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Demystifying NY's Nonforfeiture Law

Section 1, Lesson 1: Overview of Applicable Law and Regulation

The nonforfeiture requirements for most deferred annuities in New York are located in Section 4223 of the New York Insurance Law. This section does not apply to variable annuities whether they are individual or group products. It does apply to all other individual deferred annuities.

The applicability of Section 4223 to group products is mixed and much more complicated. First, if the group annuity contract meets the definition of an employee benefit plan under the Employee Retirement Income Security Act - or ERISA for short – then, the certificates issued under the group contract are **not** subject to Section 4223. The group contract does not have to be **subject** to ERISA, but just meet ERISA's definition of an employee benefit plan. This is referred to as the "employee benefit plan exemption."

Then, certificates under groups **not** eligible for the employee benefit plan exemption are subject to 4223 only if **at least one** of the following applies:

1. The certificates provide benefits under an individual retirement account or are issued as an individual retirement annuity (other than Simplified Employee Pensions), both as defined in Section 408 of the Internal Revenue Code.

   OR

2. The certificates are issued in accordance with Subsection 403(b) of the Internal Revenue Code where the payments are derived wholly from a salary reduction agreement or an agreement to forego an increase in salary.

   OR

3. The certificates are funded wholly by contributions from the certificate holder.

So to recap, if the certificates are a non-SEP IRA, a 403(b) where contributions are indirectly from participants, or in some other way funded wholly by the certificate holder, the group certificates ARE subject to the nonforfeiture requirements of Section 4223.

So we now know when Section 4223 applies, but we also need to know what it applies to.

It basically applies to all non-variable deferred annuities. These can be broken out into four main categories.

The first category is Basic Deferred Annuities. This is a basic accumulation product where premium is added to the contract and grows with interest until either the entire contract is surrendered, a death benefit is paid, or it goes into the payout stage or annuitizes.

In these contracts, the minimum guaranteed interest rate at which the contract grows is either specified or described in the contract. A rate **higher** than the minimum guaranteed interest rate may be declared and paid by the company. The full account value less any applicable surrender charges is available to the contract holder at all times.

The second category is Market Value Adjusted – or MVA – Annuities. MVA Annuities are like the basic annuity, but the cash surrender value is adjusted by a factor called a "market value adjustment." This can result in either positive or negative changes to the contract value. These are also sometimes called Modified Guaranteed Annuities.

The third category is Equity Index Annuities, or EIAs. EIAs are again similar to the basic accumulation annuity, but the growth of the contract is determined in part by the changes in an equity index or indexes. Many companies resist calling these products equity index products, but that terminology is a part of NY's law and so that resistance is futile.

The final category is Deferred Income Annuities or DIAs. DIAs vary significantly from the other annuities that are included in Section 4223. These are true income products. There are no cash surrender benefits and there may or may not be a death benefit. A premium is paid today with a fixed amount of income scheduled to start at a later date.

Since we've mentioned MVA Annuities, now is a good time to discuss New York Regulation 127. New York's insurance regulations can be a bit confusing because there's a regulation # and an official citation that has nothing to do with that number. In this case, "Regulation 127" is how it's usually referred to, but it's also (and officially) known as 11 NYCRR 44 or Part 44. All the section numbers use this 44 as the beginning of the reference number. Among other things Regulation 127 sets forth the rules and standards for an acceptable market value adjustment. These are found in Section 44.5 with examples provided Section 44.10.

Section 44.2 provides the scope of the regulation and basically indicates that if the product is subject to Section 4223, then the product is subject to Regulation 127.

As we talk about these products in more detail later on in the course, we'll talk about some of the other sections and their applicability to nonforfeiture.

And lastly in this lesson we need to discuss how these annuity contracts are funded. It's possible for all four of these product types to be funded by a single premium. These are usually referred as Single Premium Deferred Annuities, or SPDAs. As the name suggests only one premium is paid.

New York permits a variation of the SPDA – the Modified Single Premium Deferred Annuity. Under these contracts additional premium payments can be made after the initial premium, but only for a maximum period of one year. This is primarily to accommodate timing issues for the transfer of funds from other contracts into the new Modified SPDA.

And, finally, there are Flexible Premium Deferred Annuities or FPDAs. As the name suggests there's flexibility in the payment of the premium, although there's likely to be a minimum initial premium requirement. And there may also be maximum limits, such as an annual limit and/or an aggregate limit.

To summarize, Section 4223 applies to all individual fixed annuities, including SPDAs, FPDAs, MVAs, EIAs and DIAs. It also applies to some group annuity certificates if they are IRAs, 403(b)s or other certificates funded solely by salary reduction agreements or other participant-only arrangements. There's an exception for group certificates that meet the definition of an employee benefit plan under ERISA. From here we'll look more deeply at the definitions that are foundational to Section 4223's requirements and how they apply to each of these products.