

## GROUP ANNUITY TERMINAL FUNDING AND CLOSE OUT CONTRACTS

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## GROUP ANNUITY TERMINAL FUNDING AND CLOSE OUT CONTRACTS

### VII. **Applicability**

- A. **Scope:** This product outline covers all group annuity terminal funding contracts and group annuity close out contracts.
- B. **Definitions:** The terms “terminal funding contracts” and “close out contracts” are often used interchangeably. For purposes of this outline, the terms
1. **Close out contract** refers to allocated group annuity contracts that provide for a single consideration and are used to fund terminating defined benefit plans and terminating defined contribution plans or to assume liability of certain segments of ongoing defined benefit plans, such as for terminated vested participants, or existing accrued benefits for currently active participants.
  2. **Terminal funding contracts** refer to allocated group annuity contracts that are used for both defined benefit plans and defined contribution plans and provide for the purchase of annuity benefits on an ongoing basis as plan participants terminate employment (i.e., for benefit payments made as a result of retirement, disability or death).
    - (a) Purchase of annuities for terminated vested or retired participants;
    - (b) Funds accumulated under an alternative plan funding arrangement for active participant lives, such as a trust or certain unallocated group annuity contracts.
  3. **Allocated Contract** means a contract in which deposits are credited to an accumulation fund, if applicable, and allocated to specific plan participants’ accounts under the contract or to the purchase of annuity benefits for specific plan participants or their beneficiaries. See §3223(d).
  4. **Unallocated amounts** means any funds credited to the accumulation fund which the insurer is not currently irrevocably committed to apply under the terms of the contract to the payment of benefits by it to specific plan participants or beneficiaries or to the purchase of annuities for specific plan participants, adjusted for any accrued experience rating charges or credits, including expenses and administrative, sales and surrender charges provided for under the contract. See §40.2(z).
  5. **Allocated amounts** refers to any funds credited to the accumulation fund which the insurer is irrevocably committed to apply under the terms of the contract to the payment of benefits by it to specific plan participants or beneficiaries or to the purchase of annuities for

specific plan participants, adjusted for any accrued experience rating charges or credits, including expenses and administrative, sales and surrender charges provided for under the contract.

### C. **Markets**

1. IRC 401(a) Qualified Plans
2. Non-Qualified Plans
  - (a) Non-Qualified Excess Benefit Plans.
  - (b) Non-Qualified Deferred Compensation Arrangements.

## VIII. **Filing Requirements**

### A. **Overview**

1. **Prior Approval Requirement:** Section 3201(b)(1) provides that no policy form shall be delivered or issued for delivery in this state unless it has been filed with and approved by the superintendent as *conforming to the requirements of the Insurance Law* (standard and generally applicable provisions) and *not inconsistent with law* (federal and state statutory, regulatory and decisional law).
2. **Discretionary Authority For Disapproval:** Section 3201(c)(1) and (2) permits the Superintendent to disapprove any policy form that contains provisions that are misleading, deceptive, unfair, unjust, or inequitable or if its issuance would be prejudicial to the interests of policyholders or members. See also §§2123, 3209, 4224, 4226, 4228(h), 4231, 4239.
3. **Alternative Approval Procedure** - Section 3201(b)(6) and Circular Letter No. 2 (1998) provide for an expedited approval procedure designed to prevent delays by deeming forms to be approved or denied if the Department or insurer fail to act in a timely manner.
4. **Recent Procedural Changes**
  - (a) Pursuant to Circular Letter No. 14 (1997), submissions that are incomplete or not drafted to conform to New York requirements **will** be rejected. Submissions that are poorly organized, difficult to understand or that contain several substantive omissions or objectionable provisions **may** be rejected.
  - (b) Circular Letter No. 8 (1999) describes the requirements for the caption of the submission letter and provided for a fifteen-day response limit to comment letters.
  - (c) Administrative Procedure: The Department may limit the number of comment letters on any one file to no more than two each from the reviewing attorney and actuary.

### B. **Preparation of Forms for Submission.** Basic Rules - See Circular Letters 1963-6 and 1969-4.

1. No filing fee required.

2. Each policy form should be designated with a form number on lower left- hand corner of face page to distinguish the form from all others of the insurer.
3. New policy forms should be submitted without amendatory riders or endorsements, unless:
  - (a) changes are necessitated by distinctive New York requirements.
  - (b) riders are expressly permitted.
  - (c) Riders are permitted to conform policy to change in law, rules or regulations, unless resulting policy would have tendency to confuse or mislead.
4. Submit duplicate copies of forms.
5. Printed forms should be used unless its use is too limited to justify printing. The form should be clear, legible and reasonably permanent. Computer generated forms are acceptable. See also readability provision Section 3102.
6. Blank spaces in form should be filled in and completed with hypothetical data to indicate purpose and use of forms. Alternatively, the submission letter can also explain purpose and use of the form.
7. All incorporations by reference should be attached to or accompany the submission. See also Section 3204.
8. If application (or enrollment form) will be attached to policy, it should be submitted. If previously approved, the form or submission letter should so indicate.
9. If application (or enrollment form) will be attached to policy, it should be submitted. If previously approved, the form or submission letter should so indicate.
10. Variable material used with impairment, waiver or exclusion riders should be submitted with the form for approval.
11. Illustrative material may be used for items that vary from case to case, such as names, dates, eligibility requirements.

**C. Submission Letters** - Circular Letters 1963-6, 1969-4 and No. 8 (1999).

1. Caption of submission letter should identify all forms submitted for approval or acceptance. Specify form number, designate form as individual or group, provide a generic product description and generic form description. See Circular Letter No. 8 (1999).
2. Submit two copies of the submission letter (and all other correspondence regarding the file), signed by a representative of the company authorized to submit forms filing or approval. C.L. 63-6 § I.G.
3. Identification of Insurer.
4. Listing of form numbers. C.L. 63-6 § I.G.1.
5. Table of Contents of all material in the filing.
6. When the policy form is designed as an insert page form, the insurer must submit a statement of the mandatory pages which must always be included in the policy form, and a list of all optional pages, if any,

including application forms, together with an explanation of how the form will be used (previously approved forms should be identified by form number and approval date).

- (a) We object to a company's use of the matrix approach that identifies benefit provisions within a document with separate form numbers.
  - (b) See Circular Letter No. 6 (1963) § I.G.8. and Circular Letter No. 4 (1963) § I.A.2.
7. Statement as to whether the form is new or is intended to replace a previously approved form. Rule I.G.3, 4, 5, 6 and 8.
- (a) If the form is intended to supersede another approved or filed form, the form number of the form approved or filed by the Department, together with a statement, of the material changes made; if the previous form is still in process, the form number, control number and submission date. A redlined copy is helpful.
  - (b) If a form submitted for approval had previously been submitted for preliminary review, a reference to the previous submission and a statement setting out either (a) that the formal filing agrees precisely with the previous submission or (b) the changes made in the form since the time of preliminary review. Submit a highlighted copy showing the differences or changes made to the form. A redlined copy is helpful.
  - (c) If the form is other than a policy or contract, give the form number of the policy or contract form or forms with which it will be used, or, if for more general use describe the type or group of such forms.
  - (d) If a form is intended to replace a very recently approved form because of an error found in the approved form, the insurer must, if the approved form has not been issued, return the approved form with a statement in the submission letter that the form has not been issued. The insurer may, under these circumstances, use the same form number on the corrected form being submitted. If, however, the form has been issued, the insurer must place a new form number on the corrected form and need not return the previously approved form.
8. Statement as to how the form will be used and how it will be marketed, as described in Circular Letter 1976-12.
- (a) Description of benefits/coverage provided. Circular Letter No. 6 (1963) § I.G.2 and 7.
  - (b) Type of group policyholder, as defined in Section 4238(b)  
Specify \_\_\_\_\_
  - (c) Classes covered, as defined in §4238 if not all persons are eligible (i.e., conditions pertaining to employment or a combination of conditions pertaining to employment and family status),

- (d) Statement as to whether the contract is noncontributory, contributory or funded solely by employee or member contributions. If the policy is contributory for some insureds, or for some levels of insurance, or under some conditions, indicate what situations or conditions would permit or require contributions from the insureds.
  - (e) Statement describing the type of pension plan or other program funded by the policy.
  - (f) Submission letters should be as detailed as possible explaining the need for the product, any unique features and any special market or intended use of the form.
9. For §3201(b)(6) expedited approval submissions, the caption of the submission letter should identify the submission as a *Section 3201(b)(6) Deemer Submission*. The certification of compliance should be attached to the submission letter.

#### **D. Attachments To Submission**

##### **1. Explanation of Variable Material**

- (a) Illustrative material may be used for items which may vary from case to case such as names, dates, eligibility requirements, premiums and schedules for determining the amount of insurance for each person insured.
- (b) If an explanatory memorandum accompanying a cover letter or appropriate reference to material filed with schedules of premium rates (in duplicate) clearly indicates the nature and scope of the variations to be used. Portions of other provisions such as insuring clauses, benefit provisions, restrictions, and termination of coverage provisions may be submitted as variable. The areas of the forms to be considered variable should be suitably indicated by red ink, underlining, bracketing or otherwise. The method of indicating variable material should be clearly stated in both the submission letter and the explanation of variable material.
  - (i) For example, it may be indicated that variations will be made within the limits set out in the explanatory memorandum or that any one of several alternative provisions may be used or that a provision may be either included as submitted or else completely omitted.
  - (ii) An explanation of variable material that the variations "will conform to law" or "as requested by the policyholder" is not acceptable.
- (c) The alternative language, if any, should be supplied in duplicate, independent of the insurer's letter. For alternative text, exact language is required.

- (d) Ranges for actuarial items must to be specified in the explanation. Include the minimum and maximum amounts, where applicable.
  - (e) Open-face riders or endorsements may be filed for general use in amending illustrative or variable material within the limitations of the preceding paragraph.
2. **Flesch Score Certification -- Readability Requirement**
- (a) Section 3102(b)(1) excludes
    - (i) any certificates issued pursuant to a group life insurance policy issued to an employer covering persons employed in more than one state,
    - (ii) any group insurance policy covering a group of one hundred or more lives, other than dependents, at the date of issue, provided that this exclusion does not apply to certificates delivered or issued for delivery in this state.
  - (b) The number of words, sentences and syllables in the form should be set forth as part of the certification. Please refer to the Department's February 18, 1982 letter on Section 3102 compliance for a sample certification form.
  - (c) "Text" includes all printed matter **except**:
    - (i) name and address of the insurer; name, number or title of the policy; the table of contents or index; captions and subcaptions; specification pages, schedules or tables; and
    - (ii) any language which is drafted to conform to the requirements of any state or federal law, regulation or agency interpretation; any language required by any collectively bargained agreement; any medical terminology; words which are defined in the insurance policy; any language required by law or regulation - provided the insurer identifies the language excepted by Section 3102 and certifies in writing that the language or terminology is entitled to be excepted.
  - (d) The text must achieve a minimum score of 45 on the Flesch reading ease test or an equivalent score on any other comparable test, as described in this subsection;
  - (e) The text must be printed in at least 10 point type, and such type must be at least one point leaded, except for specification pages, schedules and tables;
  - (f) Each section must contain an underlined, boldface or otherwise conspicuous title or caption at the beginning that indicates the nature of the subject matter included in or covered by the section;
  - (g) There must be a Table of Contents or an index of the principal sections of the policy if the policy has more than 3000 words or if the policy has more than three pages, regardless of the number of words;

- (h) The policy must have adequate margins, and be printed in such a manner that it includes sufficient contrast of ink and paper to be legible;
  - (i) Filings must include a certification by an officer of the insurer that the filing meets the minimum reading ease score on the test used. To confirm the accuracy of the certification, the superintendent may require the submission of further information to verify the certification in question.
  - (j) At the option of the insurer, riders, endorsements, applications and other forms may be scored as separate forms or as part of the insurance policy with which they may be used;
  - (k) Lower scores are permitted under certain circumstances described in Section 3102.
3. **Certification of Compliance For §3201(b)(6) Submissions**
- (a) Submit a certification of compliance signed by an officer of the insurer who is knowledgeable of the law and regulation applicable to the type of policy form.
  - (b) The certification should state that the form complies with applicable laws and regulations.
  - (c) The certification should make reference to any law regulation or circular letter that specifically applies or is unique to the type of form. The certification need not refer to all generally applicable provisions. See Circular Letter No. 2 (1998).
    - (i) At a minimum, the certification should refer to §§ 3223, 4238, and 4240 of the New York Insurance Law as well as Regulation Nos. 47, 128 and 139, to the extent applicable.
    - (ii) The certification should indicate that the forms comply with all requirements set forth in the product outline, including Department interpretations.
    - (iii) An insurer should be wary of making a submission under §3201(b)(6) that does not comply in all respects with the product outline.
    - (iv) As a best practice, the alternative approval procedure should be used for routine submissions, not new, innovative or controversial product filings.
  - (d) A certification to the effect that the contract is in compliance with all applicable laws and regulations is not acceptable.
  - (e) Expedited review is not available when the form filed is to be used with a form currently under review by the Department. (Department Interpretation).
  - (f) Circular Letter No. 2 (1998) also states that the Department does not contemplate taking action with respect to a certification which is based upon prior Department positions or interpretations of applicable statutory or regulatory requirements where the prior positions or interpretations have been revised.
4. **Product Outline Checklist/Summary Sheet**

A completed checklist and/or summary sheet should be attached to the submission letter.

- E. Pre-filed Group Insurance Coverage - Circular Letter 1964-1.**
1. Purpose. Circular Letter 64-1 permits insurers to provide or assume risk for group life and annuity coverage prior to the filing of approved forms. This procedure can be used for funding agreements.
  2. Conditions For Providing Coverage Prior to Approval.
    - (a) Immediate coverage requested by policyholder to meet specific need of policyholder.
    - (b) Insurer has reasonable expectation of approval or acceptance.
    - (c) Confirmation letter sent to policyholder by insurer stating:
      - (i) The nature and extent of benefits or change in benefits.
      - (ii) The forms may be executed and issued for delivery only after filing with or approval by the Department;
      - (iii) An understanding that, if such forms are not filed or approved or are disapproved, the parties will be returned to status quo insofar as possible, or the coverage will be modified retroactively to meet all requirements necessary for approval; and
      - (iv) The effective date of coverage (Best Practice).
    - (d) Department Notification.
      - (i) Insurers are advised to notify Department of coverage within 30 days (i.e., copy of confirmation letter) of coverage and submit forms within six months. (Best Practice).
      - (ii) Statement explaining circumstances and reasons for delay in submitting forms within twelve months for group annuity.
      - (iii) Follow-up statement every six months for group annuity until form is submitted. If reason for delay is unacceptable, Department may pursue a violation under Section 4241 for willful violation of the prior approval requirement.
  3. Recommended Practice.
    - (a) Insurers should review pre-filings periodically (monthly) to verify compliance with conditions for pre-filing.
    - (b) Insurers should vigorously pursue approval (or acceptance for out-of-state filings) of pre-filed cases after forms have been submitted to mitigate harm if forms are found not to comply with applicable requirements.
- F. Out-of-State Filings**
1. Filing Requirement for Domestic Insurers: Pursuant to §3201(b)(2), domestic insurers must file all policy forms intended for delivery outside of the state.

2. Disapproval Standard: §3201(c)(6) permits disapproval of such out-of-state filing if the issuance would be prejudicial to the interests of the insurers, policyholders or members.
3. Procedures: (Circular Letter 63-6)
  - (a) File two copies of each policy form issued by a domestic insurer for delivery only outside of New York or with policies or contracts delivered outside New York.
  - (b) The transmittal letter shall include the following information:
    - (i) a comparison of benefits and premiums with similar forms approved or pending approval for use in New York.
    - (ii) a list of the states or jurisdiction in which the form is be delivered.
    - (iii) a commitment to notify the Department in the event any such state disapproves any of the forms.

## IX. Eligible Group Requirements

### A. Definitions

1. **Group Annuity Contract** means any policy or contract, except a joint, reversionary or survivorship annuity contract, whereby annuities are payable dependent upon the continuance of the lives of more than one person. Section 4238(a).
  - (a) We view group contracts that provide for the purchase of annuities or the payment of annuity benefits for plan participants or their beneficiaries to be group annuity contracts
  - (b) The terminology used in Sections 3223 and 4238 was drafted to apply to group deferred annuity contracts which are rarely sold today.
  - (c) Plans funded by group annuity contracts include 401(a), 401(k), 457, 414(d), and 403(b), among others.
2. **Contractholder** means the party or parties to whom or to which the contract is issued. Section 4238(a).
3. **Annuitant** refers to any person upon whose continued life such annuity is dependent. Section 4238(a).
4. **Participant** means any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit. See §3(7) of ERISA.
5. **Annuities** means all agreements to make periodical payment for a period certain or where the making or continuance of all or some of a series of such payments, or the amount of such payment depends upon the continuance of human life. Section 1113(a)(2).

- (a) *Period Certain* annuities first authorized in New York by Section 1 of Chapter 864 of the Laws of 1985.
- 6. **Employee** may include retired employees, employees of affiliates and subsidiaries of the employer, individual proprietors affiliated with the employer, and partners and employees of individuals affiliated with the employer and of firms controlled by the employer. §4238(c).

**B. Types of Contractholders**

- 1. **Employer Group.** Section 4238(a)(1).
  - (a) Contract issued to an employer
  - (b) Contract permits all employees or all of any specified class or classes of employees to become annuitants
  - (c) Payments to the insurer need not be remitted by the contractholder. L1991, c.349, Section 2.
  - (d) Note:
    - (i) Contracts issued to the trustees of a trust established by an employer are described in Section 4238(b)(4).
    - (ii) This approach differs from the eligible group provisions in Section 4216 for group life insurance and Section 4235 for group accident and health insurance.
- 2. **Employers' Association Group.** Section 4238(a)(2).
  - (a) Contract issued to an employers' association
  - (b) Contract permits all of the employees of such employers or all of any specified class or classes to become annuitants
  - (c) The employers' association may provide for representation by annuitants on its board of directors.
- 3. **Labor Union Group.** Section 4238(b)(3).
  - (a) Contract is issued to a labor union
  - (b) Contract permits all of the members of such union or all of any specified class or classes to become annuitants
- 4. **Bona Fide Trust Group.** §4238(b)(4).
  - (a) Contract issued to the trustees of a trust
  - (b) Trust established by
    - (i) an employer
    - (ii) an employers' association
    - (iii) one or more labor unions
    - (iv) one or more employers and one or more labor unions (Taft-Hartley Trust)
  - (c) Contract permits all of the employees of the employers or all of the members of the unions or of any specified class or classes thereof to become annuitants
  - (d) Note - The trust must be established by an eligible entity. It cannot be merely participated in by such entities. Contrast this requirement with Section 4216(b)(4) and Section 4235(c)(1)(D) and §4238(b)(7).
- 5. **Association Group.** Section 4238(b)(5).

- (a) Contract issued to an association or the trustees established by such association of persons having a common interest, calling or profession who constitute a homogeneous group
  - (b) Association has a constitution and by-laws
  - (c) Association is organized and maintained in good faith for purposes other than obtaining annuities
  - (d) Contract permits all members of the association and their employees or any specified class or classes thereof to become annuitants
  - (e) Note:
    - (i) This group is used primarily for professional associations
    - (ii) The “common interest, calling or profession” requirement appears to be more flexible than corresponding group life and group accident and health sections.
6. **IRC Section 408 IRA Groups:** Added by L.1997, c.544
- (a) Contract issued to a
    - (i) Bank
    - (ii) Trust Company
    - (iii) Trustees of one or more trusts
  - (b) Contract permits individuals for whom contributions are made to:
    - (i) Individual retirement accounts; or
    - (ii) Individual retirement annuities
  - (c) Individual Pay-all Program -- Contracts and certificates are subject to the provisions of the Insurance Law applicable to individual annuities
  - (d) Groups described in Section 4238(b)(6) do not qualify for the group exception to the mail order prohibition for unauthorized insurers in Section 1101(b)(2)(B)(i)(III)
7. **Other Trust Groups.** Section 4238(b)(7).
- (a) Contract issued to the trustees of one or more trust for employees of one or more employers
    - (i) Not a trust described in Section 4238(b)(4) (i.e., not “established by” an employer, employers’ association, labor union or Taft-Hartley Trust)
    - (ii) Employers need not adopt (establish or participate in) the trust. See L.1991, c.349, Section 1.
  - (b) Contract permits all of the employees of each such employer or of any specified class or classes to become annuitants
  - (c) If payments are derived wholly from funds contributed by such employees, the insurer must issue a certificate complying with the requirements of the Insurance Law applicable to individual annuities for delivery to each employee who contributes to the contract. (See Sections 3219, 4223, 4240 and Regulations 47 and 127).
  - (d) This group appears to allow bank collective investment funds or pooled GIC funds. Gives small plan sponsors access to well-

diversified, competitively priced GICs that are otherwise only available to larger plans.

- (e) Groups described in Section 4238(b)(7) do not qualify for group exception from mail order prohibition for unauthorized insurers in Section 1101(b)(2)(B)(i)(III).
- 8. **Foundation or Endowment Fund Groups.** Section 4228(b)(8). L.1993, c.541, §1
  - (a) Contract issued to the trustees of a foundation or endowment fund
  - (b) Contract permits any specified class or classes of professional person to become annuitants.

#### C. **Non-Recognized Groups -- Out-of-State Cases**

- 1. Note that Section 4238 was not modernized to permit the newly recognized groups for group life insurance in Section 4216(b), (12), (13) and (14) and for group accident and health insurance in Section 4235(c), (K), (L) or (M) for:
  - (a) Affinity Association Groups
  - (b) Financial Institution Groups
  - (c) Discretionary Groups
- 2. As such, group contracts that are not recognized or described in §4238(b) of the Insurance Law must be delivered outside of New York.
  - (a) Insurers must deliver group annuity contracts issued to financial institution groups and discretionary groups outside of New York.
- 3. Group annuity contracts delivered outside of New York need not comply with New York's eligible group requirements in §4238(b).
- 4. However, group annuity certificates delivered in this state that are funded solely by individual contributions must comply with the provisions of the Insurance Law applicable to individual annuities.
  - (a) Such certificates should be submitted for review and approval.
  - (b) The group annuity contract should be submitted as well. It will be reviewed to ensure that the contract and certificate are not inconsistent. The contract cannot include provisions that invalidate or impair the terms of the certificate.

#### D. **Unauthorized Insurers**

- 1. Section 1101(b)(1) prohibits unlicensed insurers from doing an insurance business in this state by mail or otherwise.
- 2. Section 1101(b)(2)(B) provides an exception (referred to as the "group exception") to the prohibition in Section 1101(b)(1) for certain types of group insurance issued outside of New York.
  - (a) The group exception applies to group annuity contracts where the group conforms to the definitions of eligibility in §4238(b) of the Insurance Law, except paragraphs (6) and (7), and the master contracts were lawfully issued without this state in a

jurisdiction where the insurer was authorized to do an insurance business.

3. Section 1101(b)(2)(B) excepts from the group exception to the mail order prohibition any transaction with respect to a group annuity contract used in the individual insurance market noted above, including
  - (a) IRC §408 contracts (IRAs);
  - (b) IRC§403(b) (Tax Sheltered Annuities), and
  - (c) Plans under which payments are derived wholly from funds contributed by the persons covered thereunder. See L.1978, c.428.
4. As such, any New York certificate funded solely by employee or individual contributions is subject to prior approval.

## X. **Contract Provisions**

### A. **Cover Page of the Contract and Certificate**

1. **Company's Name and Address**
  - (a) The New York licensed insurer's name should appear on the cover page (front or back).
  - (b) The contract cannot be labeled or advertised in a manner that would have a tendency to mislead or deceive as to the true identity of the insurer, or create the impression that someone other than the insurer would have any responsibility for the financial obligations under the contract. See §219.4(a), (l) and (p) of Regulation No. 34-A. See also §1313(d).
    - (i) The name of the issuing insurer should be clearly disclosed, with equal prominence to any other entity mentioned.
    - (ii) The contract should be clearly identified as an annuity contract issued by the insurer.
2. **Form Identification Number** -- The form number should be stated in the lower left-hand corner of the face page pursuant to Section I. D. of Circular Letter 63-6.
3. **Brief Description of Contract – Participation Status and Variability**
  - (a) A description of the contract, such as “Terminal Funding Contract” or “Close Out Contract”.
  - (b) There must be a statement indicating whether the contract is participating or nonparticipating.
4. **Officer's Signatures**

- (a) The signature of at least one officer of the company is needed to execute the separate account group annuity contract or funding agreement as a matter of contract law.
- (b) Signatures are usually underlined or placed in brackets to denote variable material.
- (c) When the signature is changed, the insurer should notify the Department for informational purposes. The contracts do not need to be re-filed.

**B. Standard Provisions: §3223**

Every group annuity contract delivered or issued for delivery in this state and every certificate used in connection therewith shall contain in substance the following provisions to the extent that such provisions are applicable or provisions which are more favorable to the annuitants , or not less favorable to annuitants and more favorable to the contractholders:

1. **Grace Period-§3223(a)**-There shall be a 31-day grace period following the due date of any required payment after the first payment within which the payment may be made. During such grace period, the contract shall continue in full force.
  - (a) This provision has no application to single consideration close out contracts.
  - (b) It does apply if a payment is required to pay any fee or expense charges.
  - (c) If the contract continues in force without penalty, no grace period provision is necessary.
  - (d) See liquidated damages provision below. IV.C.5.
2. **Entire Contract-§3223(b)**-A provision specifying the document or documents, which shall include the contract and, if a copy is attached thereto, the application of the contractholder , constituting the entire contract between the parties. See also §3204.
  - (a) An attachment to the contract listing of plan participants and/or their beneficiaries with the benefit amount, commencement date and type of annuity benefit should be submitted with the form.
  - (b) We have permitted insurers to use illustrative data and bracket the listing the names of retirees in the attachment.
3. **Misstatement of Age or Sex-§3223(c)**-A provision for the equitable adjustment of the benefits payable or of the payments to be made to the insurer if the age or sex of any person, or of any other fact affecting the amount or date of payment by or to the insurer has been misstated.
  - (a) The *Arizona vs. Norris* decision held that Title VII of the Civil Rights Act of 1964 prohibits an employer from offering its

employees a retirement benefit option where a women is paid a lower monthly retirement benefit than a man who has made the same contributions.

- (b) We have permitted misstatement provisions that omit the reference to sex.
- (c) §3219(a)(5) requires that the interest rate to be charged or credited to underpayments and overpayments be specified in the contract and cannot exceed six percent. . (Best Practice)-- *The §3223(c) provision should also state whether and how much interest will be charged against or credited to such underpayments and overpayments. The rate must be the same for overpayments and underpayments. We may question any rate above six percent.*

4. **Retired Life Certificate-§3223(e)**-A provision stating that the insurer shall issue for delivery to each person to whom annuity benefits are being paid thereunder a certificate setting forth a statement in substance of the benefits to which such person is entitled under the contract.

- (a) The retired life certificate must include the following provisions:
  - (i) Entire contract provision.
  - (ii) Misstatements provision.
  - (iii) A provision identifying the insurer, including the mailing address.
  - (iv) A provision describing the annuity benefit and any limitations, if any, on the insurer's guarantees with respect to such benefit, including the amount and frequency of annuity payments, the minimum number of payments, any refund features and survivorship rights, etc.
  - (v) A facility of payment provision. Note that such provision should not conflict with Article 81 of the New York Mental Hygiene Law and the Americans with Disability Act. In New York, until a person is found to be legally incompetent to handle annuity payments and no guardian has been appointed, the insured is entitled to such payments.
  - (vi) A beneficiary provision.
- (b) The retired life certificate should be submitted for review, unless a previously approved certificate will be used. In such case, the submission letter should specify the form number, file number and approval date. Please note that retired life certificates are considered policy forms as defined in §3201(a).

5. **No Active Life Certificate Required.** Note that no active life certificate is required for terminal funding and close out contracts because the contract does not provide for the maintenance by the

insurer of one or more accounts for each plan participant/annuitant. See §3223(d).

### C. Regulation No. 139 And Other Provisions

1. **General Note:** Pursuant to §40.1(a)(3) of Regulation No. 139, only the disclosure rules in Section 40.3 apply to group annuity contracts under which funds received by the insurer are immediately applied to the purchase of immediate and deferred annuities. Furthermore, since Section 40.5(a) only applies to unallocated amounts, the contract termination rules in §40.5 do not apply to close out and terminal funding contracts because such contracts do not include any unallocated amounts. However, to the extent that an insurer uses a single contract to fund immediate and deferred annuity payments as well as an active life fund, contract provisions should not conflict with the provisions in Regulation No. 139 below.
2. **Plan Benefit Rule** -- §40.4(a) of Regulation 139 – Any contract issued in connection with a defined contribution plan which provides the contractholder with the right to withdraw from the contract the amounts required to pay lump sum benefits of the participant's individual account balance as they arise in accordance with the provisions of the plan upon bona fide termination of employment must provide for such withdrawals to be made on a basis pursuant to which neither the amount withdrawn from the contract nor the amount of the remaining principal balance of the accumulation fund following such withdrawal is adjusted to reflect changes in interest rates or asset values since the receipt of funds.
  - (a) Terminal funding contracts and close out contracts do not give annuitants the right to withdraw funds once annuity payments have commenced.
3. **Betterment of Rates** -- §40.4(b) -- For any group annuity contract funding a defined contribution plan, the contract must provide that any annuity benefit purchased with respect to an amount equal to the plan participant's account value as determined at the time of its commencement shall not be less than that which would be determined by the application of such amount to purchase a single consideration immediate annuity offered by the company to the same class of contracts.
  - (a) The betterment of rates provision ensures that annuities will be purchased on a new money basis.
  - (b) For single consideration close out contracts, a betterment of rates provision is not necessary because the contractholder will seek the lowest responsible price.

- (c) For terminal funding contracts that allow for subsequent purchases of annuity benefits as plan participants terminate their employment and retire, contracts funding defined contribution plans should include a betterment of rates provision.
  - (d) Contracts funding defined benefit plans should also include this provision to the extent that annuities are provided for under the contract. If the contractholder cannot purchase annuities on a new money basis, it can be argued that the interest rate guarantees are misleading.
  - (e) This provision/concept was borrowed from §4223(a)(1)(E) of the Insurance Law, except that the entire accumulation value is applied to provide the annuity.
4. **Bona Fide Termination of Employment** -- §40.4(f) – The contract can include procedures or conditions in order to establish that a requested contractual withdrawal is being made in accordance with a bona fide termination of employment and in accordance with the plan provisions.
- (a) Termination of employment means the cessation of an employment relationship with an employer, multiple employer or membership in an employee organization sponsoring the plan, including cessations due to retirement, death, and disability.
  - (b) Termination of employment does not include:
    - (i) Any temporary absence,
    - (ii) A change in position or other occurrence qualifying as a temporary break in service under the plan,
    - (iii) Transfer or other change of position resulting in employment by an entity controlling, controlled by, or under common control with the employer,
    - (iv) Cessation of an employment relationship resulting from a reorganization, merger, or sale or discontinuance of all or any part of the plan sponsor's business. The risk for these transactions are typically not considered by the insurer in making the guarantees provided in the contract. Such transaction may result in unexpected withdrawal activity that was not priced for when the contract was issued.]
    - (v) Plan termination or partial plan termination.
5. **Liquidated Damages Provision** -- §40.2(m) of Regulation 139 defines liquidated damages as the charges or adjustments which may become applicable in the event contributions are not made in the amounts or on the dates specified in the contract and which reasonably reflect the actual losses anticipated by the insurer in making commitments in advance of the receipt of the specified contributions. A liquidated damages provision is an alternative to

contract termination in the event that the contractholder fails to make a scheduled contribution.

- (a) For most close out and terminal funding contracts this provision is not applicable, since additional contributions are not required.
- (b) We have objected to provisions that provide for a fixed charge or fixed interest rate reduction for any such failure to contribute.
- (c) The method for calculating the charge should be set forth in the contract. The contractholder should be able to calculate the adjustment from the terms of the contract. Many insurers use an explicit formula similar to the market-value adjustment formula.

- 6. **Purchase Rate Guarantee -- Unilateral Change.** For terminal funding contracts, the mortality and interest basis for guaranteed purchase rates should be stated in the contract. Companies can make unilateral changes in guaranteed annuity purchase rates for new contributions. With respect to mortality, the Department recommends that insurers start using the 94 GAR Table or a static variation thereof. We have accepted the 83 GAM with projection scale H.
- 7. **Involuntary Cashout.** ERISA §203(e)(1) and IRC §411(a)(11) provide for a \$5000 threshold amount for annuity payments. The contractholder/plan sponsor may decide to pay the participant a lump sum, in lieu of a small annuity.

#### D. **Participating and Nonparticipating Contracts – Dividend Provisions**

- 1. **General Note –** Participating annuity contracts differ considerably from the nonparticipating annuity contracts typically used to close out terminated plans.
  - (a) Under a typical nonparticipating annuity, plan assets are paid to the insurer which assumes the obligations to make benefit payments under the terminated plan. All actuarial experience under the arrangement whether favorable or not, is borne by the insurer and no additional funds are paid to or from the plan's trust or the employer with respect to those plan benefits.
  - (b) Under a participating annuity contract an ongoing relationship is created between the contractholder (the plan's trust or the employer) and the insurance company. The cost of the participating annuity contract is more than the cost of the nonparticipating annuity. In return for the payment of the additional amount, the contractholder is entitled to receive funds (dividends) resulting from favorable actuarial experience under the contract (e.g., investment gains or higher than expected mortality). In some participating contracts, the insurer establishes a separate account for assets under the contract.

2. **Non Participating Immediate Annuities – §4231(e)(1).** Pursuant to §4231(e)(1), any policies or contracts described in §4231(g)(2) and deferred annuity providing a period of deferment of annuity payments not in excess of one year can be issued on a nonparticipating basis.
  - (a) As such, immediate annuity contracts and deferred annuity contracts providing a period of deferment of annuity payments not in excess of one year can be issued on a nonparticipating basis pursuant to §4231(e)(1).
  - (b) A mutual insurer does not need acquire a revocable permit to issue such nonparticipating contracts.
  - (c) Since payments to annuitants usually commence immediately in close out contracts and terminal funding contracts, the contracts can be and usually are written on a nonparticipating basis.
  - (d) Close out contracts and terminal funding contracts are almost always written on a nonparticipating basis. We would raise questions if a close out or terminal funding contract used in connection with a defined contribution plan was written on a participating basis. For defined contribution plans, it is clear that any participating feature should benefit the plan participant/annuitant rather than the group annuity contractholder.
  
3. **Plan Termination – Guaranteed Cost Nonparticipating Deferred Annuities §4231(g)(2).** Section 4231(g)(2) provides, in part, that dividends need not be distributed on
  - (a) Any deferred annuity contract for the period following the period of deferment of annuity payments, nor
  - (b) On any group annuity contract providing deferred annuities
    - (i) for a class or classes of participants in a qualified pension or profit sharing plan who have terminated their participation under such plan, or
    - (ii) with respect to which class or classes further contributions have been discontinued under the plan and notice of such discontinuance has been given to the commissioner of internal revenue (or regulatory authority of such other jurisdiction). See Chapter 752 of the Laws of 1961 and Chapter 90 of the Laws of 1966.
  - (c) By virtue of §4231(g)(2), an insurer can issue guaranteed cost nonparticipating immediate and deferred annuities in connection with the termination of pension plans or termination of a class or classes of participants in a pension plan.
  - (d) The Department has approved the use of guaranteed cost nonparticipating deferred annuities in connection with corporate acquisitions and mergers where benefit accruals are frozen and

future pension accruals are funded under the surviving corporations pension plan. A single premium guaranteed cost nonparticipating deferred annuity is used to fund the “frozen” accrued benefits under a defined benefit plan (for retired participants, vested terminated participants and active participants) and to irrevocably fix the cost of plan benefits accrued to a specified date.

- (i) The insurer assumes the liability of the accrued benefits as determined as of a specified date in accordance with plan requirements;
  - (ii) The insurer determines a present value of such accrued benefits using then current mortality and interest assumptions to arrive at a guaranteed purchase price. The consideration for the contract is payable in single sum subject to adjustment upon receipt of final employee benefit data.
  - (iii) Since the pricing assumptions are not conservative in nature as is the case with traditional participating insurance products, it is not expected that any significant dividends will accrue.
- (e) The Department has approved the use of guaranteed cost nonparticipating deferred annuities in connection with the settlement of defined benefit plan liabilities by plan sponsors pursuant to the Financial Accounting Standards Board’s Statement of Financial Accounting Standards No. 88.
- (i) While there may not be a technical termination of the entire plan as envisioned by the current language in §4231(g)(2), the settlement of accrued benefits as of a specified date could be viewed as a “freeze” of the plan sponsor’s liability for pension benefits.
  - (ii) From a defined benefit plan participant’s viewpoint, the issuance of a guaranteed cost nonparticipating annuity contract will not adversely affect retirement benefits.

4. **Participating Contracts.** We note that terminating defined benefit plans have used immediate participation guarantee contracts to fund annuity payments for retired lives. Such contracts will be covered in another product outline.

- (a) In the late 1980s, the IRS considered whether such participating annuity contracts provided the level of security and protection of plan participant’s benefits to satisfy the annuitization requirement in the implementation guidelines on asset reversions for purposes of processing certain terminations (spinoff/termination and termination/reestablishment transactions) of qualified defined benefit plans. See G.C.M. 39765.

- (b) IRS Memorandum dated February 27, 1987 provides that the employer and insurer must certify that the participating annuity contract provides
  - (i) For payment of all plan benefits on a termination basis, except for benefits satisfied in a single sum,
  - (ii) That the insurer's obligation to individuals under the contract is irrevocable and not conditioned upon the experience under the contract, payment of subsequent premiums, or the sufficiency of assets in any separate account, and
  - (iii) That the plan participants under the contract have equivalent and legally enforceable rights to the general assets of the insurance company as have participants in a traditional annuity in the event separate account funds are exhausted or the insurance company becomes insolvent.
- (c) If residual assets are to be distributed to plan participants, a participating annuity contract may be purchased to satisfy the requirement that annuities be provided by the purchase of irrevocable commitments. However, the portion of the price of the contract that is attributable to the participation feature may not be (i) taken into account in determining the residual assets; or (ii) paid from residual assets allocable to participants. See PBGC Reg. §4041.28(c)(4).

## XI. Advertising and Disclosure

### A. Regulation 139 - Section 40.3

- 1. Written statement and/or specimen contract with a statement citing location in contract of disclosures required by paragraphs (1),(3),(4),(5),(6),(9) and (10) of §40.3(b) of Regulation 139. See §40.3(a)
  - (a) Statement indicating any restrictions as to amount and timing of contributions, and penalties for non-payment. §40.3(b)(1)
  - (b) Description of the right to discontinue contributions to contract, and penalties resulting from such action. §40.3(b)(2)
  - (c) Statement of all current fees and charges that are or may be assessed against the contractholder or deducted from the contract, including a description of the extent and frequency to which such fees and charges may be modified and the extent to which they take precedence over other payments. §40.3(b)(3)
  - (d) Statement of the interest rates and/or method of determination of rates and a description as to how any withdrawals, transfers or payments will affect the amount of interest credited. §40.3(b)(4)
  - (e) Description of expense, interest and benefit guarantees under the contract and any rights to modify or eliminate such guarantees, including the right to apply surrender charges or market-value adjustments to plan benefit payments if there are

plan amendments or changes in the manner of plan administration. §40.3(b)(5)

- (f) Description of the contractholder's and participant's right to withdraw funds (or apply to purchase annuities), along with a description of any charges, fees or market-value adjustments applicable to such withdrawals or a statement that no such withdrawals or payment are permissible prior to maturity or the happening of a certain event. §40.3(b)(6)
- (g) Statement indicating any pro rata, percentage or other limitations which may apply to benefit payments to be purchased or provided under the contract when the plan is not funded entirely under the contract. §40.3(b)(7)
- (h) Statement that contractholder or participant withdrawals under the contract are to be made in a FIFO or LIFO basis or other applicable basis. §40.3(b)(8)
- (i) Statement that the contract may be amended, including any right of the insurer to unilaterally amend the contract. §40.3(b)(9)
- (j) Statement, if applicable, that any dividends and experience rate credits are subject to the insurer's discretion. § 40.3(b)(10)
- (k) Statement, if applicable, concerning supporting asset's affect on withdrawal timing. § 40.3(b)(11)
- (l) Statement that the contractholder or plan sponsor is solely responsible for determining whether the contract is a suitable funding vehicle. §40.3(b)(12)
- (m) Statement, if applicable, that the insurer does not have responsibility to reconcile participants' individual account balances with the accumulation fund balance where the insurer does not maintain individual account balances. §40.3(b)(13)

**B. Rules Governing Advertisements of Life Insurance and Annuity Contracts -- Regulation 34-A -**

**XII. Related Matters**

**A. Pension Benefit Guaranty Corporation – ERISA Title IV**

1. The PBGC insures the benefits of participants in most defined benefit pension plans. However, the federal guarantee ceases in two cases.
  - (a) It ceases when an ongoing plan purchases allocated insurance annuities for participants who retire or leave a company.
  - (b) It ceases when a fully funded plan terminates (a "standard termination") and purchases allocated insurance annuities for participants.
  - (c) In both cases, there is an irrevocable commitment within the meaning of PBGC's regulations (i.e., an irrevocable annuity contract for a participant). (An irrevocable commitment is "an

obligation by an insurer to pay benefits to a named participant or surviving beneficiary, if the obligation cannot be cancelled under the terms of the insurance contract (except for fraud or mistake) without the consent of the participant or beneficiary and is legally enforceable by the participant or beneficiary.” See 29 C.F.R. § 2618.2.)

- (d) See GAO/HRD-93-29, GAO/HRD-91-79.
- 2. *Notice of Annuity Contract.* Where plan benefits are distributed through annuity contracts under standard termination, the plan administrator or insurer must provide each participant and beneficiary with a copy of the annuity contract or a certificate indicating the insurer’s name and address and clearly reflecting the insurer’s obligation to provide the benefit. See PBGC Reg. §4041.28(d)(1).
  - (a) The information must be provided within 30 days after it is available.
  - (b) If the contract or certificate is not provided by the date on which the post-distribution certification is required to be filed, the plan administrator must provide each participant and beneficiary with written notice stating that the obligation to provide plan benefits has been transferred to the insurer. See PBGC Reg. §4041.28(d)(2).
    - (i) In addition, the name and address of the insurer and the name, address and telephone number of the person designated by the insurer to answer inquires regarding the annuity must be provided.
    - (ii) The notice must also inform the participant and beneficiary that they will receive a copy of the annuity contract or a certificate indicating the insurer’s name and address and clearly reflecting the insurer’s obligation to provide the plan benefits.
  - (c) Note that the plan administrator must issue a notice of benefit distribution in plan termination cases, including notice of annuity information which contains information about the state guaranty fund and states that the PBGC will no longer guarantee a participant’s title IV benefits once plan assets have been distributed by purchase of an annuity contract. See PBGC Reg. §4041.48(c) and §4041.27(b)(3).
- 3. *Selection of Annuity Provider.* The selection of an annuity provider is a fiduciary decision and the U.S. DOL has brought has filed several actions against fiduciaries who have failed to follow adequate procedures in selecting the safest available annuity provider.
  - (a) The PWBA has provided guidance for fiduciaries to follow when selecting an annuity provider for purposes of benefit distributions where the plan intends to transfer liability for benefits to the

annuity provider. See PWBA Interpretive Bulletin 95-1, 3-6-95, (60 FR 12328).

- (i) Fiduciaries may not select an annuity provider without an objective, thorough, and analytical search and an evaluation of factors relating to the annuity provider's credit worthiness and ability to pay claims.
  - (ii) The fiduciary may not rely solely on ratings provided by insurance rating services, but must consider the quality and diversification of the annuity provider's investment portfolio, the size of the insurer relative to the proposed contract, the level of the insurer's capital and surplus, the lines of business of the annuity provider and other indications of an insurer's exposure to liability, the structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts, and the availability of additional protection through state guaranty associations and the extent of those guarantees.
- (b) Note that federal courts do not require ERISA fiduciaries to select the safest available annuity. Fiduciaries will satisfy their duty of prudence if they utilize appropriate methods, including the use of outside experts, to diligently investigate the purchase of an annuity. See *Riley v. Murdock, et al*, CA-4 (1996), No. 952414.
  - (c) Cost may be considered. The safest available annuity may not be in the interests of participants and beneficiaries where it is only marginally safer, but disproportionately more expensive than competing annuities and participants are likely to bear a significant portion of the increased cost. However, a fiduciary may not purchase a riskier, lower-priced annuity to maximize an employer's reversion following the termination of an overfunded plan or because there are insufficient funds to purchase a safer annuity.

## **B. State Guaranty Fund**

- 1. The Life Insurance Guaranty Corporation of New York in Article 77 of the Insurance Law provides protection in the amount of
  - (a) \$500,000 limit for all benefits, including cash values, with respect to any one life under a covered policy; and
  - (b) \$1,000,000 limit for all benefits, including cash values, with respect to a group annuity contract (or portion of any such contract) that does not guarantee annuity benefits with respect to any specific individual identified in the contract.

# GROUP ANNUITY TERMINAL FUNDING AND CLOSE OUT CONTRACTS

## I. Filing Process

### A. Type of Filing:

- For prior approval - §3201(b)(1); Circular Letter 1997-14
- Expedited approval -§3201(b)(6); Circular Letter 1998-2
- For delivery outside of New York, only - Circular Letter 1963-6
- Pre-filed Insurance Coverage - Circular Letter 1964-1

### B. Submission Letter - Circular Letter 1963-4; Circular Letter 1963-6; Circular Letter 1969-4

- 2 copies
- Identification of Insurer
- Listing of form numbers
- Table of Contents of all material in the filing
- Listing of the mandatory or optional insert pages, if any
- Description of the benefits provided
- Type of group, as defined in §4238(b). Specify paragraph(s) \_\_\_\_\_
- Classes covered, as defined in §4238
- Statement as to source of contributions -- Employer \_\_\_ -- Employee \_\_\_
- Statement as to whether the form is new or is intended to replace previously approved form. Identify prior submission(s) \_\_\_\_\_
- Statement as to how the form will be used and how it will be marketed, as described in Circular Letter 1976-12
- Caption identifies all forms, describe type of insurance and type of form Circular Letter No. 8 (1999)
- Certification of compliance if deemer submission with appropriate caption

### C. Preparation of Forms and Attachments- Circular Letter Nos. 63-4, 63-6 and 69-4

- 2 copies of Forms
- 2 copies of Explanatory Memorandum describing variability
- Readability Certification, in accordance with §3102

## II. Contract Provisions

### A. Cover Page

- Company's Name and Address
- Form Identification Number
- Brief Description of Policy
- Officer's Signatures

### B. Standard Provisions

- Grace Period
- Entire Contract
- Misstatement of Age or Sex

- Retired Life Certificate
- No Active Life Certificate Required
  
- C. Regulation No. 139 And Other Provisions
  - Plan Benefit Rule
  - Betterment of Rates
  - Bona Fide Termination of Employment
  - Liquidated Damages Provision
  - Purchase Rate Guarantee -- Unilateral Change
  - Involuntary Cashout
  
- D. Participating and Nonparticipating Contracts – Dividend Provisions
  - Non Participating Immediate Annuities
  - Plan Termination – Guaranteed Cost Nonparticipating Deferred Annuities
  - Participating Contracts
  
- V. Advertising and Disclosure
  - A. Regulation 139 - Section 40.3
  - B. Rules Governing Advertisements of Life Insurance and Annuity Contracts Regulation 34-A