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INDEPENDENT REGULATORY REVIEW COMMISSION
333 MARKET STREET, 14TH FLOOR, HARRISBURG, PA 17101

June 13, 2002

Honorable M. Diane Koken, Commissioner
Insurance Department
1326 Strawberry Square
Harrisburg, PA 17120

Re: Regulation #11-204 (IRRC #2263)
Insurance Department
Safeguarding Insurer Securities

Dear Commissioner Koken:

Enclosed are the Commission's Comments which list objections and suggestions for consideration when you prepare the final version of this regulation. These Comments are not a formal approval or disapproval; however, they specify the regulatory criteria which have not been met.

The Comments will soon be available on our website at www.irrc.state.pa.us. If you would like to discuss them, please contact my office at 783-5417.

Sincerely,

Robert E. Nyce
Executive Director
evp
Enclosure

cc: Honorable Nicholas A. Micozzie, Majority Chairman, House Insurance Committee
Honorable Anthony DeLuca, Democratic Chairman, House Insurance Committee
Honorable Edwin G. Holl, Chairman, Senate Banking and Insurance Committee
Honorable Jack Wagner, Minority Chairman, Senate Banking and Insurance Committee

Comments of the Independent Regulatory Review Commission

on

Insurance Department Regulation No. 11-204

Safeguarding Insurer Securities

June 13, 2002

We submit for your consideration the following objections and recommendations regarding this regulation. Each objection or recommendation includes a reference to the criteria in the Regulatory Review Act (71 P.S. § 745.5a(h) and (i)) which have not been met. The Insurance Department (Department) must respond to these Comments when it submits the final-form regulation. If the final-form regulation is not delivered within two years of the close of the public comment period, the regulation will be deemed withdrawn.

1. Section 148a.1. Definitions. – Clarity.

Custodian

In Subsections (i)(A) and (ii)(C) the phrase “adequately capitalized” is used. The word “adequately” is unnecessary and should be deleted from both of these Subsections.

A Federal Savings Bank commented that while they are not a member of the Federal Reserve System, they are regulated by the Office of Thrift Supervision and meet all other requirements for the definition of “custodian”. Why isn’t a Federal Savings Bank included in the definition of custodian?

Instructions

Subsection (ii)(B) states that verbal instructions are to be followed “promptly” by written instructions. The Department should replace the term “promptly” with a specific time frame in which they will require written instructions.

Insurer

In Subsection (x) the Department has included the phrase “other entity” as an insurer. This phrase is vague and should be deleted.

State

Both the District of Columbia, listed in Subsection (ii), and Puerto Rico, listed in Subsection (iii), are territories as listed in Subsection (i). Therefore, Subsections (ii) and (iii) are unnecessary.

2. Section 148a.2. Permissible methods of holding securities. – Clarity.

Under Subsection (d), will custodial agreements be required for insurers' securities held by a state treasurer or other regulatory authority? If not, this section should be clarified.

3. Section 148a.3. Requirements for custodial agreements. – Clarity.

We have several concerns with Subsection (b).

Paragraph (3) allows a custodian to utilize an agent to gain entry in a clearing corporation or the Federal Reserve book-entry system. We have two concerns with this subsection. First, the regulation does not contain a provision that the insurer must be notified if a custodian enters an agreement with an agent. Second, Subparagraph (ii) contains the phrase "ultimate responsibility." The word "ultimate" is superfluous and should be deleted from the final-form regulation.

Paragraph (10) is one sentence that contains two separate provisions. It requires custodians to indemnify the insurer for any loss of securities in certain circumstances (e.g. burglary, mysterious disappearance). It also states that a custodial agreement may provide that the custodian will not be liable for failure to take action under other circumstances (e.g. war, act of God, strikes). For clarity, the final-form regulation should divide this paragraph into two sentences.

Paragraph (12) requires a custodian to notify the Department if a custodial agreement is terminated or if 100% of the assets are withdrawn from the account. This notice must be provided to the Department within three days.

We question why the Department set the trigger for notification at 100% of all assets. Any time a substantial amount of an insurers' securities are withdrawn the Department should be notified. The Department should consider setting a lower rate to trigger notification.

In addition, if the intent is to insure that adequate resources are maintained, wouldn't the Department want to know as soon as possible, such as within 24 hours, that substantial holdings have been withdrawn?

The Preamble notes that Paragraphs (13)—(17) address record-keeping and reporting duties under the custodial agreements. It states that these sections assure that the custodian is aware of its responsibilities to provide the Department with timely access to information required in a financial examination conducted under Article IX of the Insurance Act of 1921 (40 P.S. §§ 323.1—323.8). For clarity, the final-form regulation should include a reference to this statute.

Paragraph (14) requires the custodian to provide certain information to the insurer if the request is made in writing. The final-form regulation should provide a specific time frame for submission of the required information by the custodian.

In addition, will an internal audit meet the requirements in Subparagraph (ii)?

4. Section 148a.4. Requirements for investment company securities. – Reasonableness.

This section allows an insurer's investment company securities to be held by the investment company if two conditions are met. First, the investment company must provide the insurer with reports on at least a monthly basis. Second, the investment company must maintain records and

information to enable the insurer to comply with certain requirements of the Department, and provide the information required for an audit or financial examination of the insurer.

Since custodial agreements are not required between an insurer and an investment company, how would an insurer or the Department be certain that the investment company is maintaining records required by Subsection (2)?

5. Section 148.a.5. Penalty and existing custodial agreements. – Clarity.

This section includes two different topics, penalty and existing custodial agreements. For clarity, this section should be divided into two subsections, one for penalty and one for existing custodial agreements.