

PROPOSED RULEMAKING

DELAWARE RIVER BASIN COMMISSION

[25 PA. CODE CH. 901]

Proposed Amendments to the Administrative Manual—Rules of Practice and Procedure Concerning Fees Associated with Responses to FOIA Requests

The Delaware River Basin Commission (Commission) will hold a public hearing to receive comments on proposed amendments to the Commission's *Administrative Manual—Rules of Practice and Procedure*, 25 Pa. Code § 901.1, updating the fee schedule associated with Commission responses to Freedom of Information Act (FOIA) requests. The current schedule of fees was promulgated in 1975 and has not been updated since. Over the past quarter of a century, computer technologies have introduced new methods of recording and reproducing information that were not contemplated by the 1975 regulations, and administrative costs have increased. The proposed fee structure reflects current technology and costs.

Dates

The public hearing will be held on Friday, May 31, 2002, during the Commission's regular business meeting, which will begin at 1 p.m. The meeting on May 31, 2002, must end by 3 p.m., but if necessary, the hearing will continue at the Commission's next scheduled business meeting until all those who wish to testify are afforded an opportunity to do so. Persons wishing to testify are asked to register in advance with the Commission Secretary, (609) 883-9500 ext. 203. Written comments will be accepted through the close of the public hearing; however, earlier submittals would be appreciated.

Addresses

The public hearing will be held at Grey Towers National Historic Landmark, 151 Grey Towers Drive, Milford, PA. Directions will be posted on the Commission's website at <http://www.drbc.net> by April 1, 2002. Written comments should be addressed to the Commission Secretary, Delaware River Basin Commission, P. O. Box 7360, West Trenton, NJ 08628-0360.

Further Information, Contacts

Contact Pamela Bush at (609) 883-9500 ext. 203 with questions about the proposed amendments or the rule-making process. Notice also is posted on the Commission's website at <http://www.drbc.net>.

It is proposed to amend Article 8, Section 2.8.10 "Fees" of the *Administrative Manual—Rules of Practice and Procedure*, by striking the language of sub-section A of that section and replacing it with the following:

A. Unless waived in accordance with the provisions of Section 2.8.11, the following fees shall be imposed for production of any record pursuant to this part.

1. Administrative Fees.

a. Charges for administrative fees include staff time associated with:

- (i) Processing FOIA requests;
- (ii) Locating and reviewing files;
- (iii) Monitoring file reviews;

(iv) Generating computer records (electronic print-outs); and

(v) Preparing logs of records deemed non-public.

b. Administrative charges will be calculated as follows: Administrative charges will be billed to the requester per quarter hour following the first quarter hour. These charges will be billed at the current, hourly paygrade rate (pro-rated for quarter hour increments) of the personnel performing the service. Administrative charges will be in addition to any copying charges.

c. Appointment Rescheduling/Cancellation—Requesters that do not reschedule or cancel appointments to view files at least one full business day in advance of the appointment may be subject to the administrative charges incurred by the Commission in preparing the requested records. The Commission will prepare an itemized invoice of these charges and mail it to the requester for payment.

2. *Photocopying Fees*—The following are charges for photocopies of public records made by Commission personnel:

a. Standard Sized, Black and White Copies

The charge for copying standard sized, black and white public records shall be \$0.15 per printed page (i.e., single-sided copies are \$0.15 and double-sided copies are \$0.30). This charge applies to copies on the following standard paper sizes:

- (i) 8.5" × 11"
- (ii) 8.5" × 14"
- (iii) 11" × 17"

b. Color Copies/Printouts

The charge for color copies or color printouts shall be as follows:

- (i) 8.5" × 11"—\$1.00 per page
- (ii) 8.5" × 14"—\$1.50 per page
- (iii) 11" × 17"—\$2.00 per page

(iv) The charge for all color copies larger than 11" x 17" (including, but not limited to: photographic imagery, GIS print-outs, and maps) shall be calculated at the rate of \$2.50 per square foot.

c. Electronically Generated Records

Charges for copying records maintained in electronic format will be calculated by the material costs involved in generating the copies (including, but not limited to: magnetic tape, diskette, or compact disc costs) and administrative costs.

d. Other Copying Fees

The Commission, at its discretion, may arrange to have records copied by an outside contractor if the Commission does not have the resources or equipment to copy such records. In this instance, the requester will be liable for payment of these costs.

3. Forwarding material to destination. Postage, insurance, and special fees will be charged on an actual cost basis.

PAMELA M. BUSH,
Secretary

Fiscal Note: 68-41. No fiscal impact; (8) recommends adoption.

(Editor's Note: The notice which appeared at 32 Pa.B. 1661 (March 30, 2002) was published prematurely. This document is the official Notice of Proposed Rulemaking of the Delaware River Basin Commission regarding § 901.1 (relating to rules of practice and procedure.)

Annex A

TITLE 25. ENVIRONMENTAL PROTECTION

PART V. DELAWARE RIVER BASIN COMMISSION

CHAPTER 901. GENERAL PROVISIONS

§ 901.1. Rules of Practice and Procedure.

The rules of practice and procedure as set forth in 18 CFR 401 (2002) are hereby incorporated by reference and made a part of this title.

[Pa.B. Doc. No. 02-571. Filed for public inspection April 12, 2002, 9:00 a.m.]

INSURANCE DEPARTMENT

[31 PA. CODE CH. 83a]

Life Insurance; Annuity Disclosure

The Insurance Department (Department) proposes to add Chapter 83a (relating to annuity disclosure) to read as set forth in Annex A. The proposal is made under the authority of sections 205, 506, 1501 and 1502 of The Administrative Code of 1929 (71 P. S. §§ 66, 186, 411 and 412). Likewise, this proposal is made under the Department's rulemaking authority in the Unfair Insurance Practices Act (40 P. S. §§ 1171.1—1171.15) (as such authority is further explained in *PALU v. Insurance Department*, 371 A.2d 564 (Pa. Cmwlth. 1977)), because the Insurance Commissioner has determined that the inadequate disclosure of key elements of annuity contracts by members of the insurance industry constitutes an unfair method of competition and an unfair or deceptive act or practice.

Purpose

The purpose of this rulemaking is to add Chapter 83a to provide new consumer protections that apply to certain individual annuity contracts and riders and group certificates and certificate riders. This proposed rulemaking would require insurers and insurance producers selling certain types of annuity products in this Commonwealth to provide their consumers with a simplified document that discloses important components of the annuity contract. These components include, inter alia, any applicable interest rates, bonuses and persistency credits as well as any fees, surrender charges or value reductions caused by contract withdrawals. With the information provided in the disclosure statement, an insurance consumer will be able to more adequately and completely understand the nature of the annuity product that is being purchased or applied for, thereby allowing the consumer to make a more informed decision on the suitability of the contracts. This proposed rulemaking is not intended to prohibit insurers or producers from using, in the sale of an annuity contract, additional material or disclosures which are not in violation of this proposed rulemaking or any other law or regulation currently in effect.

The Department worked closely with this Commonwealth's insurance industry on the development of this proposed rulemaking. The Department shared this pro-

posed rulemaking with the agent associations and the insurance industry trade groups. Informal meetings were held with members of the industry to discuss earlier drafts of the regulation. Comments were received from members of the agents association and the insurance industry, and these comments were taken into consideration during the drafting of this proposed rulemaking.

Explanation of Regulatory Changes

Section 83a.1 (relating to purpose) is being proposed to explain the purpose of the chapter.

Section 83a.2 (relating to applicability) explains the exemptions to the rulemaking.

Sections 83a.3 (relating to definitions) defines the terms used in this rulemaking.

Section 83a.4 (relating to disclosure statement delivery) describes the procedures to be followed for face-to-face solicitation and solicitations made in other manners, such as through telephonic and electronic means.

Section 83a.5 (relating to disclosure statement) describes the elements that are necessary to provide a consumer with a complete and adequate disclosure statement.

Section 83a.6 (relating to use and nonmodification of annuity disclosure system results) provides that a producer may not alter or modify the results of an annuity disclosure system that is provided or approved in writing by the insurer.

Section 83a.7 (relating to Department right of review of disclosure statements) describes when the Department may ask for submission of a completed disclosure statement.

Section 83a.8 (relating to report to contract owners) describes the insurer's responsibility to provide a report at least annually to consumers purchasing certain deferred annuity contracts.

Section 83a.9 (relating to penalties) describes the enforcement actions and penalties that the Department may consider for violating this chapter.

Fiscal Impact

There will be a minor fiscal impact as a result of the proposed rulemaking. Insurers will be required to provide a disclosure to the consumer. The disclosure must be separate from the annuity contract, thereby creating some additional costs will be incurred in the production and provision of the disclosure. Any fiscal impact on insurers or insurance producers is expected to be relatively minimal, especially when compared to the important value that consumers will gain in being provided the disclosure statements for consideration when purchasing annuity contracts.

Paperwork

The proposed rulemaking will affect all licensed insurers and insurance producers that sell or market annuities in this Commonwealth.

Effectiveness

The rulemaking will become effective upon final-form publication in the *Pennsylvania Bulletin*.

Contact Person

Questions or comments regarding the proposed rulemaking may be addressed in writing to Peter J. Salvatore, Regulatory Coordinator, Insurance Department, 1326 Strawberry Square, Harrisburg, PA 17120,

within 30 days following the publication of this notice in the *Pennsylvania Bulletin*. Questions and comments may also be e-mailed to 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)), on April 4, 2002, the Department submitted a copy of this proposed rulemaking to the Independent Regulatory Review Commission (IRRC) and to the Chairpersons of the Senate Banking and Insurance Committee and the House Insurance Committee. In addition to the submitted proposed rulemaking, the Department has provided IRRC and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the Department in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." A copy of that material is available to the public upon request.

Under section 5(g) of the Regulatory Review Act, if IRRC has objections to any portion of the proposed rulemaking, it will notify the Department within 10 days after the close of the Committees' review. The notification shall specify the regulatory review criteria that have not been met by that portion. The Regulatory Review Act specifies detailed procedures for the Department, the Governor, and the General Assembly to review these objections before final publication of the regulations.

M. DIANE KOKEN,
Insurance Commissioner

Fiscal Note: 11-200. No fiscal impact; (8) recommends adoption.

Annex A

TITLE 31. INSURANCE

PART IV. LIFE INSURANCE

CHAPTER 83a. ANNUITY DISCLOSURE

Sec.	
83a.1.	Purpose.
83a.2.	Applicability.
83a.3.	Definitions.
83a.4.	Disclosure statement delivery.
83a.5.	Disclosure statement.
83a.6.	Use and nonmodification of annuity disclosure system results.
83a.7.	Department right of review of disclosure statements.
83a.8.	Report to contract owners.
83a.9.	Penalties.

§ 83a.1. Purpose.

The purpose of this chapter is to:

- (1) Provide standards for the disclosure of certain minimum information about annuity contracts to protect consumers and foster consumer education.
- (2) Specify the minimum information which must be disclosed and the method for disclosing the information in connection with the sale of annuity contracts.
- (3) Ensure that purchasers of annuity contracts understand certain basic features of the contracts being purchased.

§ 83a.2. Applicability.

This chapter applies to all individual annuity contracts and riders and group certificates and certificate riders except transactions involving the following:

- (1) Group annuities used to fund prearranged funeral contracts.

- (2) Registered or nonregistered variable annuities, or other registered products subject to the prospectus delivery requirements of the Securities Act of 1933 (15 U.S.C.A. §§ 77a—77aa).

- (3) Immediate annuities that do not contain any nonguaranteed elements.

- (4) Annuity contracts used to fund any of the following plans:

- (i) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act of 1974 (ERISA) (29 U.S.C.A. §§ 1001—1461).

- (ii) A plan described by section 401(a), 401(k) or 403(b) of the Internal Revenue Code (26 U.S.C.A. §§ 401(a), 401(k) and 403(b)), when the plan, for purposes of ERISA, is established or maintained by an employer.

- (iii) A governmental or church plan as defined in section 414 of the Internal Revenue Code (26 U.S.C.A. § 414).

- (iv) A deferred compensation plan of a state or local government or tax exempt organization under section 457 of the IRC (26 U.S.C.A. § 457).

- (v) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

(5) Notwithstanding paragraph (4), the requirements of this chapter apply to annuities used to fund a plan or arrangement that is funded solely by contributions an employee elects to make, whether on a pretax or after-tax basis, and when the insurer has been notified that plan participants may choose from among two or more fixed annuity providers and there is a direct solicitation of the individual employee by a producer for the purchase of an annuity contract. As used in this subsection, "direct solicitation" does not include any meeting held by a producer solely for the purpose of educating individuals about the plan or arrangement or enrolling individuals in the plan or arrangement.

(6) A structured settlement annuity.

§ 83a.3. Definitions.

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

Agent—As defined in section 601 of The Insurance Department Act of 1921 (40 P. S. § 231).

Application—The first form used by the producer or the insurer that constitutes or captures the applicant's request for an annuity contract or that captures from the applicant information needed to issue an annuity contract.

Bonus—An amount credited to the account value, cash surrender value or annuitization value of a contract in addition to the credited interest rates.

Broker—As defined in section 622 of The Insurance Department Act of 1921 (40 P. S. § 252).

Commissioner—The Insurance Commissioner of the Commonwealth.

Contract—Any individual annuity contract or rider or group annuity certificate or certificate rider.

Contract owner—The owner named in the annuity contract or certificate holder in the case of a group annuity contract.

Department—The Insurance Department of the Commonwealth.

Determinable elements—The premiums, crediting interest rates, benefits, values, bonuses, persistency credits, noninterest based credits, charges, fees and elements of formulas used to determine any of these that are guaranteed at issue but not determined until some point in time after issue. The processes or methods that are applied to derive the determinable elements are guaranteed at issue and not subject to insurer discretion. An element is considered determinable if it was calculated from underlying determinable elements only, or from both determinable and guaranteed elements.

Direct response solicitation—A solicitation of an annuity through a sponsoring or endorsing organization or individually through the mail, telephone, Internet or other mass communication medium.

Equity indexed annuity—An annuity contract with interest credits or benefits that are linked to an external equity reference or an equity index.

Generic name—A short title descriptive of the annuity contract, any supplemental built in benefit being disclosed. Examples of acceptable generic names are “single premium deferred annuity” and “equity indexed deferred annuity.”

Guaranteed elements—The premiums, crediting interest rates, benefits, values, bonuses, persistency credits, noninterest based credits, charges, fees and elements of formulas used to determine any of these, that are guaranteed and determined at issue of the contract. An element is considered guaranteed if all of the underlying elements that are used in its calculation are guaranteed.

Guaranteed minimum interest rate—The underlying guaranteed interest rate.

Insurer—A life insurance company licensed under section 202 of The Insurance Company Law of 1921 (40 P. S. § 382) or a fraternal benefit society licensed under the Fraternal Benefit Societies Code (40 P. S. §§ 1142-101—1142-701).

Internet—The global information system comprised of independent computer networks which are interconnected and share information without the use of a central processing center by use of the transmission control protocol/internet protocol (TCP/IP) suite, to include without limitation, the World Wide Web, proprietary or “common carrier” electronic delivery systems or similar media.

Nonguaranteed elements—The premiums, crediting interest rates, benefits, values, bonuses, persistency credits, noninterest based credits, charges, fees and elements of formulas used to determine any of these, that are subject to insurer discretion and are not guaranteed at issue of the contract. An element is considered nonguaranteed if any of the underlying elements that are used in its calculation are nonguaranteed.

Producer—An agent or broker.

Prominent type—Font or formatting techniques which differentiate selected text from other text. The term includes, for example, capital letters, contrasting color and underscoring.

Structured settlement annuity—A qualified funding asset as defined in section 130(d) of the Internal Revenue Code (26 U.S.C.A. § 130(d)) or an annuity that would be a qualified funding asset under section 130(d) of the Internal Revenue Code but for the fact that it is not owned by an assignee under a qualified assignment.

§ 83a.4. Disclosure statement delivery.

(a) *Face-to-face solicitation*. When the application for an annuity contract to which this chapter applies is taken in a face-to-face meeting, the applicant shall be given an annuity disclosure statement in compliance with this chapter no later than the time the application for the annuity is signed.

(b) *Other than face-to-face solicitation*. When the application for an annuity contract to which this chapter applies is taken by means other than in a face-to-face meeting, the applicant shall be provided with an annuity disclosure statement in compliance with this chapter no later than 5 business days after the completed annuity application is received by the insurer or producer or at the time of contract delivery if less than 5 business days after the completed annuity application is received by the insurer.

(1) With respect to an application received as a result of a direct response solicitation through the mail, providing the disclosure in a mailing inviting a prospective applicant to apply for an annuity contract shall be deemed to satisfy the delivery requirement of subsection (b).

(2) With respect to an online application via the Internet, taking reasonable steps to make available for viewing, printing, saving or downloading to a file from the marketing website for at least 7 days after application shall be deemed to satisfy the delivery requirement of subsection (b).

§ 83a.5. Disclosure statement.

(a) *Disclosure statement requirements*. The following information shall be included in the disclosure statement:

(1) A prominent type title as follows: Annuity Disclosure Statement.

(2) The name and home office address (city and state) of the insurer to whom application will be made and a mailing address of the insurer's home, executive or administrative office to which correspondence should be addressed.

(3) The identification of the contract, any rider or supplemental benefit built into the contract, including:

(i) The fact that the contract is an annuity.

(ii) The generic name of the contract, any supplemental built-in benefit or any rider.

(4) A description of the contract and its specific features, relating to the annuity solicited and applied for, emphasizing its long-term nature, including examples when appropriate. The examples may be based on assumed premiums. The description shall include:

(i) The guaranteed, nonguaranteed and determinable elements of the contract, and their limitations, if any, and an explanation of how they operate.

(ii) An explanation of the initial crediting rate, the duration of the initial crediting rate, and the fact that future crediting rates may change from time to time and are not guaranteed.

(iii) A description, whether or not stated in the contract, of any adjustments in the credits, charges or settlement option rates necessary to offset the cost to the insurer for providing the bonus (for example, the interest credit will be 1% less than the rate that would be credited if the contract did not contain a bonus). If because of the pricing structure, an explicit expense charge or reduction in interest credits can not be determined, a general

description that the expense charges may be higher or interest credits lower than the charges or credits for a contract without the bonus and that the amount of the charges or reduction in interest credits may exceed the amount of the bonus or an alternative description that provides the same level or degree of disclosure and is found acceptable by the Department.

(iv) Any value reductions caused by withdrawals from the contract or surrender of the contract

(v) The values used to determine the annuity income payments.

(vi) If applicable, an explanation that the values upon surrender of the contract are less than the values used to determine the annuity income payments.

(vii) How values in the contract can be accessed.

(viii) Periodic income options with an explanation of the guaranteed and nonguaranteed basis.

(ix) The death benefit, if available, and how it is calculated.

(x) A summary of the Federal tax status of the contract and any penalties applicable on withdrawal of values from the contract.

(xi) The impact of any rider, such as a long-term care rider or disability surrender fee waiver rider, on the contract benefits.

(b) *First page declarations.* The first page of the disclosure statement shall include the information required by subsection (a)(1) and the descriptions concerning the following:

(1) Interest rates.

(2) Bonuses and persistency credits.

(3) Charges and fees.

(4) Surrender charges.

(5) Value reductions caused by contract withdrawals or surrenders

(6) Any difference between the surrender value and the value used to determine the annuity income payment.

(c) *Nonguaranteed disclosure.* Any nonguaranteed element amounts appearing in the annuity disclosure statement shall be accompanied by a prominent type disclosure that the amounts are not guaranteed and are subject to change by the insurer.

(d) *Right to examine contract.* The disclosure statement shall include the language of the applicable right to examine contract provision required by section 410E of The Insurance Company Law (40 P. S. § 510d).

(e) *Page numbers.* Each page of the disclosure statement shall be numbered and show its relationship to the total number of pages in the disclosure statement.

(f) *Language of statement.* Terms used in the disclosure document shall be written in terms that are not confusing or misleading to a person of average intelligence. Terminology that would not be ordinarily understood by a person of average intelligence shall be defined or explained.

§ 83a.6. Use and nonmodification of annuity disclosure system results.

A producer shall only use and may not withhold, alter, change or in any way modify the results of an annuity disclosure system provided by an insurer or approved in

writing by an officer of the insurer or another person as the insurer may designate for that purpose.

§ 83a.7. Department right of review of disclosure statements.

The Department may request the submission of a completed disclosure statement.

§ 83a.8. Report to contract owners.

A report shall be provided, at least annually, to the contract owner of a deferred annuity during the accumulation period and to the contract owner of a deferred or immediate annuity during the payout period if the contract provides for nonguaranteed elements during the payout period. The report shall be provided without charge.

(1) The report for a nonequity indexed annuity shall contain at least the following information:

(i) The beginning and ending date of the current report period

(ii) The account value, if any, at the beginning of the current report period and at the end of the current report period.

(iii) The cash surrender value, if any, at the end of the report period.

(iv) For an annuity which provides for an adjustment in the cash surrender values based on changes in the market value of the assets underlying the contract, a statement that the cash surrender value includes a reduction for the surrender charge and for either a market value adjustment or a total return adjustment.

(v) The amounts, if any, that have been credited or debited to the contract during the current report period. The credited and debited amounts shall be identified by type; for example, premium payments, interest credits, bonus credits, persistency credits, expense charges, withdrawal amounts and withdrawal charges.

(vi) The amount of outstanding loans, if any, as of the end of the current report period.

(2) The report for an equity indexed annuity shall contain at least the following information:

(i) The beginning and ending date of the current report period.

(ii) The minimum guaranteed cash surrender value at the beginning of the current report period and at the end of the current report period.

(iii) The amounts, if any, that have been credited or debited to the minimum guaranteed cash surrender value during the current report period. The credited and debited amounts shall be identified by type; for example, premium payments, interest credits, bonus credits, persistency credits, expense charges, withdrawal amounts and withdrawal charges.

(iv) The vested index adjusted account value at the beginning of the current report period and at the end of the current report period.

(v) The amounts, if any, that have been credited or debited to the vested index adjusted account value during the current report period. The credited and debited amounts shall be identified by type; for example, premium payments, interest credits, bonus credits, persistency credits, expense charges, withdrawal amounts and withdrawal charges.

(vi) The cash surrender value, if any, at the end of the current report period.

(vii) The amount of outstanding loans, if any, as of the end of the current report period.

(3) The end of the current report period may not be more than 3 months prior to the date of the mailing of the report.

§ 83a.9. Penalties.

(a) For failing to make the required disclosure about the product being sold or otherwise violating this chapter, a producer may be subject to the penalties provided in:

(1) Section 639 of The Insurance Department Act of 1921 (40 P. S. § 279) for conduct that would disqualify a producer from the initial issuance of a certificate of qualification or a license under sections 604 or 622 of that act (40 P. S. §§ 234 and 252).

(2) Section 637 of The Insurance Department Act of 1921 (40 P. S. § 277) for misrepresenting the terms of an insurance policy.

(b) For failing to ensure the required disclosure about the product being sold or otherwise violating this chapter, an insurer may be subject to the penalties provided in section 350 of The Insurance Company Law of 1921 (40 P. S. § 475) for violation of sections 347—349 of that act (40 P. S. §§ 472—474).

(c) For failing to ensure the required disclosure about the product being sold or otherwise violating this chapter, a fraternal benefit society may be subject to the penalties provided in section 610 of the Fraternal Benefit Society Code (40 P. S. § 1142-610).

(d) In addition to subsections (a)—(c), failure to make the required disclosures outlined in this chapter or otherwise violating this chapter may be considered a violation of the Unfair Insurance Practices Act (40 P. S. §§ 1171.1—1171.15).

(e) The insurer shall bear the burden in any investigation, hearing or determination by the Department or the Commissioner to prove that a properly completed disclosure was provided to the annuity applicant as required by this chapter.

[Pa.B. Doc. No. 02-572. Filed for public inspection April 12, 2002, 9:00 a.m.]

[31 PA. CODE CHS. 148 AND 148a] Safeguarding Insurer Securities

The Insurance Department (Department) proposes to delete Chapter 148 (relating to securities held under custodial agreements and participation by insurers in depository trust companies and federal reserve book entry systems) and adopt Chapter 148a (relating to safeguarding insurer securities) to read as set forth in Annex A. 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); 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; 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 the Health Care Services Malpractice Act (40 P. S. §§ 1301.801—1301.811). The proposed regulations prescribe permissible methods of holding securities owned by the various types of insurance entities regulated by the Department (insurers) and requirements for insurer securities held under custodial agreements. Insurers shall comply with the regulations for their securities to be reported as assets (admitted assets) in financial statements filed with the Department.

Purpose

This proposed 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 proposed rulemaking will update the regulations to recognize changes in the securities marketplace and to better safeguard against the theft or loss of insurer securities. The proposed regulations are the result of the Department's consideration of the need for domestic insurers to participate efficiently in the securities market while preserving the value and safety of their assets. Specific protections have been added as a result of a review by Commonwealth insurance regulators of the circumstances in a recent highly publicized case where a number of insurer insolvencies were caused by the alleged theft of their securities. The Department participated in the review of this case, known as the Frankel case, which also resulted in the update of a model regulation relating to insurer securities adopted by the National Association of Insurance Commissioners (NAIC).¹ Therefore, this proposed rulemaking is needed to update the regulations to better safeguard against the theft or loss of insurer securities and to establish up-to-date, clear requirements for insurer securities held under custodial arrangements.

Explanation of Regulatory Requirements

Section 148a.1 (relating to definitions) includes definitions of "agent," "clearing corporation," "custodian," "Federal Reserve book-entry system" and "securities" consistent with the definitions in the NAIC model regulation. The definition of "insurer" expands the definition in the existing regulations to add health maintenance organizations and preferred provider organizations and to clarify the scope of the regulations with respect to other regulated entities. This broader definition is needed to clearly apply the safeguards in the regulations to all types of insurers. Definitions of "instructions" and "authorized person" are included to clarify who may issue instructions on behalf of an insurer to a custodian and the proper form of the instructions. The definition allows both written and verbal instructions subject to certain criteria and conditions. Definitions of "investment company" and "investment company securities" are included to differentiate between investments in mutual funds and other types of securities. Finally, the terms "foreign country," "registered form" and "State" are defined to clarify these terms for purposes of the regulations.

Section 148a.2 (relating to permissible methods of holding securities) lists what types of entities, as defined in the regulations, are permitted to hold insurer securities and how the securities may be held. An insurer may hold its own securities in definitive certificates. A custodian may hold insurer securities under a written agreement if the agreement contains at least the terms and conditions prescribed by the regulations. Investment company (mutual fund) securities may be held by the invest-

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

ment company that issued the securities if specific requirements are met. Insurer securities also may be held by a state treasurer or other state regulatory authority if required as a condition of doing business in that state.

Section 148a.3 (relating to requirements for custodial agreements) requires an agreement between an insurer and a custodian to be in writing, properly authorized by both parties and to contain the provisions in § 148a.3(b). Section 148a.3(b)(1) requires the securities to be deposited and withdrawn as instructed by the insurer and provides for verbal instructions to be superseded by written instructions in the event of a discrepancy or dispute. In addition, § 148a.3(b)(2) prohibits the custodian from having a security interest or lien in the securities because the securities shall be available to the insurer immediately upon request. Section 148a.3(b)(3) allows the custodian to utilize an agent for electronic transactions if the custodian enters into a written agreement with the agent and remains ultimately responsible for the safekeeping of the securities and for compliance with the provisions of the custodial agreement. Section 148a.3(b)(4)—(8) establishes how securities may be registered, held and identified in the custodian's records according to the form of the securities. Section 148a.3(b)(9)—(11) relates 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. Section 148a.3(12) requires the custodian to notify the Department 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 added to safeguard against securities fraud or theft as a result of a review of the Frankel case. A similar provision has been added to the NAIC model regulation. Section 148a.3(b)(13)—(17)(ii) establishes recordkeeping and reporting duties under custodial agreements. These requirements provide the insurer with timely information needed to monitor custodial account transactions, be informed about audits and reports on the custodian's trust accounts and system of internal controls, and to have sufficient information to comply with financial statement reporting and audit requirements. In addition, these sections assure 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). Finally, § 148a.3(17)(iii) prescribes the form of an affidavit that shall be provided by the custodian upon the insurer's request. The affidavit is needed to confirm the value and location of insurer securities for purposes of financial examinations conducted by the Department. The requirements relating to custodial agreements will clarify and strengthen regulatory provisions for the protection and availability of insurer securities held under these arrangements.

Section 148a.4 (relating to requirements for investment company securities) establishes the conditions under which an insurer's investment company securities may be held by the investment company that issued the securities. The conditions assure that the investment company provides at least monthly reports of transfers of investments to or from the insurer's account and maintains adequate records for financial statement reporting and financial examination purposes.

Section 148a.5 (relating to penalty and existing custodial agreements) establishes that failure to comply with the regulations will result in the insurer's securities being nonadmitted assets for purposes of financial statements filed with the Department. The section also allows insurers 1 year to bring existing agreements into compliance with the regulations.

External Comments

In drafting this proposed rulemaking, the Department requested comments 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 in response to the Department's request were considered in the development of this rulemaking.

Fiscal Impact

The proposed safeguards and reporting requirements for custodial arrangements are not materially different from existing regulatory requirements and will impose no significant additional costs on insurers or custodians. Department costs in conducting financial examinations associated with the review of custodial arrangements and verification of insurer securities will not increase as a result of this proposed rulemaking. This proposed rulemaking will not affect costs to political subdivisions. While this proposed rulemaking has no immediate fiscal impact on the general public, the general public will benefit to the extent that adoption of this proposed rulemaking enhances regulatory safeguards against the loss or theft of securities held by insurers to meet obligations under insurance policies.

Paperwork

The proposed rulemaking reduces paperwork to the extent that it replaces three different affidavit forms required under the current regulations with one consolidated form. The proposed rulemaking also may reduce paperwork by allowing reports and confirmations to be transmitted in electronic form. The proposed 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 recordkeeping requirements in the proposed 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

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

Contact Person

Questions or comments regarding this proposed 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 within 30 days following the publication of this notice in the *Pennsylvania Bulletin*. Questions or comments also may be e-mailed to 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)), on April 1, 2002, the Department submitted a copy of this proposed rulemaking to the Independent Regulatory Review Commission (IRRC) and the Chairpersons of the Senate Banking and Insurance Committee and the House Committee on Insurance. In addition to submitting the proposed rulemaking, the Department has provided IRRC and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the Department in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." A copy of this material is available to the public upon request.

Under section 5(g) of the Regulatory Review Act, if IRRC has objections to any portion of the proposed rulemaking, it will notify the Department within 10 days of the close of the Committees' review period. The notification shall specify the regulatory review criteria that have not been met by the portion of the proposed rulemaking to which an objection is made. The Regulatory Review Act specifies detailed procedures for review, prior to final publication of the rulemaking, by the Department, the General Assembly and the Governor of objections raised.

M. DIANE KOKEN,
Insurance Commissioner

Fiscal Note: 11-204. No fiscal impact; (8) recommends adoption.

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

(Editor's Note: As part of this proposed rulemaking, the Department is proposing to delete the text of Chapter 148 which currently appears at 31 Pa. Code pages 148-1—148-6, serial pages (254727)—(254732).)

Sec.
148.1—148.4. (Reserved).

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, state bank or trust company that is:

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

(B) Either regulated by 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 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 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 VIII 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 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 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:

(i) The custodian enters into a written agreement with the agent whereby the securities 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.

(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 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 of the custodian's receipt of the insurer's notice terminating the agreement or within 3 business days 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:

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

(ii) 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 financial examination of the insurer, 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 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 financial examination of the insurer's financial statements, including, the identifying numbers assigned to the securities by the Committee on Uniform Securities Identification Procedures (CUSIP).

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

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 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 this rulemaking.*) to achieve compliance with this chapter.

[Pa.B. Doc. No. 02-573. Filed for public inspection April 12, 2002, 9:00 a.m.]
