

MAINE STATE LEGISLATURE

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119th MAINE LEGISLATURE

SECOND REGULAR SESSION-2000

Legislative Document

No. 2520

S.P. 974

In Senate, January 24, 2000

An Act to Amend Investment-related Provisions of the Maine Insurance Code.

Approved for introduction by a majority of the Legislative Council pursuant to Joint Rule 203.

Reference to the Committee on Banking and Insurance suggested and ordered printed.

A handwritten signature in cursive script that reads "Joy J. O'Brien".

JOY J. O'BRIEN
Secretary of the Senate

Presented by Senator LaFOUNTAIN of York.
Cosponsored by Representative SULLIVAN of Biddeford and
Senator ABROMSON of Cumberland, Representatives: DUDLEY of Portland, GLYNN of
South Portland, JONES of Pittsfield, MAYO of Bath, SAXL of Bangor.

Be it enacted by the People of the State of Maine as follows:

2 **Sec. 1. 24 MRSA §2301, sub-§9-A, ¶E**, as enacted by PL 1993, c.
4 702, Pt. A, §1, is amended to read:

6 E. Notwithstanding any provisions of this section and Title
8 24-A, chapter 13-A allowing other investments, a corporation
10 subject to this chapter shall maintain cash or investment
12 grade obligations, as defined in Title 24-A, section ~~1162-A~~
14 1151-A, that at all times have a fair market value of not
16 less than 100% of the corporation's liability for claims
18 payable, incurred, but not reported, claims payable, unpaid
20 claims adjustment expenses, unearned premiums and, as
22 applicable, any statutory, special or additional reserves
provided by the corporation for the benefit of subscribers
as of the close of the corporation's most recent calendar
quarter prepared on the basis of statutory accounting
principles. If the corporation's liability for these
enumerated items increases more than 10% prior to the end of
the calendar quarter, the corporation must, within 10 days
of the determination, reallocate its investments to ensure
compliance with this paragraph.

24 **Sec. 2. 24-A MRSA §1109, first ¶**, as amended by PL 1993, c.
26 313, §22, is further amended to read:

28 An insurer may invest in obligations, other than those
30 eligible for investment under section 1124 (mortgage loans),
32 issued, assumed or guaranteed by any solvent institution created
34 or existing under the laws of the United States or of Canada, or
of any state, province, district or territory thereof, provided
that the obligations are not in default as to principal or
interest, are investment grade ~~corporate~~ obligations as defined
in section ~~1162-A~~ 1151-A, subsection 7 24, and are qualified
under any of the following.

36 **Sec. 3. 24-A MRSA §1110, sub-§3**, as enacted by PL 1993, c.
38 313, §25, is amended to read:

40 3. The terms defined in section ~~1162-A~~ 1151-A have the same
42 meanings as used in this chapter.

44 **Sec. 4. 24-A MRSA §1151-A** is enacted to read:

46 **§1151-A. Definitions**

48 As used in this chapter and chapter 13, unless the context
50 otherwise indicates, the following terms have the following
meanings.

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1. Acceptable collateral. "Acceptable collateral" means:

A. As to securities lending transactions and for the purpose of calculating counter-party exposure amount: cash, cash equivalents, letters of credit or direct obligations or securities that are fully guaranteed as to principal and interest by the government of the United States, the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation;

B. As to foreign securities lending transactions: sovereign debt rated "1" by the Securities Valuation Office of the National Association of Insurance Commissioners; and

C. As to repurchase transactions and reverse repurchase transactions: cash, cash equivalents, letters of credit or direct obligations or securities that are fully guaranteed as to principal and interest by the government of the United States, the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.

2. Admitted assets; asset value. "Admitted assets" means "assets" as defined in section 901. "Asset value" is that value that may be contained in the annual statement of the corporation filed pursuant to section 423.

3. Aggregate amount of investments. "Aggregate amount of investments" means the aggregate value of those investments, as determined under sections 981 to 984, except as provided in section 1157, subsection 5.

4. Business entity. "Business entity" means a sole proprietorship, corporation, limited liability company, association, general or limited partnership, joint stock company, joint venture, mutual fund, bank, trust, real estate investment trust, joint tenancy or other similar form of business organization, whether organized as a for-profit or nonprofit organization.

5. Cap. "Cap" means an agreement obligating the seller to make payments to the buyer with each payment based on the amount by which a reference price or level or the performance or value of one or more underlying interests exceeds a predetermined number, sometimes called the "strike rate" or "strike price."

6. Cash equivalents. "Cash equivalents" means highly rated, highly liquid and readily marketable investments or securities with a remaining term to maturity of one year or less. For purposes of this definition, "highly rated" means an investment rated "P-1" by Moody's Investors Service, Inc., "A-1"

2 by the Standard and Poor's Division of the McGraw Hill Companies,
4 Inc. or an equivalent rating by a nationally recognized
6 statistical rating organization recognized by the Securities
8 Valuation Office of the National Association of Insurance
10 Commissioners.

12 7. Collar. "Collar" means an agreement to receive payments
14 as the buyer of an option, cap or floor and to make payments as
16 the seller of a different option, cap or floor.

18 8. Counter-party. "Counter-party" means the other party to
20 an investment practices transaction with an insurer or, as to a
22 securities lending transaction, the custodian bank or agent, if
24 any, acting on behalf of an insurer.

26 9. Counter-party exposure amount. "Counter-party exposure
28 amount" means:

30 A. For an over-the-counter derivative instrument not
32 entered into pursuant to a written master agreement that
34 provides for netting of payments owed by the respective
36 parties:

38 (1) The market value of the over-the-counter
40 derivative instrument if the liquidation of the
42 derivative instrument would result in a final cash
44 payment to the insurer; or

46 (2) Zero if the liquidation of the derivative
48 instrument would not result in a final cash payment to
50 the insurer; and

B. For an over-the-counter derivative instrument entered
into pursuant to a written master agreement that provides
for netting of payments owed by the respective parties, if
the domiciliary jurisdiction of the counter-party is either
within the United States or within a foreign jurisdiction
listed as eligible for netting in the purposes and
procedures manual of the Securities Valuation Office of the
National Association of Insurance Commissioners or its
successor publication, the greater of zero or the net sum
payable to the insurer in connection with all derivative
instruments subject to the written master agreement upon
their liquidation in the event of default by the
counter-party pursuant to the master agreement, assuming
there are no conditions precedent to the obligations of the
counter-party to make such a payment and no setoff of
amounts payable pursuant to any other instrument or
agreement.

2 For purposes of this definition, "market value" or the "net sum
3 payable" is determined at the end of the most recent quarter of
4 the insurer's fiscal year and must be reduced by the market value
5 of acceptable collateral held by the insurer or a custodian on
6 the insurer's behalf.

7 10. Derivative instrument. "Derivative instrument" means
8 any agreement, option or instrument or any series or combination
9 of those agreements, options or instruments:

10 A. To make or take delivery of, assume or relinquish a
11 specified amount of one or more underlying interests, or to
12 make a cash settlement in lieu thereof; or

13 B. That has a price, performance, value or cash flow based
14 primarily upon the actual or expected price, yield, level,
15 performance, value or cash flow of one or more underlying
16 interests.

17 For purposes of this definition, "derivative instrument" includes
18 options, warrants not attached to another financial instrument
19 purchased by the insurer, caps, floors, collars, swaps, forwards,
20 futures and any other substantially similar agreements, options
21 or instruments, or any series or combinations of those
22 agreements, options or instruments. "Derivative instrument" does
23 not include collateralized mortgage obligations, other
24 asset-backed securities, principal-protected structured
25 securities, floating rate securities or instruments in which an
26 insurer is otherwise authorized to invest or that an insurer is
27 otherwise authorized to receive under this chapter other than
28 under section 1153, subsection 4, and any debt obligations of the
29 insurer.

30 11. Derivative transaction. "Derivative transaction" means
31 a transaction involving the use of one or more derivative
32 instruments. For purposes of section 1153, subsection 4, dollar
33 roll transactions, repurchase transactions, reverse repurchase
34 transactions and securities lending transactions may not be
35 included as derivative transactions.

36 12. Dollar roll transaction. "Dollar roll transaction"
37 means 2 simultaneous transactions with settlement dates no more
38 than 96 days apart so that in one transaction an insurer sells to
39 a business entity and in the other transaction the insurer is
40 obligated to purchase from the same business entity substantially
41 similar securities of the following types:

42 A. Mortgage-backed securities issued, assumed or guaranteed
43 by the Government National Mortgage Association, the Federal

2 National Mortgage Association, the Federal Home Loan
Mortgage Corporation or their respective successors; and

4 B. Other mortgage-backed securities referred to the
Secondary Mortgage Market Enhancement Act of 1984, 15 United
6 States Code, Section 77r-1, as amended.

8 13. Domestic institution. "Domestic institution" means an
institution created or existing under the laws of the United
10 States or any state, district or territory.

12 14. Floor. "Floor" means an agreement obligating the
seller to make payments to the buyer in which each payment is
14 based on the amount by which a predetermined number, sometimes
called the "floor rate" or "price," exceeds a reference price,
16 level, performance or value of one or more underlying interests.

18 15. Foreign investment. "Foreign investment" means an
investment in a foreign jurisdiction or an investment in a
20 person, real estate or asset domiciled in a foreign
jurisdiction. An investment may not be deemed as a foreign
22 investment if the issuing person, qualified primary credit source
or qualified guarantor is a domestic jurisdiction or a person
24 domiciled in a domestic jurisdiction unless:

26 A. The issuing person is a shell business entity; and

28 B. The investment is not assumed, accepted, guaranteed,
insured or otherwise backed by a domestic jurisdiction or a
30 person that is not a shell business entity, domiciled in a
domestic jurisdiction.

32 For purposes of this subsection, "shell business entity" means a
34 business entity having no economic substance, except as a vehicle
for owning interests in assets issued, owned or previously owned
36 by a person domiciled in a foreign jurisdiction; "qualified
guarantor" means a guarantor against which an insurer has a
38 direct claim for full and timely payment, evidenced by a
contractual right for which an enforcement action can be brought
40 in a domestic jurisdiction; and "qualified primary credit source"
42 means the credit source to which an insurer looks for payment as
to an investment and against which an insurer has a direct claim
44 for full and timely payment, evidenced by a contractual right for
which an enforcement action can be brought in a domestic
jurisdiction.

46 16. Foreign jurisdiction. "Foreign jurisdiction" means:

48 A. A jurisdiction other than a domestic jurisdiction; or
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2 B. A commonwealth, territory or possession of the United
3 States.

4 17. Forward. "Forward" means an agreement other than a
5 future to make or take delivery in the future of one or more
6 underlying interests, or effect a cash settlement based on the
7 actual or expected price, level, performance or value of such
8 underlying interests. "Forward" does not mean or include spot
9 transactions effected within customary settlement periods,
10 when-issued purchases or other similar cash market transactions.

12 18. Future. "Future" means an agreement to make or take
13 delivery of or effect a cash settlement based on the actual or
14 expected price, level, performance or value of one or more
15 underlying interests that are traded on a futures exchange.

16 19. Futures exchange. "Futures exchange" means a foreign
17 or domestic exchange, contract market or board of trade on which
18 trading in futures is conducted and, in the United States, that
19 has been authorized for futures trading by the Commodities
20 Futures Trading Commission or its successor.

22 20. Hedging transaction. "Hedging transaction" means a
23 derivative transaction that is entered into and maintained to
24 manage:

26 A. The risk of a change in the value, yield, price, cash
27 flow or quantity of assets or liabilities or a portfolio of
28 assets or liabilities that an insurer has acquired or
29 incurred or anticipates acquiring or incurring; or

32 B. The currency exchange rate risk related to assets or
33 liabilities or a portfolio of assets or liabilities that an
34 insurer has acquired or incurred or anticipates acquiring or
35 incurring.

36 21. High-yield obligations. "High-yield obligations" means
37 obligations that are neither investment grade nor medium grade
38 obligations.

40 22. Income generation transaction. "Income generation
41 transaction" means a derivative transaction that is entered into
42 to generate income. A derivative transaction that is entered
43 into as a hedging transaction or a replication transaction may
44 not be considered an income generation transaction.

46 23. Institution. "Institution" means a corporation,
47 joint-stock association, business trust, business partnership,
48 business joint venture or any other similar entity.

2 **24. Investment grade obligation.** "Investment grade
3 obligation" means an obligation that at the time of acquisition
4 by the insurer is rated "1" or "2" by the Securities Valuation
5 Office of the National Association of Insurance Commissioners.
6 If not valued by the Securities Valuation Office of the National
7 Association of Insurance Commissioners, "investment grade
8 obligation" means an obligation that at the time of acquisition
9 by the insurer is rated the equivalent of "1" or "2" by one of
10 the following nationally recognized independent rating agencies:
11 Moody's Investors Service, Inc., Standard and Poor's Division of
12 the McGraw Hill Companies, Inc., Fitch Investors Service, Inc. or
13 Duff and Phelps Credit Rating Company.

14 **25. Investment practices.** "Investment practices" means
15 transactions of the types described in section 1153, subsection 4
16 and section 1160, subsection 6.

17 **26. Market value.** "Market value" means the price for the
18 security or derivative instrument obtained from a generally
19 recognized source or the most recent quotation from such a source
20 or, to the extent no generally recognized source exists, the
21 price for the security or derivative instrument as determined
22 pursuant to the terms of the instrument or in good faith by the
23 insurer as can be reasonably demonstrated to the superintendent
24 upon request, plus accrued but unpaid income thereon to the
25 extent not included in the price as of the date that market value
26 is determined.

27 **27. Medium grade obligation.** "Medium grade obligation"
28 means an obligation that at the time of acquisition by the
29 insurer is rated by the Securities Valuation Office of the
30 National Association of Insurance Commissioners as Class "3"
31 quality. If not valued by the Securities Valuation Office of the
32 National Association of Insurance Commissioners, "medium grade
33 obligation" means an obligation that at the time of acquisition
34 by the insurer is rated the equivalent of "3" by Moody's
35 Investors Service, Inc., Standard and Poor's Division of the
36 McGraw Companies, Inc., Fitch Investors Service, Inc. or Duff and
37 Phelps Credit Rating Company.

38 **28. Not acquired by the insurer from an issuer, underwriter**
39 or dealer. "Not acquired by the insurer from an issuer,
40 underwriter or dealer" means acquired by the insurer in an exempt
41 transaction described in the United States Securities Act of
42 1933, Section 4(1) or Section 4(3), 15 United States Code,
43 Section 77d(1) or Section 77d(3), as from time to time amended.

44 **29. Obligations.** "Obligations" means bonds, debentures,
45 notes and other evidences of indebtedness, regardless of whether

2 liability for payment extends beyond the security for them, as
3 well as participation interests in any of those.

4 30. Option. "Option" means an agreement giving the buyer
5 the right to buy or receive, sell or deliver, enter into, extend
6 or terminate or effect a cash settlement based on the actual or
7 expected price, spread, level, performance or value of one or
8 more underlying interests, including, without limitation, an
9 option to purchase or sell a swap at a given price and time or at
10 a series of prices and times.

11 31. Over-the-counter derivative instrument.
12 "Over-the-counter derivative instrument" means a derivative
13 instrument entered into with a business entity other than through
14 a securities exchange or futures exchange or cleared through a
15 qualified clearinghouse.

16 32. Person. "Person" means an individual, business entity,
17 multilateral development bank or a government or
18 quasi-governmental body, such as a political subdivision or a
19 government sponsored enterprise.

20 33. Potential exposure. "Potential exposure" means:

21 A. As to a futures position, the amount of initial margin
22 required for that position; or

23 B. As to swaps, collars and forwards, 0.5% times the
24 notional amount times the square root of the remaining years
25 to maturity.

26 34. Qualified bank. "Qualified bank" means:

27 A. A national bank, state-chartered bank or trust company
28 that at all times is no less adequately capitalized as
29 determined by standards adopted by federal banking
30 regulators and that either is regulated by state banking
31 laws or is a member of the Federal Reserve System; or

32 B. A bank or trust company incorporated or organized under
33 the laws of a country other than the United States that is
34 regulated as a bank or trust company by that country's
35 government and that at all times is no less adequately
36 capitalized as determined by standards adopted by
37 international banking regulators.

38 35. Qualified broker or dealer. "Qualified broker or
39 dealer" means a broker or dealer that is organized under the laws
40 of a state, is registered under the United States Securities
41 Act of 1933, and is a member of the National Securities
42 Association, Inc., or the National Futures Association, Inc.,
43 or is a member of the International Securities Association, Inc.,
44 or is a member of the International Futures Association, Inc.,
45 or is a member of the International Commodity Association, Inc.,
46 or is a member of the International Association of Dealers in
47 International Money Markets, Inc., or is a member of the
48 International Association of Banks, Inc., or is a member of the

2 Exchange Act of 1934, 15 United States Code, Sections 78a to 78kk
and has net capital in excess of \$250,000,000.

4 **36. Qualified business entity.** "Qualified business entity"
means:

6
8 A. An issuer of obligations or preferred stock that is
10 rated "1" or "2" by the Securities Valuation Office of the
12 National Association of Insurance Commissioners or an issuer
14 of obligations, preferred stock or derivative instruments
16 that are rated the equivalent of "1" or "2" by the
Securities Valuation Office of the National Association of
Insurance Commissioners or by a nationally recognized
statistical rating organization recognized by the Securities
Valuation Office of the National Association of Insurance
Commissioners; or

18 B. A primary dealer in United States Government securities
20 that is recognized by the Federal Reserve Bank of New York.

22 **37. Qualified clearinghouse.** "Qualified clearinghouse"
24 means a clearinghouse subject to the rules of a securities
26 exchange or a futures exchange that provides clearing services,
including acting as a counter-party to each of the parties to a
transaction such that the parties no longer have credit risk to
each other.

28 **38. Qualified financial institution.** "Qualified financial
30 institution" means a bank or a trust company that is organized
32 under the laws of a state or the United States, has assets in
34 excess of \$5,000,000,000, has, or its parent corporation has,
senior obligations outstanding rated AA or better and has a ratio
of primary capital to total assets of at least 5 1/2% and a ratio
of total capital to total assets of at least 6%.

36 **39. Qualified for public sale.** "Qualified for public sale"
38 means registered under the United States Securities Act of 1933,
15 United States Code, Sections 77a to 77aa.

40 **40. Replication transaction.** "Replication transaction"
42 means a derivative transaction or combination of derivative
44 transactions effected either separately or in conjunction with
46 cash market investments included in the insurer's investment
portfolio in order to replicate the risks and returns of another
authorized transaction, investment or instrument or operate as a
substitute for cash market transactions. A derivative
transaction entered into by the insurer as a hedging transaction
48 may not be considered a replication transaction.

2 **41. Repurchase transaction.** "Repurchase transaction" means
3 a transaction in which an insurer purchases securities from a
4 business entity that is obligated to repurchase the purchased
5 securities or equivalent securities from the insurer at a
6 specified price, either within a specified period of time or upon
7 demand.

8 **42. Reverse repurchase transaction.** "Reverse repurchase
9 transaction" means a transaction in which an insurer sells
10 securities to a qualified bank or a qualified business entity or
11 a bank or a business entity whose obligations with respect to
12 such transaction are guaranteed by a qualified bank or a
13 qualified business entity and the insurer is obligated to
14 repurchase the sold securities or equivalent securities from the
15 bank or business entity at a specified price, either within a
16 specified period of time or upon demand.

17 **43. Securities exchange.** "Securities exchange" means:

18 A. An exchange registered as a national securities exchange
19 or a securities market registered under the Securities
20 Exchange Act of 1934, 15 United States Code, Section 78 et
21 seq., as amended;

22 B. A market of private offerings resales and trading
23 through automated linkages; or

24 C. A designated offshore securities market as defined in
25 Securities Exchange Commission Regulation S, 17 Code of
26 Federal Regulations, Part 230, as amended.

27 **44. Securities lending transaction.** "Securities lending
28 transaction" means a transaction in which securities are loaned
29 by an insurer to a qualified bank or a qualified business entity
30 or a bank or a business entity whose obligations with respect to
31 such transaction are guaranteed by a qualified bank or a
32 qualified business entity that is obligated to return the loaned
33 securities or equivalent securities to the insurer, either within
34 a specified period of time or upon demand.

35 **45. Subsidiary.** "Subsidiary" has the meaning as prescribed
36 in section 222, subsection 2, paragraph F. The term "subsidiary"
37 does not include a separate account established under section
38 2537.

39 **46. Swap.** "Swap" means an agreement to exchange or to net
40 payments at one or more times based on the actual or expected
41 price, yield, level, performance or value of one or more
42 underlying interests.

2 47. Underlying interest. "Underlying interest" means the
3 assets, liabilities or other interests, or a combination of those
4 assets, liabilities or interests, underlying a derivative
5 instrument, such as any one or more securities, currencies,
6 rates, indices, commodities or derivative instruments that are or
7 relate to investments or investment practices that an insurer is
8 permitted to acquire or engage in pursuant to this chapter.

9
10 48. United States. "United States" when used to signify
11 place includes those geographical areas and the lands and waters
12 adjacent to those geographical areas under the jurisdiction of
13 the United States.

14 49. Warrant. "Warrant" means an instrument that gives the
15 holder the right to purchase or sell the underlying interest at a
16 given price and time or at a series of prices and times outlined
17 in the warrant agreement.

18
19 Sec. 5. 24-A MRSA §1153, sub-§2, as enacted by PL 1987, c.
20 399, §14, is repealed.

21 Sec. 6. 24-A MRSA §1153, sub-§4 is enacted to read:

22
23 4. Derivative transactions. This chapter does not prohibit
24 an insurer from engaging in hedging transactions, income
25 generation transactions and replication transactions under the
26 following conditions.

27
28 A. Prior to entering into any derivative transaction, the
29 board of directors of the insurer shall determine that the
30 insurer, directly or through an investment management
31 subsidiary or affiliate, has adequate professional
32 personnel, technical expertise and systems to implement
33 investment practices involving derivative transactions and
34 approve a derivative instruments use plan that:

35
36 (1) Describes investment objectives and risk
37 constraints, such as counter-party exposure amounts;

38
39 (2) Defines permissible transactions including
40 identification of the risks that may be hedged, the
41 assets or liabilities that may be replicated and
42 permissible types of income generation transactions; and

43
44 (3) Requires compliance with internal control
45 procedures.

46
47 B. The insurer shall establish written internal control
48 procedures that provide for:

2 (1) A quarterly report to the board of directors that
3 reviews:

4 (a) All derivative transactions entered into,
5 outstanding or closed out;

6 (b) The results and effectiveness of the
7 insurer's implementation of its derivative
8 instruments use plan; and

9 (c) The credit risk exposure to each
10 counter-party for over-the-counter derivative
11 transactions based upon the counter-party exposure
12 amount;

13 (2) A system for determining whether hedging, income
14 generation or replication strategies utilized by the
15 insurer have been effective;

16 (3) A system of regular reports on at least a monthly
17 basis to management that include:

18 (a) A description of all derivative transactions
19 entered into, outstanding or closed out during the
20 period since the last report;

21 (b) The purpose of each outstanding derivative
22 transaction;

23 (c) A performance review of the derivative
24 instruments program; and

25 (d) The counter-party exposure amounts for
26 over-the-counter derivative transactions;

27 (4) Written authorizations that identify the
28 responsibilities and limitations of authority of
29 persons authorized to effect and maintain derivative
30 transactions; and

31 (5) Documentation appropriate for each transaction
32 including:

33 (a) The purpose of the transaction;

34 (b) The assets or liabilities to which the
35 transaction relates;

36 (c) The specific derivative instrument used in
37 the transaction;

2 (d) For over-the-counter derivative instrument
4 transactions, the name of the counter-party and
 the counter-party exposure amount; and

6 (e) For exchange-traded derivative instruments,
8 the name of the exchange and the name of the firm
 that handled the transaction.

10 C. Whenever the derivative transactions entered into under
12 this subsection are not in compliance with this subsection
14 or, if continued, may now or subsequently create a hazardous
16 financial condition of the insurer that affects its
18 policyholders, creditors or the general public, the
 superintendent may, after notice and an opportunity for a
 hearing, order the insurer to take such action as may be
 reasonably necessary to rectify such noncompliance or such
 hazardous financial condition or prevent an impending
 hazardous financial condition from occurring.

20 D. An insurer may enter into hedging transactions under
22 this subsection if as a result of and after giving effect to
24 each such transaction:

(1) The aggregate statutory financial statement value
26 of all outstanding options other than collars, caps,
28 floors and warrants not attached to another financial
 instrument purchased by the insurer pursuant to this
 subsection does not exceed 7.5% of its admitted assets;

30 (2) The aggregate statutory financial statement value
32 of all outstanding options other than collars,
34 warrants, caps and floors written by the insurer
 pursuant to this subsection does not exceed 3% of its
 admitted assets; and

36 (3) The aggregate potential exposure of all
38 outstanding collars, swaps, forwards and futures
40 entered into or acquired by the insurer pursuant to
 this subsection does not exceed 6.5% of its admitted
 assets.

42 With respect to hedging transactions, an insurer shall
44 demonstrate to the superintendent upon request the intended
46 hedging characteristics and effectiveness of the hedging
48 transaction or combination of hedging transactions through
 cash-flow testing, duration analysis or other appropriate
 analysis.

2 E. An insurer may enter into an income generation
3 transaction if:

4 (1) As a result of and after giving effect to the
5 transaction, the aggregate statutory financial
6 statement value of admitted assets that are then
7 subject to call or that generate the cash flows for
8 payments required to be made by the insurer under caps
9 and floors sold by the insurer and then outstanding
10 under this paragraph, plus the statutory financial
11 statement value of admitted assets underlying
12 derivative instruments then subject to calls sold by
13 the insurer and outstanding under this paragraph, plus
14 the purchase price of assets subject to puts then
15 outstanding under this paragraph does not exceed 10% of
16 its admitted assets; and

17 (2) The transaction is one of the following types and
18 meets the other requirements specified in this
19 subparagraph that are applicable to such type of
20 transaction:

21 (a) Sales of call options on assets, if the
22 insurer holds or has a currently exercisable right
23 to acquire the underlying assets during the entire
24 period that the option is outstanding;

25 (b) Sales of put options on assets, if the
26 insurer holds sufficient cash, cash equivalents or
27 interests in a short-term investment pool to
28 purchase the underlying assets upon exercise
29 during the entire period that the option is
30 outstanding, and has the ability to hold the
31 underlying assets in its portfolio. If the total
32 market value of all put options sold by the
33 insurer exceeds 2% of the insurer's admitted
34 assets, the insurer shall set aside pursuant to a
35 custodial or escrow agreement cash or cash
36 equivalents having a market value equal to the
37 amount of its put option obligations in excess of
38 2% of the insurer's admitted assets during the
39 entire period the option is outstanding;

40 (c) Sales of call options on derivative
41 instruments if the insurer holds or has a
42 currently exercisable right to acquire assets
43 generating the cash flow to make any payments for
44 which the insurer is liable pursuant to the
45 underlying derivative instruments during the
46 entire period that the call options are
47 outstanding;

2 outstanding and has the ability to enter into the
3 underlying derivative transactions for its
4 portfolio; or

5 (d) Sales of caps and floors, if the insurer
6 holds or has a currently exercisable right to
7 acquire assets generating the cash flow to make
8 any payments for which the insurer is liable
9 pursuant to the caps and floors during the entire
10 period that the caps and floors are outstanding.

11 F. An insurer may enter into replication transactions, if:

12 (1) The insurer would otherwise be authorized under
13 this chapter to invest its funds in the asset being
14 replicated; and

15 (2) The asset being replicated is subject to all the
16 provisions and limitations on the making thereof
17 specified in this chapter with respect to investments
18 by the insurer as if the transaction constituted a
19 direct investment by the insurer in the replicated
20 asset.

21 G. An insurer may purchase or sell one or more derivative
22 instruments to offset, in whole or in part, any derivative
23 instrument previously purchased or sold, without regard to
24 the quantitative limitations of this subsection, provided
25 that such offsetting transaction utilizes the same type of
26 derivative instrument as the derivative instrument being
27 offset.

28 H. Each derivative instrument must be:

29 (1) Traded on a securities exchange;

30 (2) Entered into with, or guaranteed by, a qualified
31 bank or a qualified business entity;

32 (3) Issued or written by or entered into with the
33 issuer of the underlying interest on which the
34 derivative instrument is based; or

35 (4) In the case of futures, traded through a broker
36 that is registered as a futures commission merchant
37 under the federal Commodity Exchange Act or that has
38 received exemptive relief from such registration under
39 rule 30.10 promulgated under the federal Commodity
40 Exchange Act.

41

2 **Sec. 7. 24-A MRSA §1155, sub-§2**, as enacted by PL 1987, c.
399, §14, is amended to read:

4 **2. Government obligations; policy loans; other**
5 **limitations.** Except as otherwise expressly provided, an insurer
6 may not invest ~~more than 10% of its assets in the securities of~~
7 in investments in or incur counter-party exposure amounts to any
8 one person if, after giving effect to those investments, the
9 aggregate of those investments in and counter-party exposure
10 amounts to that person would exceed 10% of the insurer's admitted
11 assets, other than investments eligible under the following
12 sections:

14 A. Government obligations, section 1156, subsection 2,
15 paragraph A; and

16 B. Policy loans, section 1158.

18 **Sec. 8. 24-A MRSA §1156, sub-§2, ¶C**, as enacted by PL 1987, c.
20 399, §14, is amended to read:

22 C. Obligations secured by liens on real property or
23 interests in ~~that~~ real property located within the United
24 States and not eligible under paragraph A or B; acquired
25 directly or indirectly through limited partnership
26 interests, general partnership interests, joint ventures,
27 stock of an investment subsidiary or membership interests in
28 a limited liability company, trust certificates or other
29 similar instruments if, at the time of the acquisition, the
30 obligation does not exceed:

32 (1) Ninety percent of the fair market value of the
33 real estate, if the mortgage loan is secured by a
34 purchase money mortgage or like security received by
35 the insurer upon disposition of the real estate;

36 (2) Eighty percent of the fair market value of the
37 real estate, if the mortgage loan requires immediate
38 scheduled payment in periodic installments of principal
39 and interest, has an amortization period of 30 years or
40 less and requires periodic payments made no less
41 frequently than annually. Each periodic payment must
42 be sufficient to ensure that at all times the
43 outstanding principal balance of the mortgage loan may
44 not be greater than the outstanding principal balance
45 that would be outstanding under a mortgage loan with
46 the same original principal balance, with the same
47 interest rate and requiring equal payments of principal
48 and interest with the same frequency over the same
49 amortization period. Mortgage loans are permitted
50

2 under this subparagraph notwithstanding the fact that
3 the loans provide for a payment of the principal
4 balance prior to the end of the period of amortization
5 of the loan. For residential mortgage loans, the 80%
6 limitation may be increased to 97% if acceptable
7 private mortgage insurance has been obtained; or

8 (3) Seventy-five percent of the fair market value of
9 the real estate for mortgage loans that do not meet the
10 requirements of subparagraph (1) or (2).

12 A mortgage loan that is secured by other than a first lien
13 may not be acquired under this paragraph unless the insurer
14 is the holder of the first lien. For purposes of this
15 paragraph, the amount of an obligation required to be
16 included in the calculation of the loan-to-value ratio may
17 be reduced to the extent the obligation is insured by the
18 Federal Housing Administration or guaranteed by the
19 Administrator of Veterans' Affairs, or their successors. A
20 mortgage loan that is acquired under this paragraph and is
21 restructured in a manner that meets the requirements of a
22 restructured mortgage loan in accordance with the National
23 Association of Insurance Commissioners accounting practices
24 and procedures manual or successor publication continues to
25 qualify as a mortgage loan under this paragraph.

26 A credit lease transaction is exempt from the requirements
27 of this paragraph if: the loan amortizes over the initial
28 fixed lease term at least in an amount sufficient so that
29 the loan balance at the end of the lease term does not
30 exceed the original appraised value of the real estate; the
31 lease payments cover or exceed the total debt service over
32 the life of the loan; a tenant or its affiliated entity
33 whose rated credit instruments have a rating of "1" or "2"
34 from the Securities Valuation Office of the National
35 Association of Insurance Commissioners or a comparable
36 rating from a nationally recognized statistical rating
37 organization recognized by the Securities Valuation Office
38 has a full faith and credit obligation to make the lease
39 payments; the insurer holds or is the beneficial holder of
40 a first lien mortgage on the real estate; the expenses of
41 the real estate are passed through to the tenant, excluding
42 exterior, structural, parking and heating, ventilation and
43 air conditioning replacement expenses, unless annual escrow
44 contributions, from cash flows derived from the lease
45 payments, cover the expense shortfall; and there is a
46 perfected assignment of the rents due pursuant to the lease
47 to, or the benefit of, the insurer;
48

2 **Sec. 9. 24-A MRSA §1156, sub-§2, ¶G**, as amended by PL 1993, c.
313, §27, is further amended to read:

4 **G. The following foreign investments and investment**
practices with persons in foreign jurisdictions:

6 (1) Canadian securities and investments substantially
8 of the same classes as those eligible for investment
10 under paragraphs A to F, but the aggregate amount of
12 those investments that are held at any time by any
14 insurer may not exceed 10% of total admitted assets,
 except when a greater amount is permitted pursuant to
 subparagraph (2), in which case this subparagraph is
 not applicable;

16 (2) In the case of any insurer that is authorized to
18 do business in a foreign country or possession of the
20 United States or that has outstanding insurance,
22 annuity or reinsurance contracts on lives or risks
24 resident or located in a foreign country or possession
26 of the United States, securities and investments in
28 that foreign country or possession that are
30 substantially of the same classes as those eligible for
32 investment under paragraphs A to F, but the aggregate
34 amount of such investments in a foreign country or a
 possession of the United States and of cash in the
 currency of that country or possession that is at any
 time held by that insurer may not, except as provided
 in paragraph H, exceed 1 1/2 times the amount of its
 reserves and other obligations under those contracts or
 the amount that that insurer is required by law to
 invest in that country or possession, whichever is
 greater; and

36 ~~In addition to the foreign investments permitted~~
38 ~~under subparagraphs (1) and (2), securities~~ Foreign
40 investments and investments investment practices with
42 persons in foreign countries jurisdictions that are
44 substantially of the same classes as those eligible for
 investment under paragraphs A to F, but the aggregate
 amount of those investments made pursuant to this
 subparagraph may not exceed 1% of total admitted
 assets, and this chapter, if after giving effect to the
 investment or transaction:

46 (a) The aggregate amount of foreign investments
48 then held by the insurer under this subparagraph
 does not exceed 20% of its admitted assets; and

2 (b) The aggregate amount of foreign investments
3 then held by the insurer under this subparagraph
4 in a single foreign jurisdiction does not exceed
5 10% of its admitted assets as to a foreign
6 jurisdiction that has a sovereign debt rating of
7 "1" from the Securities Valuation Office of the
8 National Association of Insurance Commissioners or
9 3% of its admitted assets as to any other foreign
10 jurisdiction; and

11 (4) Notwithstanding the provisions of subparagraph
12 (3), investments and investment practices denominated
13 in foreign currencies or additional foreign currency
14 exposure as a result of the termination or expiration
15 of a hedging transaction with respect to investments
16 denominated in a foreign currency if:

17 (a) The aggregate amount of investments then held
18 by the insurer under this subsection denominated
19 in foreign currencies does not exceed 10% of its
20 admitted assets; and

21 (b) The aggregate amount of investments then held
22 by the insurer under this subsection denominated
23 in the foreign currency of a single foreign
24 jurisdiction does not exceed 10% of its admitted
25 assets as to a foreign jurisdiction that has a
26 sovereign debt rating of "1" from the Securities
27 Valuation Office of the National Association of
28 Insurance Commissioners or 3% of its admitted
29 assets as to any other foreign jurisdiction.

30 An investment may not be considered denominated in a
31 foreign currency if the acquiring insurer enters into
32 one or more contracts in transactions permitted under
33 section 1153, subsection 4 and the business entity
34 counter-party agrees under the contract or contracts to
35 exchange all payments made on the foreign currency
36 denominated investment for United States currency at a
37 rate that effectively insulates the investment cash
38 flows against future changes in currency exchange rates
39 during the period the contract or contracts are in
40 effect; and

41 **Sec. 10. 24-A MRSA §1160, sub-§3, as enacted by PL 1987, c.**
42 **399, §14, is amended to read:**

43 **3. Investments in affiliates.** No insurer may purchase the
44 stock of or otherwise invest in or lend its funds upon the
45 security of any note or other evidence of indebtedness of any

2 affiliate in the insurer's holding company system, as defined in
3 section 222, or lend its funds to any director or officer of the
4 insurer or the spouse or child of any director or officer. This
5 provision may not be considered to prohibit:

6 A. Policy loans authorized under section 1158; or

7 ~~B. Investments in subsidiaries under section 1157; or~~

8 B-1. Any transaction between an insurer and any of its
9 subsidiaries or affiliates that is entered into in
10 compliance with section 222.

11 ~~C. Purchases of stock, investments or loans made in~~
12 ~~accordance with section 222 from, in or to controlling~~
13 ~~shareholders or affiliates, provided that any of these~~
14 ~~purchases, investments or loans which exceed 1/2 of 1% of~~
15 ~~the insurer's admitted assets shall be subject to the prior~~
16 ~~approval of the superintendent, which approval shall be~~
17 ~~considered given unless the superintendent objects to that~~
18 ~~transaction within 45 days of receipt of written notice of~~
19 ~~that transaction.~~

20 **Sec. 11. 24-A MRSA §1160, sub-§4, as enacted by PL 1987, c.**
21 **399, §14, is repealed.**

22 **Sec. 12. 24-A MRSA §1160, sub-§6 is enacted to read:**

23 **6. Encumbrance of securities. An insurer may enter into**
24 **securities lending transactions that are conducted directly,**
25 **through a custodian bank that is a qualified bank or through an**
26 **agent, repurchase transactions, reverse repurchase transactions**
27 **and dollar roll transactions, subject to the following**
28 **requirements.**

29 **A. The insurer's board of directors shall adopt a written**
30 **plan regarding such transactions that specifies guidelines**
31 **and objectives to be followed, such as:**

32 **(1) A description of how cash received will be**
33 **invested or used for general corporate purposes of the**
34 **insurer;**

35 **(2) Operational procedures to manage interest rate**
36 **risk, counter-party default risk, the condition under**
37 **which proceeds from reverse repurchase transactions may**
38 **be used in the ordinary course of business and the use**
39 **of acceptable collateral in a manner that reflects the**
40 **liquidity needs of the transaction; and**

41

2 (3) The extent to which the insurer may engage in
3 these transactions.

4 B. The insurer shall enter into a written agreement for all
5 transactions authorized in this subsection other than dollar
6 roll transactions. The written agreement must require each
7 transaction to terminate no more than one year from its
8 inception. The agreement must be made with the business
9 entity counter-party, but, for securities lending
10 transactions, the agreement may be through a custodian bank
11 that is a qualified bank or the agreement may be with an
12 agent acting on behalf of the insurer if the agent or the
13 guarantor of the agent's obligations under the agreement is
14 a qualified bank or a qualified business entity and if the
15 agreement with the agent requires the agent to enter into
16 separate agreements with each counter-party that are
17 consistent with the requirements of this subsection and
18 prohibits securities lending transactions under the
19 agreement with the agent or its affiliates.

20 C. Cash received in a transaction under this subsection
21 must be invested in accordance with this chapter and in a
22 manner that recognizes the liquidity needs of the
23 transaction or be used by the insurer for its general
24 corporate purposes. For so long as the transaction remains
25 outstanding, the insurer, its agent or custodian shall
26 maintain, as to acceptable collateral received in a
27 transaction under this subsection, either physically or
28 through the book entry systems of the Federal Reserve,
29 Depository Trust Company, Participants Trust Company or
30 other securities depositories approved by the superintendent:

31 (1) Possession of the acceptable collateral;

32 (2) A perfected security interest in the acceptable
33 collateral; or

34 (3) In the case of a foreign jurisdiction, title to,
35 or rights of a secured creditor to, the acceptable
36 collateral.

37 D. An insurer may not enter into a transaction under this
38 subsection if, as a result of and after giving effect to the
39 transaction:

40 (1) The aggregate amount of securities then loaned to,
41 sold to or purchased from any one business entity
42 counter-party under this subsection would exceed 5% of
43 its admitted assets. In calculating the amount sold to
44 or purchased from a business entity counter-party under

2 repurchase or reverse repurchase transactions, effect
3 may be given to netting provisions under a master
4 written agreement; or

5 (2) The aggregate amount of all securities then loaned
6 to, sold to or purchased from all business entities
7 under this subsection would exceed 40% of its admitted
8 assets.

10 E. The amount of collateral required for securities lending
11 transactions, repurchase transactions and reverse repurchase
12 transactions is the amount required pursuant to the
13 provisions of the purposes and procedures manual of the
14 Securities Valuation Office of the National Association of
15 Insurance Commissioners or its successor publication.

16 **Sec. 13. 24-A MRSA §1162-A**, as corrected by RR 1993, c. 1,
17 §§57 and 58, is repealed.

18 **Sec. 14. 24-A MRSA §4204, sub-§3-A, ¶D**, as enacted by PL 1993,
19 c. 702, Pt. A, §12, is amended to read:

20 D. Notwithstanding any provisions of this section and
21 chapter 13-A allowing other investments, a health
22 maintenance organization shall maintain cash or investment
23 grade obligations, as defined in section 1162-A 1151-A, that
24 at all times have a fair market value of not less than 100%
25 of the organization's liability for claims payable and
26 incurred, but not reported, claims, unearned premiums,
27 unpaid claims adjustment expenses and, as applicable, any
28 statutory, special or additional reserves provided by the
29 health maintenance organization for the benefit of members
30 as of the most recent calendar quarter prepared on the basis
31 of statutory accounting principles. If the organization's
32 liability for claims payable and incurred, but not reported,
33 claims increased more than 10% prior to the end of the
34 calendar quarter, the organization must, within 10 days of
35 the determination, reallocate its investments to ensure
36 compliance with this paragraph. The investments required by
37 this paragraph constitute admitted assets of the
38 organization.

42 SUMMARY

43 This bill rewrites certain provisions of the Maine Insurance
44 Code dealing with investments of life and health insurers,
45 including investments in affiliates, foreign investments,
46 encumbrance of securities and limits on both mortgage loans and
47 the use of derivative investments. It replaces portions of
48
49
50

2 current Maine law with provisions drawn from the Investment of
3 Insurers Model Act developed by the National Association of
4 Insurance Commissioners, or "NAIC," and adopted in a number of
5 other states.

6 This bill adds a number of definitions to Maine's investment
7 law to implement the provisions of this bill and repeals the
8 definition of "bona fide hedging transaction."

10 The bill addresses hedging and other uses of derivative
11 investment instruments, consistent with the model investment law
12 and more recent regulatory developments in other states. It
13 places new limits on the use of derivatives by life and health
14 insurers, while at the same time updating Maine law to recognize
15 the evolution in this area.

16 The bill amends the diversification requirements of Maine's
17 investment law to specifically apply to derivative transactions,
18 counter-party exposure amounts, securities lending transactions,
19 reverse repurchase transactions, repurchase transactions and
20 dollar roll transactions.

22 The bill imposes limits on mortgage lending by life and
23 health insurers not now imposed in Maine law. The limits are
24 similar to those contained in the NAIC model investment law.

26 The bill expands the limitations on foreign investments to
27 match those in the model investment law, allowing Maine life and
28 health insurers greater access to maturing global capital markets.

30 The bill amends the Maine Revised Statutes, Title 24-A,
31 section 1160, subsection 3 to address a conflict between Maine's
32 investment law and its insurance holding company law with respect
33 to transactions with affiliates. It is consistent with the model
34 law. The result of amending this section is to allow Title 24-A,
35 section 222, subsection 9, paragraph E, subparagraph (1),
36 division (b) to be the exclusive source of regulation on this
37 issue, eliminating confusion caused by the current overlap and
38 inconsistency of the 2 provisions.

40 The bill addresses ambiguities as to the applicability to
41 securities lending, repurchase, and reverse repurchase
42 transactions of the limits on the percentage of an insurer's
43 assets that may be pledged to secure borrowings by the insurer.
44 The bill also increases the limits to be consistent with the
45 model investment law.