INVESTMENTS OF INSURERS MODEL ACT
(Defined Standards Version)

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Statement of Principles

The development of regulation of the investments of insurers requires an analysis of the complexities, uncertainties, and competitive forces and frequent changes in the investment markets and in the insurance business, the diversity among insurers, and the need for a balance among risk, reward and liquidity of an insurer's investments. It also requires an analysis of how to safeguard the financial condition of domestic insurers and at the same time to permit them to meet their needs, and whether its existing regulatory structure may be improved by using provisions from either or both of the model laws recommended by the National Association of Insurance Commissioners (NAIC) or from existing regulatory structures in other states or industries. Two alternative model laws are recommended by the NAIC. These are:

A. Investments of Insurers Model Act (Defined Limits Version);

B. Investments of Insurers Model Act (Defined Standards Version).

These model laws are not considered by the NAIC to exhaust regulatory methods to address the regulation of investments of insurers. Nor are these model laws recommended by the NAIC to be used as standards for the examination of insurers unless substantially similar provisions are found in the statutes and regulations of the state of domicile of the insurer.

Drafting Note: States considering provisions in this model should also read the statement of principles and annotations prepared by the drafters to supplement and explain significant concepts in investment statutes.

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Section 1. Purpose and Scope

A. The purpose of this Act is to protect and to further the interests of insureds, creditors and the general public by providing, with minimum interference with management initiative and judgment, prudent standards for the development and administration of insurer investment programs.

B. This Act and the regulations adopted to interpret and implement it apply to domestic insurers and U. S. branches of alien insurers entered through this state, except for insurers organized pursuant to [cite statutes applicable to exempted insurers].

Drafting Note: This Act does not define the types of insurers subject to its provisions, leaving this to other sections of the code since state laws treat insurers writing various lines of insurance differently. For example, if an entity is authorized to operate as a health

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(d) Changes in economic conditions that would make liquidity more important than contemplated and would force untimely sale of assets or prevent timely investments;

(e) Currency devaluation to which the insurer may be subject; and

(f) Any other contingencies the commissioner can identify that may affect the insurer's operations.

(2) Controlling factors. In making the determination under this subsection, the commissioner shall take into account the following factors:

(a) The most reliable information available as to the magnitude of the various risks under Paragraph (1) of this subsection;

(b) The extent to which the risks in Paragraph (1) of this subsection are independent of each other or are related, and whether any dependency is direct or inverse;

(c) The insurer's recent history of profits or losses;

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production for current lines of business. As part of its exercise of judgment and care, the board of directors shall take into account the prudence evaluation criteria of Section 5 of this Act.

C. The insurer shall establish and implement internal controls and procedures to assure compliance with investment policies and procedures to assure that:

(1) The insurer's investment staff and any consultants used are reputable and capable;

(2) A periodic evaluation and monitoring process occurs for assessing the effectiveness of investment policy and strategies;

(3) Management's performance is assessed in meeting the stated objectives within the investment policy; and

(4) Appropriate analyses are undertaken of the degree to which asset cash flows are adequate to meet liability cash flows under different economic environments. These analyses shall be conducted at least annually and make specific reference to economic conditions.

Section 5. Prudence Evaluation Criteria

The following factors shall be evaluated by the insurer and considered along with its business in determining whether an investment portfolio or investment policy is prudent; the commissioner shall consider the following factors prior to making a determination that an insurer's investment portfolio or investment policy is not prudent:

A. General economic conditions;

B. The possible effect of inflation or deflation;

C. The expected tax consequences of investment decisions or strategies;

D. re 0 Tw 17.728 02.09

J. Tangible personal property under contract of sale or lease under which contractual payments may reasonably be expected to return the principal of and provide earnings on the investment within its anticipated useful life;

K.

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. If an insurer does not own, or is unable to apply toward compliance with this Act, an amount of assets equal to its minimum asset requirement, the commissioner may deem it to be financially hazardous under [insert reference to statute providing the failure to meet minimum asset requirements as grounds for liquidation and rehabilitation].

Section 12. Reports and Replies

A. The commissioner may require any of the following from a person subject to regulation under this Act:

(1) Statements, reports, answers to questionnaires and other information, and evidence thereof, in whatever reasonable form the commissioner designates, and at such reasonable intervals as the commissioner chooses.

(2) Full explanation of the programming of any data storage or communication system in use.

(3) That information from any books, records, electronic data processing systems, computers or any other information storage system be made available to the commissioner at a reasonable time and in a reasonable manner.

B. The commissioner may prescribe forms for the reports under Subsection A and specify who shall execute or certify the reports. The forms for the reports required under Subsection A shall be consistent, so far as practicable, with those prescribed by other jurisdictions.

C. The commissioner may prescribe reasonable minimum standards and techniques of accounting and data handling to ensure that timely and reliable information will exist and will be available to the commissioner.

D. Any officer, manager or general agent of an insurer subject to this Act, any person controlling or having a contract under which the person has a right to control the insurer, whether exclusively or otherwise, or a person with executive authority over or in charge of any segment of the insurer's affairs, shall reply promptly in writing or in other reasonably designated form, to a written inquiry from the commissioner requesting a reply.

E. The commissioner may require that any communication made to the commissioner under this section be verified.

F. A communication to the commissioner, or to an expert or consultant retained by the commissioner, required by the provisions of this Act shall not subject the person making it to an action for damages for the communication in the absence of actual malice.

G. Notwithstanding the provisions of Subsection F, the commissioner may bring suit against any person providing information required under this Act that is not truthful and accurate.

Drafting Note: If a state's insurance code and regulations contain provisions substantially similar to this section, the state may consider deleting this section or replacing this section with language contained in other portions of its code.

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Section 13. Retention of Experts

The commissioner may retain at the insurer's expense attorneys, actuaries, accountants and other experts not otherwise a part of the commissioner's staff as may be reasonably necessary to assist in reviewing the insurer's investments. Persons so retained shall be under the direction and control of the commissioner and shall act in a purely advisory capacity.

Section 14. Commissioner's Orders

A. If the commissioner determines that an insurer's investmen4 (i)-3.23.1 -3.23.1 24 (a5 Tw 4

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(c) Prescription of qualitative tests for investments and conditions under which investments may be made, including requirements of specified ratings from investment advisory services, listing on specified stock exchanges, collateral, marketability, currency matching and the financial and legal status of(in)2.3 (g)2.6 (a

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ANNOTATIONS

INVESTMENTS OF INSURERS MODEL ACT

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Despite these potentially salutary effects, review of the investment plan is ill suited as a primary basis for regulatory enforcement. Indeed, this Act has no automatic filing requirement for an insurer's investment policy; rather, the commissioner may request it under Section 12 or may require automatic filing by a regulation promulgated under Section 18. As written, this Act does not contemplate formal approval of an insurer's investment policy by the commissioner.

The reason for this approach is that a plan, by its very nature, is strictly prospective. Regulatory enforcement must also consider actions and their results. An assessment of the prospective advisability of any insurer's written investment plan is subject to highly technical and academic argumentation. When an insurer's investment policy results in adverse financial trends, decisive action is needed, not ponderous symposia of investment theory before a court of law.

Section 7

Annotation 5: States could adopt an entirely different plan of investment categories based on an independently commissioned study, retain their existing investment categories, or seek guidance from the defined limits version of this Act. A state's history and indigenous industries may serve as useful considerations. For example, if oil exploration and refining have long been an important part of a given state'

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Section 9

Annotation 7: This section recognizes that the ability to absorb investment risk varies inversely to the level of underwriting risk, and that this principle will generally apply to international operations as well as domestic operations.

If an insurer perceives that acceptable underwriting risks may be located in foreign nations with extremely unstable currencies and without suitable investment opportunities, the commissioner may waive requirements to hold the foreign-

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