variable contracts (that is, those which are issued pursuant to N.J.S.A. 17B:28-1 et seq. and delivered or issued for delivery in this State).]

(d) [All policy] **Policy** forms may incorporate surrender charges of specified amounts at specified durations, provided that the resulting cash values are at least as large as those developed under (c) above assuming [a] **the** maximum initial expense allowance and no surrender charges. [For purposes of this subsection, “specified” surrender charges means that the policyholder can determine at issue the exact amount of surrender charge applicable at any future time. Surrender charges provided by a table included in the policy or surrender charges as a percentage of initial premiums or death benefits shall be specified, but surrender charges as a percentage of variable future premiums, values or benefits are not specified.]

1. The scale of surrender charges shall be such as to satisfy the tests regarding detection and avoidance of discontinuities in life insurance policies set forth in Exhibit 1 in the Appendix to this subchapter, incorporated herein by reference. The actuarial memorandum prepared pursuant to (a) above shall include a certification from a qualified actuary that surrender charges, if any, are in compliance with these tests for representative issue ages and premium/benefit arrangements on an “apparent plan” basis or, in the alternative, provide justification for instances where the tests may not be satisfied.

2. The insurer may] **A form shall be considered to** satisfy [the] **this** requirement[s set forth in (d) above by demonstrating that] **if the** surrender charges are less than the unamortized unused initial first year expense allowance. The initial expense allowance shall be [derived pursuant to (c) above. Further, the expense allowance shall be] amortized over the period for which coverage was purchased.

[(e) In order to demonstrate compliance with the requirements set forth in (c) and (d) above, the actuarial memorandum prepared pursuant to (a) above shall contain the following:

1. A description of the calculation of the maximum initial expense allowance, including a specific reference to the guaranteed plan purchased by the initial premium;

2. A demonstration, either algebraically or by comparing the maximum initial expense allowance to the excess first year expenses for all ages and classes, that the requirements set forth in (c) are satisfied; and

3. If there are surrender charges, a comparison, either tabular or by algebraic formula, of surrender charges to unused unamortized expense allowance at all durations.

(f) In addition to surrender charges as permitted pursuant to (d) above, a policy may contain provision for surrender charges in the form of withholding portions of credited excess interest or similarly calculated percentages of accumulated amounts. This type of surrender charge shall be considered a protection against possible asset liquidation loss at time of cash value payment, and the insurer shall state in the actuarial memorandum prepared pursuant to (a) above the circumstances under which such a surrender charge would be imposed. If the charge is to be imposed unconditionally, the minimum value test required pursuant to (d) above shall include the unspecified surrender charge in all calculations, and the insurer, in policy summaries and sales illustrations, may not display any accumulation amounts greater than the cash values assuming imposition of all surrender charges.

(g) Each form submitted for filing, which the insurer asserts is exempt from providing guaranteed nonforfeiture benefits as described in N.J.S.A. 17B:25- 19, shall be accompanied by a certification from a qualified actuary:

1. Stating that an actuarial memorandum has been prepared and signed by a qualified actuary which demonstrates that the form is exempt from providing

guaranteed nonforfeiture benefits as described in N.J.S.A. 17B:25-19, which actuarial memorandum shall be available for review by the Department upon request; and

2. Stating the specific exemption from providing guaranteed nonforfeiture benefits as described in N.J.S.A. 17B:25-19 claimed by the insurer.]

11:4-[47.7] **47.6** Penalties

Failure to comply with this subchapter shall result in the [disapproval of any flexible-factor form for delivery in this State, as well as] imposition of any [other] penalties as may be authorized by law.

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