

INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
OFFICE OF SOLVENCY REGULATION

Treatment of Allocated Deposit-Type Deferred Annuity Contract Funds for Purposes of Calculating the Special Purpose Apportionment and the Fraud Assessment

Proposed New Rules: N.J.A.C. 11:2-43

Authority: N.J.S.A. 17:1-8.1, 17:1-15e, 17:1C-19 et seq., 17:33A-1 et seq. and 17B:21-1 et seq.

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

Proposal Number: PRN 2004-242

Submit comments by August 20, 2004 to

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The agency proposal follows:

Summary

Companies regulated by the Department of Banking and Insurance (Department), including insurers transacting annuity business, are required to pay a special purpose apportionment (apportionment) pursuant to N.J.S.A. 17:1C-19 et seq., to fund the financial and regulatory responsibilities of the Department, and a “fraud assessment” (assessment), pursuant to N.J.S.A. 17:33A-8g, to fund the responsibilities under the Insurance Fraud Prevention Act, N.J.S.A. 17:33A-1 et seq. The apportionment and the assessment are based on the net written premiums of each company. For purposes of the apportionment, N.J.S.A. 17:1C-20b(2) defines “net written premiums received” to mean “gross direct premiums written, less returned

premiums thereon and dividends credited or paid to policyholders as reported on the companies' annual financial statement". A similar definition is provided in N.J.S.A. 17:33A-8(g) with respect to the assessment.

In accordance with the statute, the Department bases the determination of premiums subject to the apportionment or assessment on the annual financial statements filed by insurers or other entities subject to such apportionments or assessments. With respect to annuity considerations, the Department has consistently interpreted the applicable statutes to consider all amounts reported in the appropriate column, currently Column 3 of Schedule T of the annual statement, which is labeled as "annuity considerations" as premium for purposes of determining an insurer's apportionment or the assessment. Life and health insurers, in completing their annual statements, are required to do so in the format adopted by the National Association of Insurance Commissioners (NAIC) that is in use at the time the statement is due. See N.J.S.A. 17B:21-1. This statute further provides that the annual statement shall be prepared in accordance with the annual statement instructions and the Accounting Practices and Procedures Manual adopted by the NAIC, and all applicable provisions of law. The statute also provides that annual statements shall be submitted in the form and contain any additional matters as prescribed by the Commissioner of Banking and Insurance (Commissioner).

Effective January 1, 2001, the NAIC adopted a revised Accounting Practices and Procedures Manual for use by insurers, referred to as "codification of statutory accounting principles." New Jersey, as well as virtually every other state, has adopted the revised Accounting Practices and Procedures Manual. One of the changes made under codification was to require that allocated deposit-type deferred annuity contract funds with mortality or morbidity risks (hereafter referred to as "allocated deposit-type funds") be recorded in Column 3 (annuity

considerations) of Schedule T of the annual statement. Prior to 2001, many companies had reported these allocated deposit-type funds in Column 6 of Schedule T (Deposit-Type Funds). Accordingly, prior to codification in 2001, the consideration subject to the apportionment and the assessment with respect to annuities was based on the annuity considerations column in Schedule T of the annual statement, which, for many companies, did not include allocated deposit funds. Since codification in 2001, the apportionment and the assessment bases have included such funds.

The Department has received numerous inquiries as well as objections to inclusion of allocated deposit-type funds previously not subject to the apportionment or the assessment. In rendering a decision on one such objection to the special purpose apportionment on these grounds, the Commissioner, in Order No. A03-122, rejected the objecting companies' arguments solely on the basis that the Department had based its determination of the relevant apportionment on the companies' annuity considerations as reported in Column 3, Schedule T of the annual statement. The Department, however, has continued to evaluate this issue, and has determined that it is appropriate to permit companies transacting annuity business to exclude allocated deposit-type funds solely for purposes of determining the apportionment and the assessment.

Allocated deposit-type funds arise in connection with deferred annuity contracts. These contracts consist of two separate and distinct phases characterized by different rights, liabilities, risks and relationships between the parties. The first phase is the accumulation phase, during which the customer deposits funds with the company. During this period, the contract holder enjoys certain benefits and is entitled to future rate guarantees if he or she decides to annuitize a stream of payments (annuitization). Prior to annuitization, contract holders may withdraw all or a portion of their deposited funds net of surrender or other charges.

For contract holders who choose to exercise their contractual option to receive annuity payments, a second phase of the contract begins at that point. The second phase is the annuity pay-out phase or annuitization. During this phase, the contract holder has rights to annuity payments and the company has the corresponding obligation to make payments. The deposit funds, which have accumulated during the contract phase, are used as consideration to annuitize the contract. Prior to annuitization, these deposit funds are similar to investment vehicles offered by non-insurance entities. Since these funds may be withdrawn prior to annuitization, the Department believes it is inappropriate to subject these funds to the apportionment and the assessment because amounts reported at the time represent the gross amounts received, and do not reflect deposited funds returned to contract holders.

The Department, therefore, is proposing these new rules to provide that an insurer transacting annuity business may seek to exclude allocated deposit-type funds that have not annuitized from annuity considerations that are subject to the apportionment and the assessment by filing with its annual statement a certification showing a breakout of those funds. The certification shall be filed in the form in the Appendix to the subchapter incorporated therein by reference. The Department stresses that these proposed rules do not constitute a modification of the NAIC Accounting Practices and Procedures Manual or annual statement format or instructions with respect to the reporting of annuity considerations. These rules are based on the Commissioner's authority to prescribe additional matters to be included in an insurer's annual statement, and relate solely to the determination of New Jersey's special purpose apportionment and fraud assessment pursuant to applicable state law.

Proposed N.J.A.C. 11:2-43.1 sets forth the purpose and scope of the proposed new rules.

Proposed N.J.A.C. 11:2-43.2 sets forth the definitions of terms used throughout the subchapter.

Proposed N.J.A.C. 11:2-43.3 provides that an insurer authorized to transact annuity business pursuant to Title 17B of the New Jersey Statutes may, for purposes of calculating the special purpose apportionment and the assessment, exclude from amounts reported as annuity consideration in the annual statement those amounts that constitute allocated deposit-type funds that have not annuitized. The rule provides that insurers seeking to have those amounts excluded shall file a certification providing the information set forth in the rule in the form contained in the Appendix to the proposed subchapter, incorporated therein by reference.

This rule further provides that it shall not be deemed to affect the requirements for filing annual statements for life and health insurers or the requirements for the reporting of allocated deposit-type funds under the applicable Accounting Practices and Procedures Manual adopted by the NAIC.

Proposed N.J.A.C. 11:2-43.4 provides that insurers who previously paid the apportionment or assessment based on amounts that included allocated deposit-type funds that are excludable under the proposed rules may, in the future, receive a credit against premiums subject to the apportionment or the assessment, to the extent such excess is shown by the filing of the certification set forth in the Appendix. Because there is no current information on the amounts that will not be subject to the apportionment and the assessment under these proposed new rules, the rule provides that the credit will be taken over not less than three years. This is intended to avoid any unexpected impact on all insurers. The credit also may be taken by an affiliate of the insurer. The rule provides, however, that, for good cause shown, the Commissioner may allow the credit over less time. The proposed rules provide that good cause

shown includes, but is not limited to, where the amount of the credit is de minimis with respect to the insurer involved, where the insurer is in a hazardous financial condition, or where it is necessary to preserve the assets of an insurer in administrative supervision, rehabilitation or liquidation.

Proposed N.J.A.C. 11:2-43.5 sets forth penalties for violations of the subchapter.

A 60-day comment period is provided for this notice of proposal, and therefore, pursuant to N.J.A.C. 1:30-3.3(a)5, the proposal 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 new rules will codify the Department's position that, for purposes of calculating the apportionment and the assessment, insurers transacting annuity business may seek to exclude allocated deposit-type funds prior to annuitization, that continue to be listed as annuity considerations in the insurer's applicable annual statement, by providing a certification identifying those amounts, as set forth in the form in the Appendix to the subchapter. This change will reflect amounts properly subject to the apportionment and the assessment, as opposed to those amounts that have attributes similar to investments, on the basis of which insurers compete with other entities. This will benefit insurers by clarifying the uncertainty that had resulted from the use of the NAIC Accounting Practices and Procedures Manual as revised in 2001, while allowing companies to continue to utilize that widely accepted generic reporting form. In turn, consumers will benefit, as use of the NAIC Manual instead of a different reporting format peculiar to New Jersey will help insurers contain their administrative costs, which are considered when determining rates. In addition, maintaining adequate levels for the

apportionment and assessment is important in that it enables the Department to better serve consumers through its general regulatory activities and the State to effectively combat fraud. To the extent that the proposed new rules eliminate any unfair disadvantage that may exist with respect to funds held by insurers which have attributes of investments, rather than as consideration for annuity business, they will provide a more level playing field in this State with respect to the provision of such services, thereby contributing to a healthy business climate in this State.

Economic Impact

The special purpose apportionment and the fraud assessment reimburse the Treasury for expenditures that fund various regulatory functions of the State. The proposed change, however, will not impact the amounts received by the State in reimbursement for its expenses. The change will be revenue-neutral with respect to the State.

Insurers transacting annuity business that have substantial funds in the nature of allocated deposit-type funds that are excluded as provided by the new rules will see a reduction in the amounts they paid in 2002 and 2003 for the apportionment and the assessment. Conversely, other entities will see an increase in their pro rata shares of the total apportionment and assessment amounts. The Department believes, however, that because the pro rata share amounts will be determined based upon the thousands of entities subject to the apportionment and assessment, including life and health insurers transacting annuity business, generally the impact on any one entity should be minimal. The Department cannot quantify at this time the amount of any reduction or increase with respect to any individual entity, as no specific information exists as to amounts that ultimately will be excluded.

Finally, insurers seeking to exclude allocated deposit-type funds from consideration of the apportionment and/or the assessment will incur any costs in completing the certification and breaking out those funds separately. However, filing the certification is optional with the insurer.

Federal Standards Statement

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

Jobs Impact

The Department does not anticipate that any jobs will be generated or lost as a result of the proposed new rules.

The Department invites commenters to submit any data or studies concerning the jobs impact of the proposed new rules together with their comments on other aspects of the proposal.

Agriculture Industry Impact

The proposed new rules will not have any impact on the agriculture industry in New Jersey.

Regulatory Flexibility Analysis

The proposed new rules will impose reporting and recordkeeping requirements on “small businesses” as defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq. The small businesses to which these rules apply are insurers transacting annuity business. The proposed

new rules provide no different reporting or recordkeeping requirements for small businesses, insofar as the proposed rules provide a procedure by which insurers may seek to have certain premiums that are reported as annuity considerations excluded for purposes of determining the insurer's applicable special purpose apportionment and fraud assessment. These determinations must be consistent and do not vary based on business size. The Department also notes that the decision whether to seek to exclude such funds is optional with the insurer. The Department does not believe that insurers will need to employ additional professional services to comply with these rules. Finally, the Department notes that the proposed new rules generally relate to the determination of an insurer's proportionate share for its apportionment and its assessment, which is based on the net premiums written by the insurer, which is indicative of insurer size.

For the foregoing reasons, the proposed new rules provide no differentiation in compliance requirements based on business size.

Smart Growth Impact

The proposed new rules will not have an impact on the achievement of smart growth or the implementation of the State Development and Redevelopment Plan.

Full text of the proposed new rules follows:

SUBCHAPTER 43. TREATMENT OF ALLOCATED DEPOSIT-TYPE DEFERRED ANNUITY CONTRACT FUNDS FOR PURPOSES OF CALCULATING THE SPECIAL PURPOSE APPORTIONMENT AND THE FRAUD ASSESSMENT

11:2-43.1 Purpose and scope

(a) This subchapter sets forth procedures for the treatment of allocated deposit-type funds for purposes of determining an insurer's annuity premium subject to the special purpose apportionment and the fraud assessment.

(b) This subchapter shall apply to any insurer seeking to exclude allocated deposit-type funds from application of the special purpose apportionment or fraud assessment.

11:2-43.2 Definitions

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

“Allocated deposit-type funds” means funds received by a life insurance company under deferred annuity contracts that have an identifiable life to which the funds are applied and that contain a mortality or morbidity risk.

“Commissioner” means the Commissioner of the New Jersey Department of Banking and Insurance.

“Department” means the New Jersey Department of Banking and Insurance.

“Fraud assessment” means the assessment on companies by the Commissioner pursuant to N.J.S.A. 17:33A-8g.

“Special purpose apportionment” means the apportionment made on companies pursuant to N.J.S.A. 17:1C-19 et seq.

11:2-43.3 Treatment of allocated deposit-type funds for purposes of calculating the special purpose apportionment and the fraud assessment

(a) For purposes of calculating the special purpose apportionment and the fraud assessment, an insurer authorized or admitted to transact annuity business pursuant to Title 17B of the New Jersey Statutes may have excluded from amounts reported as “annuity considerations” in the annual statement filed pursuant to N.J.S.A. 17B:21-1, those amounts that constitute allocated deposit-type funds.

(b) Any insurer seeking to have amounts excluded pursuant to (a) above shall complete and file the certification set forth in the Appendix to this subchapter, incorporated herein by reference. Certifications shall be filed with the insurer’s annual statement filed pursuant to N.J.S.A. 17B:21-1 and shall be deemed to be a part of the insurer’s annual statement.

1. All references in the Appendix to particular lines or columns in the annual statement shall be deemed to refer to the corresponding appropriate line or column in the annual statement in use at the time such statement is filed.

(c) This rule shall not affect the requirements for the reporting of allocated deposit-type funds for purposes of completing applicable financial statements filed pursuant to N.J.S.A. 17B:21-1.

11:2-43.4 Credit

An insurer may file a certification with respect to its annuity business based on the amounts reported on its 2002 Schedule T to seek an adjustment in amounts previously paid. To the extent the certification demonstrates a change in the annuity premium amount to which the special purpose apportionment and the fraud assessment apply, the Department shall recalculate

the insurer's special purpose apportionment and fraud assessment for that year. Any amounts that may be excluded pursuant to this subchapter shall be deducted from the insurer's premium on which future apportionments and assessments, as applicable, are based. The credit shall be taken over a period of not less than three years. Credit may be taken by an affiliate of the insurer. For good cause shown, the Commissioner may allow the credit to be taken over a period of less than three years. For purposes of this rule, good cause shown shall include, but not be limited to, where the amount of the credit is de minimis with respect to the insurer seeking the credit, where the insurer is or may be placed in a hazardous financial condition, or to preserve the assets of an insurer in rehabilitation, liquidation or administrative supervision.

11:2-43.5 Penalties

Failure to comply with the provisions of this subchapter may result in the imposition of penalties as authorized by law, including, but not limited to, penalties authorized pursuant to N.J.S.A. 17B:21-1 and 17B:21-2.

APPENDIX

CERTIFICATION OF ALLOCATED DEPOSIT-TYPE FUNDS
SPECIAL PURPOSE APPORTIONMENT AND FRAUD ASSESSMENT
FOR YEAR ENDED DECEMBER 31, _____

Company Name: _____ Company NAIC No. _____

- 1. Annuity Considerations (State Business Page, Line 2, Column 5) _____
- 2. Allocated Deposit-Type Deferred Annuity Contract Funds Included in Line 1 above _____
- 3. Prior Year Annuity Considerations or Immediate Annuities not included in Line 1 above or not previously included in the assessment base. _____
- 4. Dividends to Policyholders (State Business Page, Line 7.1 + Line 7.3, Column 5) _____
- 5. Net Annuity Considerations Subject to Assessment (Line 1 – Line 2 + Line 3 – Line 4) _____

CERTIFICATION

The undersigned certifies that (s)he is authorized to file this information on behalf of (Company Name) and that the information contained herein is correct to the best of his/her knowledge, information and belief.

(Signature) _____

Type or print name _____

Title _____