

REVISED

NAIC 2008 Winter National Meeting
Grapevine, Texas

EXECUTIVE (EX) COMMITTEE*
Saturday, December 6, 2008
1:00 p.m. – 2:00 p.m.
Texas Ballroom A—Ballroom Level

Honorable Sandy Praeger
Kansas Commissioner of Insurance
NAIC President—Presiding

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|-------------------------|-------------------|--------------------|
| 1. Alaska | 7. Kansas | 13. South Carolina |
| 2. Arkansas | 8. North Carolina | 14. South Dakota |
| 3. Connecticut | 9. New Hampshire | 15. Utah |
| 4. District of Columbia | 10. New Jersey | 16. West Virginia |
| 5. Florida | 11. New Mexico | 17. Wisconsin |
| 6. Iowa | 12. Oklahoma | |

*NAIC Bylaws-Amended Dec. 2004, “a member of the Executive Committee may not vote by proxy in a meeting of the Executive Committee or its subcommittees.”

AGENDA

- 1. Ratify Creation of an Executive Working Group – Credit Default Swap (EX) Working Group and Charges (Handout One).** *Commissioner Sandy Praeger (KS)*
- 2. Ratify Creation of an Executive Working Group – Capital and Surplus Relief (EX) Working Group and Charges (Handout Two).** *Commissioner Sandy Praeger (KS)*
- 3. Consider Adoption of Executive (EX) Committee, Task Force, and Working Group Reports (Handout Three).** *Commissioner Sandy Praeger (KS)*
 - **AIG Special Task Force – Commissioner Sandy Praeger (KS)**
 - **Government Relations Leadership Council – Commissioner Sandy Praeger (KS)**
 - **International Insurance Relations Leadership Council – Commissioner Sandy Praeger (KS)**
 - **NARAB Working Group – Commissioner Roger Sevigny (NH)**
 - **SVO Initiatives Working Group – Commissioner Roger Sevigny (NH)**
 - **Capital and Surplus Relief Working Group – Commissioner Thomas E. Hampton (DC)**
 - **Principles-Based Reserving Working Group – Commissioner Thomas E. Hampton (DC)**
 - **Credit Default Swap Working Group – Commissioner Thomas R. Sullivan (CT)**
 - **Indexed Annuities Working Group – Commissioner Susan Voss (IA)**
 - **Military Sales Working Group – Commissioner John Oxendine (GA)**
 - **Climate Change and Global Warming Task Force – Commissioner Sean Dilweg (WI)**
 - **Speed to Market Task Force – Director Mary Jo Hudson (OH)**

4. **Consider Adoption of Model Law Classification Requests.** *Commissioner Sandy Praeger (KS)*
 - Amendments to the Derivatives Instrument Model Regulation (#282) (**Attachment One**). *Commissioner Alfred W. Gross (VA)*
5. **Hear Reports on Model Law Development Efforts (Handout Four).** *Commissioner Sandy Praeger (KS)*
 - Standard Nonforfeiture Law for Life Insurance (#808). *(Request approved September 2007) Commissioner Sandy Praeger (KS)*
 - Standard Valuation Model Law (#820). *Request approved September 2007) Commissioner Sandy Praeger (KS)*
 - Amendments to Long-Term Care Insurance Model Regulation (#641) *(Request approved September 2008) Commissioner Joel Ario (PA)*
 - Amendments to Suitability in Annuity Transaction Model Act (#275) *(Request approved June 2008) Commissioner Sean Dilweg (WI)*
 - Amendments to Annuity Disclosure Model Regulation (#245) *(Request approved September 2008) Superintendent Eric Dinallo (NY)*
 - Amendments to Property and Casualty Insurance Guaranty Association Model Act (#540) *(Request approved September 2007). Commissioner Al Gross (VA)*
 - Amendments to Life and Health Guaranty Association Model Act (#520) *(Request approved September 2007). Commissioner Al Gross (VA)*
6. **Consider Adoption of the Oral Report of the Internal Administration (EX1) Subcommittee Meeting of December 5, 2008.** *Commissioner Sandy Praeger (KS)*
7. **Hear Oral Report of the National Insurance Producer Registry (NIPR) Board of Directors.** *Director Linda Hall (AK)*
8. **Hear Oral Report from System for Electronic Rate Form and Filing (SERFF) Board.** *Commissioner Roger Sevigny (NH)*
9. **Hear Oral Report from Interstate Insurance Product Regulation Commission (IIPRC).** *Commissioner Jane Cline (WV)*
10. **Any Other Matters to Come Before the Committee.**

DERIVATIVE INSTRUMENTS MODEL REGULATION

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Section 1. Authority

This regulation is adopted and promulgated by the Commissioner of Insurance pursuant to [insert citation to state law equivalent to Section 8 of the Investments of Insurers Model Act].

Section 2. Purpose

The purpose of this regulation is to set standards for the prudent use of derivative instruments in accordance with [insert citation to state law equivalent to Section 9 of the Investments of Insurers Model Act].

Section 3. Definitions

For the purposes of this regulation, the following definitions shall apply:

- A. “Business entity” includes a sole proprietorship, corporation, limited liability company, association, partnership, joint stock company, joint venture, mutual fund, trust, joint tenancy or other similar form of business organization, whether for-profit or not-for-profit.
- B. “Counterparty exposure amount” means:
 - (1) The net amount of credit risk attributable to a derivative instrument entered into with a business entity other than through a qualified exchange, qualified foreign exchange, or cleared through a qualified clearinghouse (“over-the-counter derivative instrument”). The amount of credit risk equals:
 - (a) The market value of the over-the-counter derivative instrument if the liquidation of the derivative instrument would result in a final cash payment to the insurer; or
 - (b) Zero if the liquidation of the derivative instrument would not result in a final cash payment to the insurer.
 - (2) If over-the-counter derivative instruments are entered into pursuant to a written master agreement which provides for netting of payments owed by the respective parties, and the domiciliary jurisdiction of the counterparty is either within the United States or if not within the United States, within a foreign jurisdiction listed in the *Purposes and Procedures of the Securities Valuation Office* as eligible for netting, the net amount of credit risk shall be the greater of zero or the net sum of:

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- (a) The market value of the over-the-counter derivative instruments entered into pursuant to the agreement, the liquidation of which would result in a final cash payment to the insurer; and
 - (b) The market value of the over-the-counter derivative instruments entered into pursuant to the agreement, the liquidation of which would result in a final cash payment by the insurer to the business entity.
 - (3) For open transactions, market value shall be determined at the end of the most recent quarter of the insurer's fiscal year and shall be reduced by the market value of acceptable collateral held by the insurer or placed in escrow by one or both parties.
- C. (1) "Derivative instrument" means an agreement, option, instrument or a series or combination thereof:
 - (a) To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or
 - (b) That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.
- (2) Derivative instruments include options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures and any other agreements, options or instruments substantially similar thereto or any series or combination thereof. Derivative instruments shall additionally include any agreements, options or instruments permitted under regulations adopted pursuant to [insert citation to state law equivalent to Section 8 of the Investments of Insurers Model Act]. Derivative instruments shall not include an investment authorized by [insert state law equivalent to Sections 11 through 17, 19 and 24 through 30 of the Investments of Insurers Model Act].
- D. "Derivative transaction" means any transaction involving the use of one or more derivative instruments.
- E. "Qualified clearinghouse" means a clearinghouse for, and subject to the rules of a qualified exchange or a qualified foreign exchange, which clearinghouse provides clearing services, including acting as a counterparty to each of the parties to a transaction such that the parties no longer have credit risk as to each other.
- F. "Qualified exchange" means:
 - (1) A securities exchange registered as a national securities exchange, or a securities market regulated under the Securities Exchange Act of 1934 (15 U.S.C. §§ 78 *et seq.*), as amended;

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- (2) A board of trade or commodities exchange designated as a contract market by the Commodity Futures Trading Commission or any successor thereof;
 - (3) Private Offerings, Resales and Trading through Automated Linkages (PORTAL);
 - (4) A designated offshore securities market as defined in Securities Exchange Commission Regulation S, 17 C.F.R. Part 230, as amended; or
 - (5) A qualified foreign exchange.
- G. “Qualified foreign exchange” means a foreign exchange, board of trade or contract market located outside the United States, its territories or possessions:
- (1) That has received regulatory comparability relief pursuant to Commodity Futures Trading Commission Rule 30.10 (as set forth in Appendix C to Part 30 of the CFTC’s Regulations, 17 C.F.R. Part 30);
 - (2) That is, or its members are, subject to the jurisdiction of a foreign futures authority that has received regulatory comparability relief pursuant to Commodity Futures Trading Commission Rule 30.10 (as set forth in Appendix C to Part 30 of the CFTC’s Regulations, 17 C.F.R. Part 30) as to futures transactions in the jurisdiction where the exchange, board of trade or contract market is located; or
 - (3) Upon which foreign stock index futures contracts are listed that are the subject of no-action relief issued by the CFTC’s Office of General Counsel, but an exchange, board of trade or contract market that qualifies as a “qualified foreign exchange” only under this paragraph shall only be a “qualified foreign exchange” as to foreign stock index futures contracts that are the subject of such no-action relief under this paragraph.

Section 4. Guidelines and Internal Control Procedures

- A. Before engaging in a derivative transaction, an insurer shall establish written guidelines that shall be used for effecting and maintaining the transactions. The guidelines shall:
- (1) Address investment or, if applicable, underwriting objectives, and risk constraints, such as credit risk limits;
 - (2) Address permissible transactions and the relationship of those transactions to its operations, such as a precise identification of the risks being hedged by a derivative transaction; and
 - (3) Require compliance with internal control procedures.
- B. An insurer shall have a system for determining whether a derivative instrument used for hedging has been effective.

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- C. An insurer shall have a credit risk management system for over-the-counter derivative transactions that measures credit risk exposure using the counterparty exposure amount
- D. An insurer's board of directors shall, in accordance with [insert citation to state law equivalent of Section 4 of the Investments of Insurers Model Act]:
 - (1) Approve the guidelines required by Subsection A of this section and the systems required by Subsections B and C of this section; and
 - (2) Determine whether the insurer has adequate professional personnel, technical expertise and systems to implement investment practices involving derivatives.

Section 5. Documentation Requirements

An insurer shall maintain documentation and records relating to each derivative transaction, such as:

- A. The purpose or purposes of the transaction;
- B. The assets or liabilities to which the transaction relates;
- C. The specific derivative instrument used in the transaction;
- D. For over-the-counter derivative instrument transactions, the name of the counterparty and the counterparty exposure amount; and
- E. For exchange traded derivative instruments, the name of the exchange and the name of the firm that handled the trade.

Section 6. Trading Requirements

Each derivative instrument shall be:

- A. Traded on a qualified exchange;
- B. Entered into with, or guaranteed by, a business entity;
- C. Issued or written by or entered into with the issuer of the underlying interest on which the derivative instrument is based; or
- D. Entered into with a qualified foreign exchange.

Section 7. Effective Date

This regulation shall become effective [insert date].

Legislative History (all references are to the Proceedings of the NAIC).

1996 Proc. 2nd Quarter 10, 33, 264 (adopted).