

INSURANCE  
DEPARTMENT OF BANKING AND INSURANCE  
DIVISION OF INSURANCE

Individual Annuity Contract Form Standards  
Standards for Contracts on a Variable Basis

Adopted Amendments: N.J.A.C. 11:4-43.3 and 44.3

Proposed: September 19, 2005 at 37 N.J.R. 3543(a)

Adopted: September 19, 2006 by Steven M. Goldman, Commissioner of the Department of Banking and Insurance

Filed: September 19, 2006 as R. 2006 d. 374, with substantive changes not requiring additional public notice and comment (see N.J.A.C. 1:30-6.3).

Authority: N.J.S.A. 17:1-15, 17B:17-5 and 17B:25-18.2

Effective Date: October 16, 2006

Summary of Public Comments and Agency Responses:

The Department of Banking and Insurance (Department) received timely written comments from ING USA Annuity and Life Insurance Company, the American Council of Life Insurers (ALCI) and Prudential Financial.

COMMENT: One commenter indicated that the proposed standards appear to streamline the approval process; however, the proposal may be interpreted to limit combinations in an unintended way that limits customer choice and does nothing to address solvency concerns. The commenter requested clarification on the Department's intention to limit or preclude combinations of N.J.A.C. 11:4-44.3(e)2 and 3.

RESPONSE: The proposed amendments would not preclude a combination of N.J.A.C. 11:4-44.3(e)2 and 3. Paragraph (c)6 permits a demonstration that a combination is of comparable value to one of the other benefits. The combination of paragraphs (e)3 and 4 is not meant to

preclude other combinations; it is permissive in the sense that the combination does not require an additional demonstration.

COMMENT: According to one commenter, N.J.A.C. 11:4-44.3(e)3 limits the death benefit to 200 percent of premiums, as reduced by withdrawals. The commenter requests that this provision be amended to provide for a death benefit of at least 250 percent of the accumulation of premiums (the commenter has a limit of 300 percent).

RESPONSE: The purpose of the rule is to define a death benefit that is incidental. The commenter provides no quantitative evidence that a higher death benefit is incidental. The standard at N.J.A.C. 11:4-44.3(e)3 stipulates that a roll-up benefit that is limited to 200 percent is "deemed" incidental (without supplementary actuarial demonstration). Using N.J.A.C. 11:4-44.3(e)6, an actuary could demonstrate that a maximum of 250 percent was comparable to paragraph (e)3 or one of the other standards.

COMMENT: One commenter elaborated that N.J.A.C. 11:4-44.3(e)4 permits a death benefit equal to a percentage of the earnings of the contract, but limits the percentage to 50 percent of such earnings when combined, and, therefore, the purpose of the benefits described in paragraph (e)4 is to cover the taxes due at death. The commenter asserts that limiting the parameter to 50 percent is equivalent to an income tax bracket of 33 percent and, therefore, renders this benefit taxable, in addition to the gains. The commenter requests that the Department change the amendment to a 55 percent limitation, which would correspond to a 35 percent tax bracket.

RESPONSE: The purpose of the rule is to set limits on the amount of mortality risk. The fact that some of the risk is identified as being incurred to cover taxes does not change the purpose of

the new rule. The maximum tax bracket to which the beneficiary may be subject could change. In addition, N.J.A.C. 11:4-44.3(e)6 allows a slightly higher benefit to be paid with an actuarial demonstration.

COMMENT: One commenter indicated that a typo should be corrected: "than" should be added between "less" and "the" in N.J.A.C. 11:4-44.3(e)5.

RESPONSE: The Department agrees that the word "than" was erroneously omitted from this provision in the proposal. However, because the provision is being amended upon adoption, rather than being corrected, the incomplete phrase in the rule as proposed will be deleted upon adoption.

COMMENT: One commenter stated that the proposal does not specify how withdrawal adjustments are made and, consequently, requires wording that characterizes adjustments as "dollar for dollar" or "pro-rata."

RESPONSE: The Department agrees that this proposal does not specify how the death benefit is to be adjusted for withdrawals or other fund adjustments. A form can meet these standards with either kind of adjustment, as long as the method is stated in the form.

COMMENT: One commenter requested that the Department clarify how market value adjustments should be reflected in the calculations for fixed and variable annuities.

RESPONSE: The Department does not feel that it is necessary to give explicit standards for market value adjustments. The contract death benefit may or may not include a market value adjustment.

COMMENT: Regarding N.J.A.C. 11:4-43.3(h)3, a commenter recommended the elimination of the 200 percent cap, since the roll-up death benefit without a cap properly rewards persistent customers. With the cap, the roll-up could become moot for a long-time contract holder whose account value has doubled and therefore the death benefit becomes less valuable.

RESPONSE: The comment does not establish that the death benefit is incidental, because there is no guarantee that the account value will double, thus making the death benefit moot. In any event, an **incidental** death benefit (for example, return of premium) would be moot under many investment return scenarios.

COMMENT: With respect to N.J.A.C. 11:4-43.3(h)5, one commenter asserted that it is unfair to link these death benefits. The roll-up death benefit in paragraph (h)3 provides protection against poor market performance, while the death benefit in paragraph (h)4, referenced as an earnings appreciation benefit, compensates the beneficiary for tax treatment deferred annuity proceeds. The commenter stated that they (death benefits) usually are offered on a stand-alone basis. The commenter further stated that the phrase "combined amount is less than the greater of the two death benefits" appears in conflict with language from the Summary which states that the "combination of death benefits set forth in 3 and 4 above, not exceeding the greater of the permitted benefits under 3 and 4."

RESPONSE: The Department does not agree with the commenter that it is unfair to allow the greater of the two different benefits. The Department perceives that, in general, these two benefits offset one another -- as the commenter notes, a roll up benefit will be operative in a down market or one with less than expected returns; the earnings benefit will be operative otherwise. The Department agrees that there is a technical inconsistency between the rule text

and the Summary ("less than the greater..." is not precisely the same as "not exceeding the greater"). This is corrected upon adoption through amendments to N.J.A.C. 11:4-43.3(h)5 and 44.3(e)5 to render them consistent with the intent of the Department as expressed in the Summary of the proposal.

COMMENT: With respect to N.J.A.C. 11:4-43.3(h)6, a commenter asked: "Does within 25 percent refer to the value at issue or along every point in a scenario?" The commenter used as an example: If we provide a roll-up death benefit without a 200 percent cap, we can probably demonstrate that it increases the cost/value of the death benefit less than 25 percent at issue. However, for a customer holding a 20-year policy, the elimination of the 200 percent cap will increase the death benefit by more than 25 percent by the 20-year time period.

RESPONSE: The reference in question was to the value at issue. It was assumed that the company would have an opportunity to demonstrate that the estimated cost of providing the benefit would be within 25 percent of the estimated cost of a permitted benefit. For benefits tied to contributions, the calculation would be done at the time of contribution.

COMMENT: It was recommended by one commenter that the application of these standards be limited to new contracts.

RESPONSE: These standards are to be applied upon new or amended policy form review. Consequently, they would not be applied to existing contracts or to previously approved forms.

COMMENT: One commenter asked: "Does accumulated value on anniversary date" qualify as a periodic value?"

RESPONSE: The Department does not understand the question. The regulation uses "highest contract anniversary value" as an example of a permitted periodic value, which is the same as the accumulated value on anniversary date. The concept of a variable annuity death benefit which is periodically reset is fairly well understood, and the Department intends to interpret this part of the rule liberally.

COMMENT: One commenter requested clarification of the qualifying period in determining the "highest periodic value attained during some prior period," as stated in the Summary of the proposal, but not defined in N.J.A.C. 11:4-43.3(h)2 and 11:4-44.3(e)2. The commenter asserted that the phrase "some prior period" should be defined or explained as to how it will be interpreted in relationship to the regulation.

RESPONSE: The regulation was drafted intentionally without a definition of the "prior period" to allow flexibility. When the highest value actually attained by the account is referenced, it is implied that this could be for any prior period when the contract was in force. N.J.A.C. 11:4-43.3(h)2 and 44.3(e)2 are being slightly amended upon adoption to clarify this point. This change may be made upon adoption since the amended language does not enlarge or curtail the scope of the proposed amendments.

COMMENT: One commenter asked if the proposed regulation permits or prohibits a variable annuity death benefit which is the greater of the contract value and net purchase payments (purchase payments less withdrawals)?

RESPONSE The Department believes that such a benefit would be permitted. Such a benefit has always been considered minimal.

Summary of Agency-Initiated Changes upon Adoption:

The Department is adding text to N.J.A.C. 11:4-43.3(h)2 and -44.3(e)2 which creates uniformity in the descriptions of “highest periodic value” and is amending text in the definition of the monetary “gain” of a combined incidental annuity death benefit amount in N.J.A.C. 11:4-43.3(h)5 and 44.3(e)5 above. These changes may be made upon adoption because the changes are incidental and technical creating uniformity of definitions and are not so substantive as to require reproposal (see N.J.A.C. 1:30-6.3)

Federal Standards Statement

The adopted amendments do not contain standards or requirements that exceed those standards or requirements imposed by Internal Revenue Service Code, Section 401, 403 (b) and 408A. Section 101 of the IRS Code provides that the proceeds of a life insurance policy maturing as a death claim, subject to the exceptions stated in the law, are not subject to income tax when paid. The amendments compel the incidentality of an annuity death benefit which may not qualify for preferential tax treatment under Federal law, however, annuities with death benefits generally do not qualify as life insurance even in the absence of the limits of these amendments.

**Full text** of the adoption follows (additions to proposal indicated in boldface with asterisks **\*thus\***; deletions from proposal indicated in brackets with asterisks \*[thus]\*):

11:4-43.3      General requirements and prohibitions

(a)-(g) (No change.)

(h) Death benefits in individual annuities will be considered subsidiary or incidental if they satisfy one of the following conditions:

1. (No change from proposal.)
2. A death benefit equal to or less than a "highest periodic value" **\*calculated for any prior period for which the contract was in force\*** (for instance, highest contract anniversary value, highest monthly value, highest five-year value) adjusted for subsequent premiums and withdrawals. Such a death benefit provision would only be applicable to an equity-indexed, market value adjusted, or other indexed contract with the potential for increase or decrease in the annuity value;

3. – 4. (No change from proposal.)

5. A death benefit based on a combination of an “accumulation” death benefit ((h)3 above) and a death benefit based upon the "gain" of the contract ((h)4 above), provided that the combined amount *\*[is less than]\** **\*does not exceed\*** the greater of the two death benefits described in (h)3 and 4 above; or

6. (No change from proposal.)

#### 11:4-44.3 Standards for variable contracts

(a) - (d) (No change.)

(e) Death benefits in annuity contracts issued on a variable basis will be considered subsidiary or incidental if they satisfy one of the following conditions:

1. (No change from proposal.)
2. A death benefit equal to or less than a "highest periodic value" **\*calculated for any prior period for which the contract was in force\*** (for instance, highest contract

anniversary value, highest monthly value, highest five-year value) adjusted for subsequent premiums and withdrawals;

3. – 4. (No change from proposal.)

5. A death benefit based on a combination of an “accumulation” death benefit ((e)3 above) and a death benefit based upon the "gain" of the contract ((e)4 above), provided that the combined amount \*[is less ]\* **does not exceed** the greater of the two death benefits described in (e)3 and 4 above;

6. (No change from proposal.)

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