

RULES AND REGULATIONS

Title 31—INSURANCE

INSURANCE DEPARTMENT

[31 PA. CODE CHS. 148 AND 148a]

Safeguarding Insurer Securities

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 final-form rulemaking 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 rulemaking, 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, known as the Frankel case, where a number of insurers became insolvent because of the theft of their securities; the National Association of Insurance Commissioners (NAIC) has updated a model regulation relating to insurers' securities as a result of the review.¹ The Department participated in the review of the Frankel case and the final-form rulemaking includes protections consistent with the updated NAIC model regulation.

Therefore, this final-form rulemaking is needed 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 final-form rulemaking was 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 (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); and Article VIII of the Health Care Services Malpractice Act (40 P. S. §§ 1301.801—1301.811).

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.

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 House and Senate 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 subparagraphs (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 subparagraphs because it is unnecessary. In response to IRRC's comment, the Department has deleted the word "adequately" in both subparagraphs.

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"

Subparagraph (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 subparagraph (x) to "other entities" acting as insurers. IRRC commented that this subparagraph was vague and should be deleted. In response to IRRC's comment, the Department has deleted subparagraph (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 subparagraphs (ii) and (iii) because territories of the United States are included under subparagraph (i). In response to IRRC's comment, the Department has deleted subparagraphs (ii) and (iii) because the subparagraphs are unnecessary to understand the meaning of the definition.

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

Section 148a.2 (relating to permissible methods of holding securities) 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 § 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).

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 final-form rulemaking. 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. The Department has divided the paragraph into two sentences as IRRC recommended.

Section 148a.3(12) requires 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 require-

ment 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 on 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 1 of 35 recommendations developed by the task force. The recommendations cover all aspects of financial solvency regulations and include better communication and cooperation among regulators, enhanced financial reporting requirements for insurers, improved regulatory practices and procedures for analyses of insurers' financial statements and onsite financial examinations. 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.

Section 148a.3(b)(13)—(17)(ii) establishes recordkeeping 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 rulemaking 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).

Section 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 rulemaking 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.

Section 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 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 paragraph (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 onsite 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 recordkeeping 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 sent Peter J. Salvatore, Regulatory Coordinator, Office of Special Projects, 1326 Strawberry Square, Harrisburg, PA 17120, (717) 787-4429, fax (717) 772-1969, e-mail psalvatore@state.pa.us.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P. S. § 745.5(a)), on September 5, 2002, the Department submitted a copy of the final-form rulemaking, which was proposed at 32 Pa.B. 1873, to IRRC and to the Chairpersons of the House Insurance Committee and the Senate Banking and Insurance Committee for review and comment.

Under section 5(c) of the Regulatory Review Act, IRRC and the Committees were provided with copies of the comments received during the public comment period, as well as other documents when requested. In preparing this final-form rulemaking, the Department has considered the comments received from IRRC, the Committees and the public.

Under section 5.1(d) of the Regulatory Review Act (71 P. S. § 745.5a(d)), on September 25, 2002, this final-form rulemaking was deemed approved by the House and Senate Committees. Under section 5.1(e) of the Regulatory Review Act, IRRC met on September 26, 2002, and approved the final-form rulemaking.

Findings

The Insurance 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 thereunder, 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:

(a) 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.

(b) 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.

(c) The Commissioner shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(d) This order shall take effect upon final publication in the *Pennsylvania Bulletin*.

M. DIANE KOKEN,
Insurance Commissioner

(Editor's Note: For the text of the order of the Independent Regulatory Review Commission, relating to this document, see 32 Pa.B. 5145 (October 12, 2002).)

Fiscal Note: Fiscal Note 11-204 remains valid for the final adoption of the subject regulations.

Annex A**TITLE 31. INSURANCE****PART VIII. MISCELLANEOUS PROVISIONS****CHAPTER 148. (Reserved)****§§ 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, Federal savings bank, state bank or trust company that is:

(A) 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) 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 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).

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—A state, territory or possession of the United States.

§ 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 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 securities of one or more insurers will be held as required under this chapter.
- (ii) The custodian retains 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:

- (A) The identity of the agent.
- (B) The date of the custodian's written agreement with the agent.

(C) 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. 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 24 hours of the custodian's receipt of the insurer's notice terminating the agreement or within 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) Internal or external reports on the custodian's system of internal control.

(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 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 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.

(b) With respect to custody agreements entered into prior to November 2, 2002, and in compliance with laws or regulations in existence immediately preceding November 2, 2002, insurers have until November 3, 2003, to achieve compliance with this chapter.

[Pa.B. Doc. No. 02-1944. Filed for public inspection November 1, 2002, 9:00 a.m.]

Title 34—LABOR AND INDUSTRY

DEPARTMENT OF LABOR AND INDUSTRY

[34 PA. CODE CH. 129]

Correction to 34 Pa. Code § 129.1602

On March 23, 2001, the Department of Labor and Industry delivered the Workers' Compensation Health and Safety final-form regulation to the Independent Regulatory Review Commission, the Senate Committee on Labor and Industry and the House Committee on Labor Relations. This regulation was deemed approved by the Senate Committee on Labor and Industry and the House Committee on Labor Relations on April 13, 2001, and was approved by the Independent Regulatory Review Commis-

sion on April 19, 2001. Thereafter, the regulation, containing an incorrect version of § 129.1602(6), was submitted to the Office of Attorney General and was reviewed and approved by the Office of Attorney General. On June 28, 2001, two copies of the Office of Attorney General-approved version were submitted to the office of the *Pennsylvania Code* and *Bulletin*. The Office of Attorney General-approved text was published in the *Pennsylvania Bulletin* on July 14, 2001.

Under the direction of the Governor's Office of General Counsel, the Department of Labor and Industry has prepared this notice to reflect the version of § 129.1602(6) previously approved by the Independent Regulatory Review Commission and the Senate Committee on Labor and Industry and the House Committee on Labor Relations.

The correct version of 34 Pa. Code § 129.1602 appears in Annex A, with ellipses referring to the existing text of the regulation.

This notice has been reviewed and approved by the Secretary of the Department of Labor and Industry, the Office of General Counsel, the House Committee on Labor Relations, the Senate Committee on Labor and Industry, the Office of Attorney General and the Independent Regulatory Review Commission.

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Annex A

**TITLE 34. LABOR AND INDUSTRY
PART VIII. BUREAU OF WORKERS'
COMPENSATION**

**CHAPTER 129. WORKERS' COMPENSATION
HEALTH AND SAFETY**

**Subchapter H. ORDER TO SHOW
CAUSE/PENALTIES**

§ 129.1602. Order to show cause/penalties.

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(6) In a proceeding under this section, the Department has the burden to demonstrate, upon a preponderance of the evidence, that the respondent has failed to comply with the act or related regulations.

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