

<b>Regulatory Analysis Form</b>		<b>This space for use by IRRC</b>
(1) Agency Insurance Department		2007 SEP -5 PM 3:27 REGULATORY COMMISSION
(2) I.D. Number (Governor's Office Use) 11-204		IRRC Number: 2263
(3) Short Title Safeguarding Insurer Securities		
(4) PA Code Cite 31 Pa. Code, Chapter 148a	(5) Agency Contacts & Telephone Numbers Primary Contact: Peter J. Salvatore, Regulatory Coordinator, 1326 Strawberry Square, Harrisburg, PA 17120, (717) 787-4429 Secondary Contact: Elaine M. Leitzel, Program Analyst, Office of Regulation of Companies, 1345 Strawberry Square, Harrisburg, PA 17120 (717) 787-8840	
(6) Type of Rulemaking (check one) <input type="checkbox"/> Proposed Rulemaking <input checked="" type="checkbox"/> Final Order Adopting Regulation <input type="checkbox"/> Final Order, Proposed Rulemaking Omitted		(7) Is a 120-Day Emergency Certification Attached? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes: By the Attorney General <input type="checkbox"/> Yes: By the Governor
(8) Briefly explain the regulation in clear and nontechnical language. <p>This final-form rulemaking prescribes the ways in which securities owned by insurers (the various types of insurance entities regulated by the Department) may be held, as well as the requirements that must be met when insurers' securities are held under custodial agreements. Securities owned by insurers are liquid assets held to allow the payment of the insurers' obligations as they come due. Insurers must comply with the regulations to be permitted to report their securities as assets (admitted assets) in financial statements filed with the Department. This final-form rulemaking replaces the regulations relating to insurers' securities initially adopted June 12, 1981, with updated regulations. In developing the final-form regulations, the Department has considered the need for domestic insurers to participate efficiently in the securities marketplace while preserving the value and safety of these liquid assets. A task force of state insurance regulators has reviewed a highly publicized case where a number of insurers became insolvent because of the theft of their securities, and the National Association of Insurance Commissioners (NAIC) has updated a model regulation relating to insurers' securities as a result of the review.<sup>1</sup> The Department participated in the review of the case, known as the Frankel case, and the final-form rulemaking includes protections consistent with the updated model regulation.</p>		
(9) State the statutory authority for the regulation and any relevant state or federal court decisions. <p>This rulemaking is proposed under the authority of sections 206, 506, 1501 and 1502 of The Administrative Code of 1929 (71 P. S. §§ 66, 186, 411 and 412) relating to the general rulemaking authority of the Department; The Insurance Department Act of 1921 (40 P. S. §§ 1-324); The Insurance Company Law of 1921 (40 P. S. §§ 341-991); 40 Pa.C.S. §§ 6101-6127 and 6301-6335 (relating to hospital plan corporations and professional health services plan corporations); the Voluntary Nonprofit Health Service Act of 1972 (40 P.S. §§ 1551-1568); the Fraternal Benefit Society Code (40 P. S. §§ 1142-101--1142-701); the Health Maintenance Organization Act (40 P.S. §§ 1551-1567); the Pennsylvania Fair Plan Act (40 P.S. §§ 1600.101-1600.502); the act of October 15, 1975, P.L. 390, No. 111 (40 P.S. §§ 1301.801-811) (relating to joint underwriting associations).</p>		

<sup>1</sup> The updated Model Regulation on the Use of Clearing Corporations and Federal Reserve Book-Entry System by Insurance Companies was adopted in October 2001.

**Regulatory Analysis Form**

(10) Is the regulation mandated by any federal or state law or court order, or federal regulation? If yes, cite the specific law, case or regulation, and any deadlines for action.

No.

(11) Explain the compelling public interest that justifies the regulation. What is the problem it addresses?

This rulemaking is needed to update the regulations to better safeguard against the theft or loss of insurer securities and to establish up-to-date, comprehensive and clear requirements for insurer securities held under custodial arrangements.

(12) State the public health, safety, environmental or general welfare risks associated with nonregulation.

There are no public health, safety, environmental or general welfare risks associated with this rulemaking.

(13) Describe who will benefit from the regulation. (Quantify the benefits as completely as possible and approximate the number of people who will benefit.)

Domestic insurers and custodians will benefit from the improved clarity and efficiency of the regulation, including the consolidation of three separate affidavit forms and provisions for electronic reporting. The general public will benefit to the extent that these improvements enhance regulatory safeguards against the loss or theft of assets held for payment of insurance obligations.

**Regulatory Analysis Form**

(14) Describe who will be adversely affected by the regulation. (Quantify the adverse effects as completely as possible and approximate the number of people who will be adversely affected.)

No adverse effects are anticipated as a result of this rulemaking.

(15) List the persons, groups or entities that will be required to comply with the regulation. (Approximate the number of people who will be required to comply.)

Domestic insurers (including health maintenance organizations and preferred provider organizations) will be required to comply with the regulation in order for their assets to be admissible in financial statements filed with the Department. Custodians who wish to hold insurer securities will be required to agree to the terms and conditions prescribed in the regulation for custodial agreements. As of December 31, 2002, 313 domestic insurers would be required to comply with the regulation.

(16) Describe the communications with and input from the public in the development and drafting of the regulation. List the persons and/or groups who were involved, if applicable.

Comments on these regulations were requested from The Insurance Federation of Pennsylvania, Inc., the Pennsylvania Association of Mutual Insurance Companies, the Managed Care Association of Pennsylvania, the Pennsylvania Fraternal Congress, Highmark, Inc., Capital Blue Cross, Independence Blue Cross and the Hospital Service Association of Northeastern Pennsylvania. The comments received were considered in the development of the proposed rulemaking. In addition, the regulatory process provided for a 30-day public comment period subsequent to publication of the proposed rulemaking in the *Pennsylvania Bulletin*.

(17) Provide a specific estimate of the costs and/or savings to the regulated community associated with compliance, including any legal, accounting or consulting procedures which may be required.

The updated reporting requirements in this regulation will impose no significant additional costs on the regulated community.

**Regulatory Analysis Form**

(18) Provide a specific estimate of the costs and/or savings to local governments associated with compliance, including any legal, accounting or consulting procedures which may be required.

There are no costs or savings to local governments associated with this rulemaking.

(19) Provide a specific estimate of the costs and/or savings to state government associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required.

The efficiency of the Department's review of custodial agreements in the conduct of financial examinations will be improved to the extent this rulemaking promotes compliance with acceptable terms and conditions for custodial agreements and timely availability of complete and accurate information relating to insurer security accounts.

**Regulatory Analysis Form**

(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years.

	<b>Current FY Year</b>	<b>FY +1 Year</b>	<b>FY +2 Year</b>	<b>FY +3 Year</b>	<b>FY +4 Year</b>	<b>FY +5 Year</b>
<b>SAVINGS:</b>	\$	\$	\$	\$	\$	\$
<b>Regulated Community</b>						
<b>Local Government</b>						
<b>State Government</b>						
<b>Total Savings</b>						
<b>COSTS:</b>						
<b>Regulated Community</b>						
<b>Local Government</b>						
<b>State Government</b>						
<b>Total Costs</b>						
<b>REVENUE LOSSES:</b>						
<b>Regulated Community</b>						
<b>Local Government</b>						
<b>State Government</b>						
<b>Total Revenue Losses</b>						

(20a) Explain how the cost estimates listed above were derived.

There are no significant measurable costs or savings associated with this rulemaking.

**Regulatory Analysis Form**

(20b) Provide the past three-year expenditure history for programs affected by the regulation. N/A

<b>Program</b>	<b>FY -3</b>	<b>FY -2</b>	<b>FY -1</b>	<b>Current FY</b>

(21) Using the cost-benefit information provided above, explain how the benefits of the regulation outweigh the adverse effects and costs.

This rulemaking will impose no significant additional costs on affected parties or the Department. Domestic insurers and custodians will benefit from the improved clarity and efficiency of the regulation, including the elimination of three separate affidavit forms and provisions for electronic reporting. The general public will benefit to the extent that these improvements enhance regulatory safeguards against the loss or theft of assets held for payment of insurance obligations.

(22) Describe the nonregulatory alternatives considered and the costs associated with those alternatives. Provide the reasons for their dismissal.

This rulemaking is the most efficient means to establish requirements to safeguard insurer securities.

(23) Describe alternative regulatory schemes considered and the costs associated with those schemes. Provide the reasons for their dismissal.

This rulemaking updates an existing regulation. No other regulatory schemes were considered.

**Regulatory Analysis Form**

(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulation.

No.

(25) How does this regulation compare with those of other states? Will the regulation put Pennsylvania at a competitive disadvantage with other states?

The regulation is substantially similar to a model regulation developed by the NAIC. The model regulation or similar regulations have been adopted by 21 other states. This rulemaking will not put Pennsylvania at a competitive disadvantage with other states.

(26) Will the regulation affect existing or proposed regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.

This rulemaking updates an existing regulation of the promulgating agency. No other regulations are affected.

(27) Will any public hearings or informational meetings be scheduled? Please provide the dates, times, and locations, if available.

No public hearings or informational meetings are anticipated.

**Regulatory Analysis Form**

(28) Will the regulation change existing reporting, record keeping, or other paperwork requirements? Describe the changes and attach copies of forms or reports which will be required as a result of implementation, if available.

The rulemaking reduces paperwork to the extent that it replaces three different affidavit forms required under the current regulations with one consolidated form. The rulemaking also may reduce paperwork by allowing reports and confirmations to be transmitted in electronic form. The rulemaking will require custodial agreements to provide for notice to the Department if the agreement is terminated or if 100% of the assets are withdrawn from one or more of an insurer's custodial accounts. The reporting and record-keeping requirements in the rulemaking are necessary to safeguard insurer securities from loss or theft and to allow the Department to readily verify insurer assets when conducting financial examinations under the law.

(29) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.

Affected parties will have one year from the effective date of the final-form rulemaking to bring existing custodial agreements into compliance with the regulation.

(30) What are the anticipated effective date of the regulation; the date by which compliance with the regulation will be required; and the date by which any required permits, licenses or other approvals must be obtained?

The regulation will take effect after approval by the legislative standing committees, the Independent Regulatory Review Commission and the Office of the Attorney General; and upon final publication in the *Pennsylvania Bulletin*.

(31) Provide the schedule for continual review of the regulation.

All Department regulations are reviewed for continued effectiveness on a triennial basis.



<p>CDL-1</p> <p style="text-align: center;"><b>FACE SHEET FOR FILING DOCUMENTS WITH THE LEGISLATIVE REFERENCE BUREAU</b></p> <p style="text-align: center;">(Pursuant to Commonwealth Documents Law)</p>	<p style="text-align: right;">RECORDED</p> <p style="text-align: right;">2002 SEP -5 PM 3: 27</p> <p style="text-align: right;">LEGISLATIVE SECRETARY REVIEW COMMISSION</p>	
<p># 2263</p> <p>DO NOT WRITE IN THIS SPACE</p>		
<p>Copy below is hereby approved as to form and legality. Attorney General</p> <p>By _____ (Deputy Attorney General)</p> <p>_____</p> <p style="text-align: center;">Date of Approval</p> <p>→ Check if applicable. Copy not approved. Objections attached.</p>	<p>Copy below is hereby certified to be a true and correct copy of a document issued, prescribed or promulgated by:</p> <p><b>Insurance Department</b></p> <p>_____</p> <p style="text-align: center;">(AGENCY)</p> <p>DOCUMENT/FISCAL NOTE NO. <u>11-204</u></p> <p>DATE OF ADOPTION: _____</p> <p>BY: <u>M. Diane Koken</u> <b>M. Diane Koken</b> <b>Insurance Commissioner</b></p> <p>TITLE: _____ (EXECUTIVE OFFICER, CHAIRMAN OR SECRETARY)</p>	<p>Copy below is hereby approved as to form and legality. Executive or Independent Agencies</p> <p>BY: <u>John V. Turner</u></p> <p style="text-align: center;"><u>8/30/02</u></p> <p style="text-align: center;">DATE OF APPROVAL</p> <p style="text-align: center;">(DEPUTY GENERAL COUNSEL) (<del>CHIEF COUNSEL, INDEPENDENT AGENCY</del>) (<del>STRIKE INAPPLICABLE TITLE</del>)</p> <p>→ Check if applicable. No Attorney General approval or objection within 30 days after submission.</p>

NOTICE OF FINAL-FORM RULEMAKING

INSURANCE DEPARTMENT

31 Pa. Code, Insurance, Part VIII  
Miscellaneous Provisions  
Chapter 148a  
SAFEGUARDING INSURER SECURITIES

## PREAMBLE

The Insurance Department (Department) by this order deletes Chapter 148 (relating to securities held under custodial agreements and participation by insurers in depository trust companies and federal reserve book entry systems) and adopts Chapter 148a (relating to safeguarding insurer securities) to read as set forth in Annex A. This final-form rulemaking prescribes the ways in which securities owned by insurers (the various types of insurance entities regulated by the Department) may be held, as well as the requirements that must be met when insurers' securities are held under custodial agreements. Insurers must comply with the regulations to be permitted to report their securities as assets (admitted assets) in financial statements filed with the Department.

### *Purpose*

This final-form rulemaking replaces the regulations relating to insurers' securities initially adopted June 12, 1981, with updated regulations. Securities owned by insurers are liquid assets held to allow the payment of the insurers' obligations as they come due. In developing the final-form regulations, the Department has considered the need for domestic insurers to participate efficiently in the securities marketplace while preserving the value and safety of these liquid assets.

A task force of state insurance regulators has reviewed a highly publicized case where a number of insurers became insolvent because of the theft of their securities, and the National Association of Insurance Commissioners (NAIC) has updated a model regulation relating to insurers' securities as a result of the review.<sup>1</sup> The Department participated in the review of the case, known as the Frankel case, and the final-form rulemaking includes protections consistent with the updated model regulation.

Therefore, this rulemaking is needed to replace the Commonwealth's regulations to establish up-to-date, clear requirements for insurers' securities held under custodial arrangements and to better safeguard against the theft or loss of insurers' securities.

### *Statutory Authority*

This rulemaking is proposed under the authority of sections 206, 506, 1501 and 1502 of The Administrative Code of 1929 (71 P. S. §§ 66, 186, 411 and 412) relating to the general rulemaking authority of the Department; The Insurance Department Act of 1921 (40 P. S. §§ 1--324); The Insurance Company Law of 1921 (40 P. S. §§ 341-991); 40 Pa.C.S. §§ 6101--6127 and 6301--6335 (relating to hospital plan corporations and professional health services plan corporations); the Voluntary Nonprofit Health Service Act of 1972 (40 P.S. §§ 1551--1568); the Fraternal Benefit Society Code (40 P. S. §§ 1142-101--1142-701); the Health Maintenance Organization Act (40 P.S. §§ 1551--1567); the Pennsylvania Fair Plan Act (40 P.S. §§ 1600.101--1600.502); Article VIII of

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<sup>1</sup> The updated Model Regulation on the Use of Clearing Corporations and Federal Reserve Book-Entry System by Insurance Companies was adopted in October 2001.

the Health Care Services Malpractice Act (40 P.S. §§ 1301.801--811) (relating to joint underwriting associations).

### *Comments*

Notice of proposed rulemaking was published at 32 Pa.B. 1873 (April 13, 2002) with a 30-day public comment period.

No comments were received from the standing committees. Comments were received after the 30-day public comment period from A.G. Edwards Trust Company FSB (A.G. Edwards). The Independent Regulatory Review Commission (IRRC) submitted its comments and suggestions to the Department on June 13, 2002. The Department has responded to all comments in this final-form rulemaking.

The following is a discussion of comments and summary of changes in the final-form rulemaking.

#### *Section 148a.1. Definitions.*

##### *Definition of "custodian"*

The proposed rulemaking used the phrase "adequately capitalized" in subsections (i)(A) and (ii)(C) in referring to capitalization standards that apply to banks and trust companies. IRRC recommended that the word "adequately" be deleted from both subsections because it is unnecessary. In response to IRRC's comment, the Department has deleted the word "adequately" in both subsections.

A.G. Edwards recommended that the definition of "custodian" be amended to allow a Federal Savings Bank to qualify as a custodian. IRRC noted the comment by A.G. Edwards and asked why a Federal Savings Bank was not included. The Department agrees that a Federal Savings Bank that meets the requirements of this chapter should not be excluded from qualifying as a custodian. Therefore, the Department has amended the definition of "custodian" to include a Federal Savings Bank.

##### *Definition of "instructions"*

Subsection (ii)(B) in the proposed rulemaking stated that verbal instructions shall be confirmed "promptly" by written instructions. IRRC recommended that the word "promptly" be replaced with a specific time frame. In consideration of IRRC's comment and the time sensitive nature of security transactions, the Department has replaced the word "promptly" with the phrase "within 24 hours."

##### *Definition of "insurer"*

The definition of "insurer" in the proposed rulemaking included a general reference in subsection (x) to "other entities" acting as insurers. IRRC commented that this

subsection was vague and should be deleted. In response to IRRC's comment, the Department has deleted subsection (x) because it is not needed to understand the scope of the chapter.

*Definition of "state"*

IRRC commented that the District of Columbia and Puerto Rico do not need to be separately listed in subsections (ii) and (iii) because territories of the United States are included under subsection (i). In response to IRRC's comment, the Department has deleted subsections (ii) and (iii) because the subsections are unnecessary to understand the meaning of the definition.

*Section 148a.2. Permissible methods of holding securities.*

Section 148a.2 lists the ways in which insurers' securities may be held. IRRC asked whether custodial agreements are needed when insurers' securities are held in the custody of or as required by a state treasurer or other regulatory authority under subsection (d). The requirements in this chapter relating to custodial agreements are intended to only apply to securities held by a custodian under subsection (b), not to securities held in the custody of or as otherwise required by a state treasurer or other regulatory authority. Therefore, in response to IRRC's comment, the Department has clarified its final-form rulemaking by adding the phrase "as required by" in subsection (d) and by referring to subsection (b) in subsection 148a.3(a) (relating to requirements for custodial agreements.)

*Section 148a.3. Requirements for custodial agreements.*

Under § 148a.3(b)(3), a custodian is permitted to utilize an agent to gain entry in a clearing corporation or in the Federal Reserve book-entry system or for other services. IRRC was concerned that the conditions relating to a custodian's utilization of an agent did not include a requirement that the insurer be notified. The Department agrees that the insurer should be notified when an agent is used for transactions or other services involving the insurer's securities. Therefore, the Department has added § 148a.3(b)(3)(iii) to require the custodian to provide notice to the insurer within 5 business days of the utilization of an agent and to require the notice to include, at a minimum, the identity of the agent, the date of the custodian's written agreement with the agent, and an acknowledgement that the custodian has retained responsibility for the insurer's securities.

IRRC also commented that the word "ultimate" in § 148a.3(b)(3)(ii) was superfluous in reference to the custodian's responsibility for the safekeeping of the insurer's securities and for compliance with the chapter. In response to IRRC's comment, the Department has deleted the word "ultimate" because it is not necessary to understand the nature and extent of a custodian's responsibility.

A.G. Edwards asked whether a custodian would be required to enter into a separate written agreement with its agent for each insurer. Separate agreements would not be

necessary; therefore, the Department has clarified the final-form rulemaking by adding the phrase “of one or more insurers” to § 148a.3(b)(3)(i).

Paragraphs 148a.3(b)(9)--(11) relate to a custodian’s duties to maintain adequate insurance protection as required by banking regulators and to indemnify the insurer for any loss of the securities under the circumstances and conditions described in the regulations. The custodian’s obligation to indemnify the insurer includes the immediate replacement of the securities or the value of the securities, plus the value of any loss of rights or privileges resulting from the loss of the securities. IRRC commented that § 148a.3(b)(10) should be divided into two sentences for clarity, and the Department has divided the paragraph into two sentences as IRRC recommended.

Paragraph 148a.3(12) required the custodian to notify the Department within 3 business days if the agreement is terminated or if 100% of the assets are withdrawn from one or more of the insurer’s custodial accounts. This provision was recently added to the NAIC model regulation as a safeguard against securities fraud or theft as a result of the review of the Frankel case. IRRC recommended that the Department consider setting a trigger rate lower than 100%. The NAIC task force considered a lower trigger rate when developing this notice requirement and ultimately concluded that a rate lower than 100% would be overly burdensome. The total value of securities held under a custodial agreement fluctuates daily in terms of both the market value of the securities being held and the volume of trading activities. Therefore, it would be difficult to develop a reliable, cost-efficient reporting system. The Department participated in the NAIC’s deliberations of this issue and agrees that the 100% trigger rate provides a reasonable safeguard against the threat of securities fraud or theft when insurers’ securities are held under custodial agreements. This notice requirement was one of 35 recommendations developed by the task force. The recommendations cover all aspects of financial solvency regulation and include better communication and cooperation among regulators, enhanced financial reporting requirements for insurers, and improved regulatory practices and procedures for analyses of insurers’ financial statements and on-site financial examinations. All of the recommendations are being addressed by the NAIC and the Department. The Department believes that, taken as a whole, the recommendations represent a comprehensive, thoughtful approach to the issues raised in the Frankel case. Therefore, the Department has retained the 100% trigger rate recommended by the NAIC task force. However, IRRC also recommended a shorter time frame, such as within 24 hours, for reporting the withdrawal of assets from custodial accounts. After considering IRRC’s concerns about the adequacy of a 3-day time frame, the Department agrees that a shorter time frame is warranted by the potential significance of a termination or 100% withdrawal and has replaced the 3-day time frame with the phrase “within 24 hours” as recommended by IRRC.

Paragraphs 148a.3(b)(13)--(17)(ii) establish record keeping and reporting duties under custodial agreements. The purposes of these requirements include assuring that the custodian is aware of its responsibility to provide the Department with timely access to information required in a financial examination conducted under Article IX of The Insurance Department Act of 1921 (40 P.S. §§ 323.1—323.8). IRRC commented that,

for clarity, the final-form regulation should include a reference to this statute. Therefore, the Department has included the statutory reference in § 148a.3(b)(16)(ii) and also in § 148a.4(2)(ii) (relating to requirements for investment company securities).

Paragraph 148a.3(b)(14) requires the custodian to provide certain reports to the insurer if requested to do so in writing. IRRC commented that the final-form regulation should provide a specific time frame for the custodian to submit the required information. In response to IRRC's comment, the Department has amended paragraphs (14) and (17) to require the custodian to provide requested information and affidavits within 30 days of receipt of a written request.

Subparagraph 148a.3(b)(14)(ii) of the proposed rulemaking required the custodian to provide, when requested in writing, reports on its system of internal control prepared by an outside auditor. IRRC and A.G. Edwards asked whether an internal audit would be acceptable. The Department has considered this question and believes an internal audit would be acceptable. Therefore, the Department has amended subparagraph (ii) to allow the custodian to provide internal or external reports on the custodian's system of internal control.

*Section 148a.4. Requirements for investment company securities.*

Section 148a.4 (relating to requirements for investment company securities) establishes the conditions under which an insurer's investment company (mutual fund) securities may be held by the investment company that issued the securities. The investment company must provide the insurer with electronic or paper reports on at least a monthly basis and must maintain sufficient records for financial reporting and examination or audit purposes. IRRC asked how the insurer or the Department would be certain that an investment company is maintaining the records required under subsection (2) for purposes of the insurer's financial reports and for financial examinations conducted by the Department. The insurer has a duty to verify that the investment company maintains adequate records prior to investing in the securities. The Department will verify the adequacy of records when conducting on-site financial examinations of the insurer. If the custodian or the insurer fails to maintain adequate records, the insurer may not take credit for the investment company securities as assets in financial statements filed with the Department.

A.G. Edwards commented that most investment companies do not issue monthly statements unless there is activity in the account. The Department believes that at least monthly reporting is necessary to adequately monitor the status of securities reported as assets in insurers' financial statements. Paragraph (1) allows the reports to be transmitted in electronic or paper form. The Department would recognize monthly statements provided by securities brokers that include the status of investment company securities. In addition, the Department believes that many investment companies provide investors with 24-hour, 7-day a week access to electronic reports on the status of their investment accounts. Therefore, the Department believes a monthly reporting requirement is not

overly burdensome for investment company securities.

*Section 148a.5. Penalty and existing custodial agreements.*

IRRC commented that, for clarity, this section should be divided into two subsections, one for penalty and one for existing custodial agreements. Therefore, the Department has divided the section into subsections (a) and (b) in this final-form rulemaking.

*Fiscal Impact*

*State Government*

Department costs in conducting financial examinations associated with the review of custodial arrangements and verification of insurers' securities will not increase as a result of this final-form rulemaking.

*General Public*

While this final-form rulemaking has no immediate fiscal impact on the general public, the general public will benefit to the extent that adoption of this final-form rulemaking enhances regulatory safeguards against the loss or theft of securities held by insurers to meet obligations under insurance policies.

*Political Subdivisions*

This final-form rulemaking will not affect costs to political subdivisions.

*Private Sector*

The safeguards and reporting requirements for custodial arrangements in this final-form rulemaking are not materially different from existing regulatory requirements and will impose no significant additional costs on insurers or custodians.

*Paperwork*

This final-form rulemaking reduces paperwork to the extent that it replaces three different affidavit forms required under the current regulations with one consolidated form. This final-form rulemaking also may reduce paperwork by allowing reports and confirmations to be transmitted in electronic form. This final-form rulemaking will require custodial agreements to provide for notice to the Department if the agreement is terminated or if 100% of the assets are withdrawn from one or more of an insurer's custodial accounts. The reporting and record-keeping requirements in this final-form rulemaking are necessary to safeguard insurer securities from loss or theft and to allow the Department to readily verify insurer assets when conducting financial examinations under the law.

### *Persons Regulated*

This final-form rulemaking applies to all types of domestic insurers regulated by the Department. Custodians and investment companies holding insurer securities also are affected by this final-form rulemaking to the extent it prescribes the terms and conditions of agreements entered into with domestic insurers.

### *Contact Person*

Questions or comments regarding this final-form rulemaking may be addressed in writing to Peter J. Salvatore, Regulatory Coordinator, Office of Special Projects, 1326 Strawberry Square, Harrisburg, PA 17120, (717) 787-4429. Questions or comments also may be e-mailed to [psalvatore@state.pa.us](mailto:psalvatore@state.pa.us) or faxed to (717) 772-1969.

### *Regulatory Review*

Under section 5(a) of the Regulatory Review Act, (71 P.S. §745.5(a)), the agency submitted a copy of this regulation on September 5, 2002 to the Independent Regulatory Review Commission and to the Chairmen of the House Insurance Committee and the Senate Banking and Insurance Committee. In addition to the submitted regulation, the agency has provided the Commission and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the agency in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." A copy of that material is available to the public upon request.

In preparing this final form regulation, the Department considered all comments received from IRRC, the Committees and the public. This final form regulation was (deemed) approved by the House and Senate Committees on \_\_\_\_\_.

In accordance with section 5a(d) of the Regulatory Review Act (71 P.S. §745.5a(d)), IRRC met on \_\_\_\_\_ and (deemed) approved the regulation in accordance with section 5a(e) of the Regulatory Review Act (71 P.S. §745.5a(e)).

### *Findings*

The Commissioner finds that:

(1) Public notice of intention to adopt this rulemaking as amended by this order has been given under sections 201 and 202 of the act of July 31, 1968 (P.L. 769, No. 240) (45 P.S. §§ 1201 and 1202), and the regulations hereunder, 1 Pa. Code §§ 7.1 and 7.2.

(2) The adoption of this final-form rulemaking in the manner provided in this order is necessary and appropriate for the administration and enforcement of the authorizing statutes.



*Order*

The Commissioner, acting under the authorizing statutes, orders that:

- (1) The regulations of the Department, 31 Pa. Code Chapters 148 and 148a, are amended by deleting §§ 148.1—148.4 and by adding §§ 148a.1—148a.5, to read as set forth in Annex A.
- (2) The Commissioner shall submit this order and Annex A to the Office of General Counsel and Office of Attorney General for approval as to form and legality as required by law.
- (3) The Commissioner shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.
- (4) This order shall take effect upon final publication in the *Pennsylvania Bulletin*.

M. DIANE KOKEN,  
*Insurance Commissioner*

CONTINUATION SHEET FOR FILING DOCUMENTS  
WITH THE LEGISLATIVE REFERENCE BUREAU  
Pursuant to Commonwealth Documents Law

ANNEX A

Title 31. Insurance, Part VIII. Miscellaneous Provisions, Chapter 148. Securities Held Under Custodial Agreements and Participation by Insurers in Depository Trust Companies and Federal Reserve Book Entry Systems.

Sec.

- 148.1. [Purposes.] **Reserved.**  
148.2. [Definitions.] **Reserved.**  
148.3. [Permissible methods of holding securities.] **Reserved.**  
148.4. [Required custodian affidavits.] **Reserved.**

§ 148.1. [Purposes.] **Reserved.**

[(a) This chapter expedites the verification of insurer assets during examinations conducted by the Department, to reduce costs and simplify delivery and receipt procedures involved in security transactions by insurers, to reduce the exposure of securities to loss, theft, misplacement, damage and other destruction, and to better provide for the storage, inspection, transportation, counting and insuring of securities.

(b) Further purposes are to establish procedures for the verification of securities which insurers deposit in banks under custodial agreements, to permit insurers to hold securities in other than definitive certificates, to better safeguard the actual securities, to facilitate checking assets of an insurer and to recognize that definitive securities no longer represent the only tangible evidence of security obligations held by an insurer.] **Reserved.**

§ 148.2. [Definitions.] **Reserved.**

[The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise:

*Department* -- The Insurance Department of the Commonwealth.

*Depository trust company* -- The Depository Trust Company which is organized as a limited purpose trust company under the banking law of New York State and a member of the Federal Reserve System or other like entity which meets similar standards of depository safeguards and regulatory control.

*Federal Reserve book-entry system* -- The systems, sponsored by the United States Department of the Treasury and certain agencies and instrumentalities of the United States, under which the issuing, holding and transferring of securities of the United States Government and the agencies and instrumentalities, respectively, through Federal Reserve Banks and member and nonmember banks the Federal Reserve System are recorded through a series of interconnected accounts.

*Insurer* -- The term includes the following domestics licensed to and transacting business in this Commonwealth: an insurance company, association or exchange; a reciprocal or interinsurance exchange; a hospital plan corporation; a professional health services plan corporation; a corporation coming under

the Voluntary Nonprofit Health Service Act of 1972 (40 P. S. §§ 1551-1568); a fraternal benefit society or beneficial association.

*Securities* -- The term includes but are not limited to bonds, notes, debentures, stock certificates and other like evidence of indebtedness.] **Reserved.**

**§ 148.3. [Permissible methods of holding securities.] Reserved.**

[(a) An insurer may hold securities in definitive certificates.

(b) An insurer may participate in the Federal Reserve book-entry system through a member bank of the Federal Reserve System which, as a custodian, may transact and maintain book-entry securities for the insurer. This subsection does not preclude an insurer from participation in the Federal Reserve book-entry system under a custodial agreement with a nonmember bank through a member bank.

(c) An insurer may participate in depository trust companies or like entities through a custodian bank.] **Reserved.**

**§ 148.4. [Required custodian affidavits] Reserved.**

[(a) Insurers shall have executed the appropriate custodian affidavits -- Form A, Form B, or Form C--- for its securities held under custodial agreements. The executed forms shall be available for purposes of insurers' examinations. Failure to provide the appropriate custodian affidavits will result in the Department's treating as nonadmitted assets those of an insurer's securities held by the custodian. Further, for the purposes of such examinations, the underlying agreement between an insurer and a custodian shall be available. The custodial agreements shall provide: a standard of responsibility on the part of the custodian which may not be less than the responsibility of a bailee for hire or a fiduciary under statutory or case law of the jurisdiction of the custodian's state of domicile, that securities held by the custodian are subject to instructions of the insurer, and that the securities may be withdrawn immediately upon demand of the insurer.

(b) It shall be the responsibility of each insurer which enters into a custodial agreement to determine that the custodian maintains sufficient records to enable the insurer to complete its appropriate investment schedules of its Annual Statement Blank.

(c) The following forms are promulgated as part of this chapter:] **Reserved.**

**[FORM A**

**CUSTODIAN AFFIDAVIT**

(For use by a custodian bank where securities entrusted to its care have not been re-deposited elsewhere.)

STATE OF            )  
                          ) SS:  
COUNTY OF        )

\_\_\_\_\_, being duly sworn deposes and says that he is \_\_\_\_\_ of \_\_\_\_\_, a banking corporation organized under and pursuant to the laws of the \_\_\_\_\_ with the principal place of business at \_\_\_\_\_ (hereinafter called the "bank");

That his duties involve supervision of activities of the bank as custodian and records relating thereto;  
That the bank is custodian for certain securities of \_\_\_\_\_, having a place of business at \_\_\_\_\_ (hereinafter called the "insurer") pursuant to an agreement between the bank and the insurer;

That the schedule attached hereto is a true and complete statement of securities (other than those caused to be deposited with The Depository Trust Company or like entity or a Federal Reserve Bank under the Federal Reserve book entry system) which were in the custody of the bank for the account of the insurer as of the close of business on \_\_\_\_\_ that, unless otherwise indicated on the schedule, the next maturing and all subsequent coupons were then either attached to coupon bonds or in the process of collection; and that, unless otherwise shown on the schedule, all such securities were in bearer form or in registered form in the name of the insurer or its nominee or a nominee of the bank, or were in the process of being registered in such form;

That the bank as custodian has the responsibility for the safekeeping of such securities as that responsibility is specifically set forth in the agreement between the bank as custodian and the insurer; and

That, to the best of his knowledge and belief, unless otherwise shown on the schedule, said securities were the property of said insurer and were free of all liens, claims or encumbrances whatsoever.

Subscribed and sworn to  
before me this \_\_\_\_ day  
of \_\_\_\_\_ 19 \_\_\_\_

\_\_\_\_\_  
(L. S.)  
Vice President or other  
authorized officer]

**[FORM B**

**CUSTODIAN AFFIDAVIT**

(For use where ownership is evidenced by book entry at a Federal Reserve Bank).

STATE OF        )  
                  ) SS:  
COUNTY OF    )

\_\_\_\_\_, being duly sworn deposes and says that he is \_\_\_\_\_ of the \_\_\_\_\_, a banking corporation organized under and pursuant to the laws of the \_\_\_\_\_ with its principal place of business at \_\_\_\_\_ (hereinafter called the "bank");

That his duties involve the supervision of activities of the bank as custodian and records relating thereto;

That the bank is custodian for certain securities of \_\_\_\_\_ with a place of business at \_\_\_\_\_ (hereinafter called the "insurer") pursuant to an agreement between the bank and the insurer;

That it has caused certain of such securities to be credited to a book-entry account with a Federal Reserve Bank under the Federal Reserve book entry system; and that the schedule attached hereto is a true and complete statement of the securities of the insurer of which the bank was custodian as of the close of business on \_\_\_\_\_ which were in a book-entry account maintained in the name of \_\_\_\_\_ on the books and records of a Federal Reserve Bank at such date;

That the bank has the same responsibility for the safekeeping of such securities whether in the possession of the bank or in said book-entry account as that responsibility is specifically set forth in the agreement between the bank as custodian and the insurer; and

That, to the best of his knowledge and belief, unless otherwise shown on the schedule, said securities were the property of said insurer and were free of all liens, claims or encumbrances whatsoever.

Subscribed and sworn to  
before me this \_\_\_\_ day  
of \_\_\_\_ 19 \_\_\_\_

\_\_\_\_ (L. S.)  
Vice President or other  
authorized officer]

[FORM C

CUSTODIAN AFFIDAVIT

(For use in instances where a custodian bank maintains securities on deposit with The Depository Trust Company or like entity).

STATE OF     )  
                  ) SS:  
COUNTY OF    )

\_\_\_\_, being duly sworn deposes and says that he is \_\_\_\_ of the \_\_\_\_\_, a banking corporation organized under and pursuant to the laws of the \_\_\_\_\_ with its principal place of business at \_\_\_\_\_ (hereinafter called the "bank");

That his duties involve supervision of activities of the bank as custodian and records relating thereto;

That the bank is custodian for certain securities of \_\_\_\_\_ with a place of business at \_\_\_\_\_ (hereinafter called the "insurer") pursuant to an agreement between the bank and the insurer;

That the bank has caused certain of such securities to be deposited with \_\_\_\_\_ and that the schedule attached hereto is a true and complete statement of the securities of the insurer of which the bank was custodian as of the close of business on \_\_\_\_\_, and which were so deposited on such date;

That the bank as custodian has the same responsibility for the safekeeping of such securities whether in the possession of the bank or deposited as that responsibility is specifically set forth in the agreement between the bank as custodian and the insurer; and

That, to the best of his knowledge and belief, unless otherwise shown on the schedule, said securities were the property of said insurer and were free from all liens, claims or encumbrances whatsoever.

Subscribed and sworn to  
before me this \_\_\_\_ day  
of \_\_\_\_ 19 \_\_\_\_

\_\_\_\_ (L. S.)  
Vice President or other  
authorized officer]

CONTINUATION SHEET FOR FILING DOCUMENTS  
WITH THE LEGISLATIVE REFERENCE BUREAU  
Pursuant to Commonwealth Documents Law  
ANNEX A

Title 31. Insurance, Part VIII. Miscellaneous Provisions, Chapter 148a. Safeguarding Insurer Securities.

Sec.

148a.1. Definitions.

148a.2. Permissible methods of holding securities.

148a.3. Requirements for custodial agreements.

148a.4. Requirements for investment company securities.

148a.5. Penalty and existing custodial agreements.

§ 148a.1. Definitions.

The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise:

*Agent* –

(i) A national bank, state bank or trust company that does any of the following:

(A) Maintains an account in its name in a clearing corporation.

(B) Is a member of the Federal Reserve System through which a custodian participates in a clearing corporation or the Federal Reserve book-entry system.

(ii) With respect to securities issued by institutions organized or existing under the laws of a foreign country or securities used to meet the deposit requirements under the laws of a foreign country as a condition of doing business in that country, the term may include a corporation organized or existing under the laws of a foreign country and legally qualified under those laws to accept custody of securities.

*Authorized person* – A person authorized in writing by an insurer's board of directors to issue instructions relating to the insurer's securities held by a custodian.

Clearing corporation –

(i) A clearing corporation as defined in 13 Pa.C.S. § 8102 (relating to definitions) and organized for the purpose of effecting transactions in securities by computerized book-entry.

(ii) With respect to securities issued by institutions organized or existing under the laws of a foreign country or securities used to meet the deposit requirements under the laws of a foreign country as a condition of doing business in that country, the term may include a corporation organized or existing under the laws of a foreign country and legally qualified under those laws to effect transactions in securities by computerized book-entry.

Custodian –

(i) A National bank, FEDERAL SAVINGS BANK, state bank, or trust company that is:

(A) Adequately capitalized as determined CAPITALIZED AS REQUIRED by the standards adopted by United States banking regulators.

(B) Either regulated by FEDERAL OR state banking laws or a member of the Federal Reserve System.

(C) Legally qualified to accept custody of securities as required under § 148a.3 (relating to requirements for custodial agreements).

(ii) With respect to securities issued by institutions organized or existing under the laws of a foreign country or securities used to meet deposit requirements under the laws of a foreign country as a condition of doing business in that country, the term may include a bank that is:

(A) Incorporated or organized under the laws of a foreign country.

(B) Regulated as a bank by that country's government, or an agency thereof.

(C) Adequately capitalized as determined CAPITALIZED AS REQUIRED by the standards adopted by international banking authorities.

(D) Legally qualified to accept custody of securities as required under § 148a.3.

Department -- The Insurance Department of the Commonwealth.

Federal Reserve book-entry system -- The computerized systems sponsored by the United States Department of the Treasury and certain agencies and instrumentalities of the United States for holding and transferring securities of the United States Government and its agencies and instrumentalities in Federal Reserve Banks through banks that are members of the Federal Reserve System or that otherwise have access to the computerized systems.

Foreign country -- A nation, province or territory other than the United States or a state thereof.

Instructions --

(i) A written statement that:

(A) States the specific purpose of the requested action.

(B) Identifies the specific transaction or type of transaction to which the requested action relates.

(C) Contains the signature of at least one authorized person.

(D) Is received by letter, facsimile or other form of electronic transmission whereby a custodian is able to verify with a reasonable degree of certainty the identity of the sender.

(ii) The verbal instructions of an authorized person if:

(A) The custodian is able to verify with a reasonable degree of certainty the identity of the sender.



(B) The verbal instructions are confirmed promptly—WITHIN 24 HOURS by written instructions.

Insurer -- The following entities domiciled and licensed to transact business in this Commonwealth:

- (i) An insurance company, association or exchange.
- (ii) A reciprocal or interinsurance exchange.
- (iii) An employers' mutual liability insurance association.
- (iv) A nonprofit health plan corporation, whether operating a hospital plan or a professional health services plan, or both.
- (v) A fraternal benefit society or beneficial association.
- (vi) A health maintenance organization.
- (vii) A preferred provider organization.
- (viii) The Industry Placement Facility under The Pennsylvania Fair Plan Act (40 P.S. §§ 1600.101--1600.502).
- (ix) A joint underwriting association under Article VII of the Health Care Services Malpractice Act (40 P.S. §§ 1301.801—1301.811).
- ~~(x) Another person, corporation, company, partnership, association or other entity acting as an insurer.~~

Investment company – An entity registered and regulated as an investment company under the Investment Company Act of 1940 (15 U.S.C.A. §§ 80a-1--80a-64).

Investment company securities – Stocks or shares issued by an investment company.

Registered form – A form of certificated security as defined in 13 Pa.C.S. § 8102.

Securities –

(i) Certificated securities and uncertificated securities as defined in 13 Pa.C.S. § 8102.

(ii) The term includes short-term and long-term investments but does not include investment company securities.

State –

(i) A state, territory or possession of the United States.

(ii) The District of Columbia.

(iii) Puerto Rico.

§ 148a.2. Permissible methods of holding securities.

(a) An insurer may hold its securities in definitive certificates.

(b) An insurer may provide for its securities to be held by a custodian under a custodial agreement as required under § 148a.3 (relating to requirements for custodial agreements).

Securities held under a custodial agreement shall be held by:

(1) The custodian.

(2) The custodian's agent.

(3) A clearing corporation.

(4) The Federal Reserve book-entry system.

(c) An insurer's investment company securities may be held by the investment company that issued the investment company securities as required under § 148a.4 (relating to requirements for investment company securities).

(d) An insurer may provide for its securities to be held in the custody of AS REQUIRED BY a state treasurer or other state regulatory authority to meet deposit requirements as a condition of doing business in that state.

§ 148a.3. Requirements for custodial agreements.

(a) An agreement between an insurer and a custodian providing for the custody of the insurer's securities UNDER § 148a.2(b) (RELATING TO PERMISSIBLE METHODS OF HOLDING SECURITIES shall be:

(1) In writing.

(2) Authorized by a resolution of either the insurer's board of directors or an authorized committee of its board of directors.

(3) Signed by at least one officer of the insurer and one officer of the custodian.

(b) A custodial agreement shall contain at least the following provisions:

(1) The custodian shall hold the securities subject to the insurer's instructions. In the event of a discrepancy or dispute, verbal instructions shall be superseded by written instructions. The securities shall be withdrawable immediately upon receipt of the insurer's written instructions.

(2) The custodian may not have a security interest or lien in any securities held under the agreement.

(3) The custodian may utilize an agent to gain entry in a clearing corporation or in the Federal Reserve book-entry system or for other services if THE CUSTODIAN ENTERS INTO A WRITTEN AGREEMENT WITH THE AGENT WHEREBY:

(i) ~~The custodian enters into a written agreement with the agent whereby the~~ THE securities OF ONE OR MORE INSURERS will be held as required under this chapter.

(ii) The custodian retains ultimate responsibility for the safekeeping of the insurer's securities and for compliance with the terms and conditions of the custodial agreement as required under this chapter.

(iii) THE CUSTODIAN PROVIDES THE INSURER WITH NOTICE WITHIN 5 BUSINESS DAYS OF THE UTILIZATION OF AN AGENT. THE NOTICE SHALL INCLUDE, AT A MINIMUM, THE IDENTITY OF THE AGENT, THE DATE OF THE CUSTODIAN'S WRITTEN AGREEMENT WITH THE AGENT, AND AN ACKNOWLEDGEMENT THAT THE CUSTODIAN HAS RETAINED RESPONSIBILITY FOR THE INSURER'S SECURITIES AS REQUIRED UNDER SUBPARAGRAPH (ii).

(4) Securities in registered form shall be registered in the name of the insurer, the insurer's nominee, the custodian's nominee or, if held by a clearing corporation, in the name of the clearing corporation or its nominee.

(5) Certificated securities shall be held by the custodian in a separate account established to hold only the insurer's securities under the custodial agreement.

(6) Securities held in a clearing corporation or in the Federal Reserve book-entry system shall be separately identified on the custodian's records as being owned by the insurer.

(7) The custodian's records shall identify which securities are held by the custodian or by its agent and which securities are in a clearing corporation or in the Federal Reserve book-entry system.

(8) The custodian's records shall identify the location of securities held in a clearing corporation or in the Federal Reserve book-entry system and, if applicable, the name of the clearing corporation and the name of the agent.

(9) The custodian shall provide a statement that it has secured and will maintain adequate insurance protection as required by the custodian's banking regulator to cover its duties and activities as custodian of the insurer's assets.

(10) The custodian shall be obligated to indemnify the insurer for any loss of securities occasioned by the negligence or dishonesty of the custodian's officers or employees, or by burglary, robbery, holdup, theft or mysterious disappearance, including loss by damage or destruction, except that the. THE agreement may provide that the custodian will not be liable for failure to take an action required under the agreement in the event and to the extent that the taking of the action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosion, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control.

(11) In the event of a loss of securities for which the custodian is obligated to indemnify the insurer under paragraph (10), the custodian shall immediately replace the following:

(i) The securities or the value thereof.

(ii) The value of any loss of rights or privileges resulting from the loss of the securities.

(12) The custodian shall provide the Department with written notice if the agreement is terminated or if 100% of the assets are withdrawn from one or more custodial accounts established under the agreement. The notice shall be directed to the attention of the Deputy Insurance Commissioner for the Office of Regulation of Companies and provided within 3 business days 24 HOURS of the custodian's receipt of the insurer's notice terminating the

agreement or within 3 business days 24 HOURS of the withdrawal of 100% of the assets in one or more custodial accounts established under the agreement. The notice shall include the date of termination or 100% withdrawal and a list of the securities held on that date.

(13) The custodian shall provide the insurer with the following:

(i) Written reports on at least a monthly basis of holdings of the insurer's securities, including written confirmations of all transfers of securities to or from the insurer's account.

(ii) Annual reports of the review of the insurer's trust accounts by the custodian's trust committee.

(14) If requested in writing by an authorized person, the custodian shall provide the following INFORMATION WITHIN 30 DAYS OF THE CUSTODIAN'S RECEIPT OF THE WRITTEN REQUEST:

(i) Reports from a clearing corporation or the Federal Reserve book-entry system.

(ii) ~~Reports~~ INTERNAL OR EXTERNAL REPORTS on the custodian's system of internal control ~~prepared by an outside auditor retained by the custodian.~~

(15) Reports and confirmations provided by the custodian may be transmitted in electronic or paper form.

(16) The custodian shall maintain records and information sufficient to enable the insurer to:

(i) Comply with accounting and reporting requirements for financial statements and supporting schedules filed with the Department, to the extent that information maintained by the custodian is relied upon by the insurer to prepare its financial statements.

(ii) Provide information required in an audit or A financial examination of the insurer UNDER ARTICLE IX OF THE INSURANCE DEPARTMENT ACT OF 1921 (40 P.S. §§ 323.1—323.8) OR AN AUDIT, including, the identifying numbers assigned to the securities by the Committee on Uniform Securities Identification Procedures (CUSIP).

(17) Upon receipt of a written request signed by an authorized person, the custodian shall:

(i) Allow officers or employees of the insurer, independent accountants retained by the insurer, and representatives of regulatory agencies to examine the custodian's records relating to the insurer's account on the custodian's premises and during the custodian's normal business hours.

(ii) Provide copies of its records relating to the insurer's account.

(iii) Provide, WITHIN 30 DAYS OF RECEIPT OF THE WRITTEN REQUEST, an affidavit sworn to and subscribed by an authorized officer of the custodian and containing language substantially similar to the following:

CUSTODIAN AFFIDAVIT

\_\_\_\_\_, being duly sworn deposes and says that he/she is  
\_\_\_\_\_ of \_\_\_\_\_, a banking corporation organized under and  
pursuant to the laws of the \_\_\_\_\_ with the principal place of business at  
\_\_\_\_\_ (hereinafter called the "bank");

That his/her duties involve supervision of activities of the bank as custodian and records relating thereto;

That the bank is custodian for certain securities of \_\_\_\_\_, having a place of business at \_\_\_\_\_ (hereinafter called the "insurer") pursuant to an agreement between the bank and the insurer;

That the schedules attached hereto are true and complete statements of securities that, as of the close of business on \_\_\_\_\_ were:

*(check all that apply)*

\_\_\_\_\_ (1) In the custody of the bank for the account of the insurer; that, unless otherwise indicated on the schedule, the next maturing and all subsequent coupons were either attached to coupon bonds or in the process of collection; and that, unless otherwise indicated on the schedule, all such securities were in bearer form or in registered form in the name of the insurer, the insurer's nominee, the custodian's nominee or, if held by a clearing corporation, in the name of the clearing corporation or its nominee, or were in the process of being registered in such form.

\_\_\_\_\_ (2) Credited to a book-entry account with a Federal Reserve Bank under the Federal Reserve book-entry system and in a book-entry account maintained in the name of \_\_\_\_\_ on the books and records of a Federal Reserve bank at such date.

\_\_\_\_\_ (3) Deposited with \_\_\_\_\_ (a clearing corporation).



That the custodian has the responsibility for the safekeeping of such securities whether in the possession of the bank, credited to a book-entry account with a Federal Reserve Bank under the Federal Reserve book-entry system or deposited with a clearing corporation, as that responsibility is specifically set forth in the agreement between the bank as custodian and the insurer; and

That, to the best of his/her knowledge and belief, unless otherwise shown on the schedule, said securities were the property of said insurer and were free of all liens, claims or encumbrances whatsoever.

§ 148a.4. Requirements for investment company securities.

An insurer's investment company securities may be held by the investment company that issued the investment company securities if the investment company:

(1) Provides the insurer with written reports on at least a monthly basis of the insurer's investment, including written confirmations of all transfers of investments to or from the insurer's account. The reports and confirmations may be transmitted in electronic or paper form.

(2) Maintains records and information sufficient to enable the insurer to:

(i) Comply with accounting and reporting requirements for financial statements and supporting schedules filed with the Department, to the extent that information maintained by the investment company is relied upon by the insurer to prepare its financial statements.

(ii) Provide information required in ~~an audit or~~ A financial examination of the insurer UNDER ARTICLE IX OF THE INSURANCE DEPARTMENT ACT OF 1921 (40 P.S. §§ 323.1—323.8) OR AN AUDIT, including, the identifying numbers assigned to the securities by the Committee on Uniform Securities Identification Procedures (CUSIP).

§148a.5. Penalty and existing custodial agreements.

(a) Failure to comply with this chapter will result in the treatment of an insurer's securities or investment company securities as nonadmitted assets for purposes of financial reports filed with the Department; ~~except that, with~~

(b) WITH respect to custody agreements entered into prior to \_\_\_\_\_ (*Editor's Note: The blank refers to the effective date of adoption of this rulemaking.*) and in compliance with laws or regulations in existence immediately preceding (the effective date of this rulemaking), insurers have until \_\_\_\_\_ (*Editor's Note: The blank refers to a date 1 year from the effective date of the adoption of this rulemaking.*) to achieve compliance with this chapter.



**COMMONWEALTH OF PENNSYLVANIA  
INSURANCE DEPARTMENT**

**SPECIAL PROJECTS OFFICE**  
1326 Strawberry Square  
Harrisburg, PA 17120

Phone: (717) 787-4429  
Fax: (717) 772-1969  
E-mail: [psalvatore@state.pa.us](mailto:psalvatore@state.pa.us)

September 5, 2002

Mr. Robert Nyce  
Executive Director  
Independent Regulatory Review Comm.  
333 Market Street  
Harrisburg, PA 17101

Re: Insurance Department Final  
Form Regulation No. 11-204,  
Safeguarding Insurer  
Securities

Dear Mr. Nyce:

Pursuant to Section 5a(c) of the Regulatory Review Act, enclosed for your review and approval is final form regulation 31 Pa. Code, Chapter 148a, Safeguarding Insurer Securities.

This final form rulemaking replaces the regulations relating to insurer securities initially adopted June 12, 1981, with updated regulations. Securities owned by insurers are liquid assets held to allow the payment of the insurer's obligations as they come due. This rulemaking will update the regulations to recognize changes in the securities marketplace and to better safeguard against the theft or loss of insurer securities.

If you have any questions regarding this matter, please contact me at (717) 787-4429.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Peter J. Salvatore".

Peter J. Salvatore  
Regulatory Coordinator



**TRANSMITTAL SHEET FOR REGULATIONS SUBJECT TO THE  
REGULATORY REVIEW ACT**

I.D. NUMBER: 011-204  
 SUBJECT: Safeguarding Insurer Securities  
 AGENCY: DEPARTMENT OF INSURANCE

**TYPE OF REGULATION**

- Proposed Regulation
- Final Regulation
- Final Regulation with Notice of Proposed Rulemaking Omitted
- 120-day Emergency Certification of the Attorney General
- 120-day Emergency Certification of the Governor
- Delivery of Tolled Regulation
  - a. With Revisions
  - b. Without Revisions

RECEIVED  
 REGULATORY COMMISSION  
 2002 SEP -5 PM 3:27

**FILING OF REGULATION**

DATE	SIGNATURE	DESIGNATION
9/5/02	<i>M.E. Hetchel</i>	HOUSE COMMITTEE ON INSURANCE
4/5/02	<i>Stella Capant</i>	
9/5/02	<i>Spencer P. Hibel</i>	SENATE COMMITTEE ON BANKING & INSURANCE
9/5/02	<i>J. McDaniel</i>	
9/5/02	<i>E. Pagan</i>	INDEPENDENT REGULATORY REVIEW COMMISSION
_____	_____	ATTORNEY GENERAL
_____	_____	LEGISLATIVE REFERENCE BUREAU

September 3, 2002