

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

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

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

Authorized By: Donald Bryan, Acting Commissioner, Department of Banking and Insurance.

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

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

Proposal Number: PRN 2005-351

Submit comments by November 18, 2005 to:

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The agency proposal follows:

**Summary**

Annuity contracts issued by life insurers and fraternal benefit societies regulated by the Department of Banking and Insurance must satisfy the definition of annuity at N.J.S.A. 17B:17-5. N.J.S.A. 17B:17-5 defines an "annuity" as: "a contract not coming within the definition of life insurance as set forth in section 17B:17-3, or health insurance as set forth in section 17B:17-4, under which an insurer obligates itself to make periodic payments for a specified period of time, such as for a number of years, or until the happening of an event, or for life, or for a period of time determined by any combination thereof. Such a contract that includes extra benefits of the

kind set forth in N.J.S.A. 17B:17-3 (life insurance) or 17B:17-4 (health insurance) shall, nevertheless, be deemed to be an annuity if such extra benefits constitute a subsidiary or incidental part of the entire contract.” This proposal focuses on the “extra benefits” referenced in N.J.S.A. 17B:17-3 (life insurance).

As stated in the statute, death benefits that would normally be considered life insurance as defined at N.J.S.A. 17B:17-3 (and subject to different and generally more stringent legal requirements) are permitted to be offered as part of an annuity contract, so long as these benefits constitute an incidental or subsidiary part of the contract. The Department is proposing these amendments to categorize those death benefits in annuity contracts which can be considered incidental or subsidiary. A contract with death benefits exceeding these criteria/standards would be considered life insurance for regulatory purposes. Consequently, such benefits would not be permitted to be sold as part of an annuity. The standards included in the proposed amendments are intended to clarify the statutory standard of “subsidiary or incidental” annuity benefits by providing codified maximums on included death benefits upon which companies may rely when submitting their annuity forms filings to the Office of Life and Health. The Department is aware that life insurance contracts must satisfy certain standards in order to receive favorable Federal tax treatment by the IRS, under Section 101 of the IRS Code, which 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 intent of Section 101 is to provide preferential tax treatment when there is substantial insurance protection. Because of the incidental nature of the insurance protection in connection with an annuity, the annuity death benefit almost certainly will not qualify for such preferential treatment.

The Department proposes to amend N.J.A.C. 11:4-43.3 (standards for individual annuities) and 11:4-44.3 (standards for variable contracts) to include standards specifying which death benefits for an annuity contract are incidental in nature pursuant to N.J.S.A. 17B:17-5.

The Department's proposed amendments include the following:

N.J.A.C. 11:4-43.3 and 44.3 are being amended to provide the following standards for those death benefits in an annuity that will be considered incidental:

1. Death benefits equal to or less than the contract value (annuity account value or surrender value);
2. Death benefits equal to or less than the “highest periodic value” attained during some prior period;
3. Death benefits equal to or less than the greater of contract value or the premium accumulated at a specified interest rate, but no more than 200 percent of premium reduced by withdrawals;
4. Death benefits, in addition to the contract value, equal to or less than a percentage of gains on the contract, but no more than 50 percent of such gains;
5. A combination of death benefits as set forth in 3 and 4 above, not exceeding the greater of the permitted benefits under 3 and 4; and
6. Any other benefits or combination of benefits which a qualified actuary, as defined in N.J.A.C. 11:4-47.2, certifies and demonstrates is of comparable value (defined as within 25 percent of the actual or expected incidental death benefit) to a death benefit permitted by 1 through 5 above.

These standards shall apply to both non-variable and variable annuity contract forms containing incidental death benefit provisions.

This notice of proposal is not required to be referenced in the rulemaking calendar since a public comment period of 60 days is being provided. See N.J.A.C. 1:30-3.3(a)5.

### **Social Impact**

These proposed amendments should have a favorable impact on insurers, policyholders and the Department. The Department and insurers will no longer need to allocate limited resources to review, in the absence of specific standards, the “incidentally” of many annuity death benefit provisions that are common in the market. These requirements may potentially restrict the magnitude of death benefits that may be offered in connection with annuities. However, the primary purpose of annuities is the provision of income; consumers who need significant death protection can purchase life insurance. Unrestricted provision of death benefits through annuity contracts presents the risk of insurer insolvency and inadequate consumer protection.

### **Economic Impact**

These proposed amendments should have a favorable economic impact upon insurers, policyholders and the Department. Insurer costs of filing forms with the Department should be reduced, as will the Department's costs to review such forms. Reduced administrative costs should enable insurers to price their products in a more competitive manner, which ultimately will inure to the benefit of consumers. Expedited entry of such forms into the marketplace may be economically advantageous to policyholders as well as insurers. Consumers may also enjoy more product choices as a result of the increased availability of incidental death benefits in their annuities, although this proposal may not offer the insureds favorable Federal tax treatment by the IRS, as the incidental nature of an annuity death benefit almost certainly will not qualify.

This failure to qualify, however, is not a result of these proposed amendments, but merely the fact that Annuities with death benefits that are not subject to the restrictions of the IRS Code cannot generally qualify as life insurance. Contracts intended to receive favorable tax treatment are designed and sold as life insurance, not annuities with a death benefit.

### **Federal Standards Statement**

The proposed amendments do not contain standards or requirements that exceed those standards or requirements imposed by Internal Revenue Service Code, Sections 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.

### **Jobs Impact**

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

### **Agriculture Industry Impact**

The proposed amendments have no impact on the agriculture industry.

### **Regulatory Flexibility Analysis**

These rules directly impact life, health and annuity insurers. The Department believes that these proposed amendments will apply to few, if any, “small businesses,” as the term is defined in the Regulatory Flexibility Act, N.J.S.A 52:14B-16 et. seq. because the affected insurers do not employ fewer than 100 full-time employees. The Department does not believe that insurers will be required to hire any consultants or bear the cost of any other professional services to comply with this proposed amendments. Existing staff will be required to make the administrative and other changes necessary for compliance, as they already do in response to evolution in the market.

The Department does not believe that different requirements based upon insurer size would be appropriate or feasible since the amendments directly affect all annuity contracts issued by authorized insurers and fraternal benefit societies policies. Accordingly, the amendments provide no differentiation in compliance requirements based upon business size. The proposed rules do not impose any additional reporting requirements upon insurers. Rather, they provide clear criteria for those death benefits which the Department will deem “incidental or subsidiary” to an annuity, and therefore permissible pursuant to N.J.S.A. 17B:17-5.

### **Smart Growth Impact**

The proposed amendments will have no impact upon the achievement of smart growth and 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 43. INDIVIDUAL ANNUITY CONTRACT FORM STANDARDS

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. A death benefit equal to or less than the contract value (annuity account value or surrender value);**

**2. A death benefit equal to or less than a "highest periodic value" (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. A death benefit equal to or less than the greater of the contract value or the accumulation of premiums at a specified interest rate (adjusted for withdrawals), not to exceed 200 percent of premiums, such premiums to be reduced by any withdrawals;**

**4. A death benefit equal to or less than a percentage of the "earnings" or "gain" on the contract (defined as the contract value less premiums paid plus withdrawals), provided that the amount of the death benefit in addition to the contract value is no greater than 50 percent of the gain on the contract;**

**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 the greater of the two death benefits described in (h)3 and 4 above; or**

**6. Any other death benefit which a qualified actuary, as defined in N.J.A.C. 11:4-47.2, certifies and demonstrates to the Department has an expected and/or maximum value that is within 25 percent of the value of a death benefit permitted by (h)1 through 5 above.**

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. A death benefit equal to or less than the contract value (annuity account value or surrender value);**
- 2. A death benefit equal to or less than a "highest periodic value" (for instance, highest contract anniversary value, highest monthly value, highest five-year value) adjusted for subsequent premiums and withdrawals;**
- 3. A death benefit equal to or less than the greater of the contract value or the accumulation of premiums at a specified interest rate (adjusted for withdrawals) not to exceed 200 percent of premiums, such premiums to be reduced by withdrawals;**

**4. A death benefit equal to or less than a percentage of the "earnings" or "gain" on the contract (defined as the contract value less premiums paid plus withdrawals), provided that the amount of the death benefit in addition to the contract value is no greater than 50 percent of the gain on the contract;**

**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 (4 above), provided that the combined amount is less the greater of the two death benefits described in (e)3. and 4. above; or**

**6. Any other death benefit which a qualified actuary, as defined in N.J.A.C. 11:4-47.2, certifies and demonstrates to the Department has an expected and/or maximum value that is within 25 percent of the value of a death benefit permitted by (e)1 through 5 above.**