

## PROJECT HISTORY - 2008

### MODEL ACT ON CUSTODIAL AGREEMENTS AND THE USE OF CLEARING CORPORATIONS (#295)

### MODEL REGULATION ON CUSTODIAL AGREEMENTS AND THE USE OF CLEARING CORPORATIONS (#298)

#### 1. Project Description

The FHLB Custodial Subgroup of the Examination Oversight (E) Task Force was created at the 2007 Summer National Meeting of the NAIC. This Subgroup was created to work on a charge given to the Task Force by the Financial Condition (E) Committee. The Subgroup was to consider the Federal Home Loan Banks' (FHLBanks) request to be included in the Model Regulation on Custodial Agreements and the Use of Clearing Corporations and provide a recommendation to the Financial Condition (E) Committee. This charge was prompted by a comment letter received from the FHLBanks dated February 16, 2007.

#### 2. Group Responsible for Drafting the Regulation

The project to review the FHLBanks request was given to the Examination Oversight (E) Task Force and assigned to the FHLB Custodial Subgroup. The following states participated in the subgroup:

Kansas, Chair	Alabama
New York	Tennessee

#### 3. Charge Authorizing the Project

The Financial Condition (E) Committee approved the following charge for the Examination Oversight (E) Task Force through an e-mail vote completed on April 30, 2007:

*The Examination Oversight (E) Task Force shall consider the FHLB request to be included in the Model Regulation on Custodial Agreements and the Use of Clearing Corporations and provide its recommendation to the Financial Condition (E) Committee.*

#### 4. General Description of the Drafting Process and Due Process

To begin reviewing the FHLBanks' request, the Subgroup had some questions about the FHLBanks' process to handle custodial assets and how that process is reviewed by its federal regulator. Initial questions were communicated to the FHLBanks in a memo dated July 26, 2007. The FHLBanks responded to the questions through their memo dated August 28, 2007. A conference call between the Subgroup and members of the FHLBanks was held September 5, 2007 to discuss the issues in greater detail. Finally, additional information was requested by the Subgroup through a memo dated September 24, 2007, and another response was received from the FHLB on November 30, 2007.

Through investigating answers to questions relating to the controls and regulation of custodial services offered by the FHLBanks, the Subgroup was able to reach a conclusion that the FHLBanks should be permitted to function as authorized custodians as outlined in the Model Act and Regulation on Custodial Agreements and the Use of Clearing Corporations. After concluding that the FHLBanks should be allowed to function as authorized custodians, the Subgroup turned its attention to proposing revisions to the Model Act on Custodial Agreements and the Use of Clearing Corporations (#295) and the Model Regulation on Custodial Agreements and the Use of Clearing Corporations (#298). Both of these models included language describing authorized custodians that would exclude the FHLBanks. However, based on a review of the NAIC's Model Law Development Framework, it was determined that changes to these models would not meet the criteria included in the framework. As such, the Subgroup determined that revisions should be made to the models and offered as guidelines to the states.

The Subgroup held a conference call on February 21, 2008, and conducted business via e-mail on March 7, 2008 to complete its work in proposing guideline revisions to the models. The guideline revisions were referred to the Examination Oversight (E) Task Force at its March 31, 2008, meeting. The Examination Oversight (E) Task Force exposed the proposed guideline revisions for a 45-day comment period during which no comments were received. On June 1, 2008, the Examination Oversight (E) Task Force adopted the proposed guideline changes to Model #295 and #298.

**5. Discussion of Key Issues**

The FHLB Custodial Subgroup conducted an in-depth review of the capital requirements, regulatory oversight and custodial controls and standards in place at the FHLBanks to reach a determination that the FHLBanks should be allowed to operate as authorized custodians of insurance company securities. As such, guideline revisions have been proposed to the Model Act on Custodial Agreements and the Use of Clearing Corporations (#295) and the Model Regulation on Custodial Agreements and the Use of Clearing Corporations (#298) to allow the FHLBanks to meet the definition of an authorized custodian.

**6. Any Other Important Information**

No other items identified at this time.

**Exhibit A: Illustrative Timeline on Due Process and Drafting Process– FHLB Custody Issue**

<i>February 2007</i>	Letter received from the FHLBanks requesting permission to act as authorized custodians of insurance company securities.
<i>March 2007</i>	(Spring National Meeting) The Examination Oversight (E) Task Force refers the letter along with its comments to the Financial Condition (E) Committee for review.
<i>April 2007</i>	The Financial Condition (E) Committee approves a charge for the Examination Oversight (E) Task Force to work on the project.
<i>June 2007</i>	(Summer National Meeting) The Examination Oversight (E) Task Force creates the FHLB Custodial Subgroup to work on the charge.
<i>July 2007</i>	A letter requesting information from the FHLBanks is sent by the FHLB Custodial Subgroup.
<i>August 2007</i>	The FHLBanks response to the information request is received by the FHLB Custodial Subgroup.
<i>September 5, 2007</i>	A conference call of the FHLB Custodial Subgroup is held to discuss the information received from the FHLBanks and to gather additional information regarding the custodial function and controls in place at the FHLBanks.
<i>September 24, 2007</i>	An additional information request letter is sent from the FHLB Custodial Subgroup to the FHLBanks.
<i>November 30, 2007</i>	The FHLBanks response to the second information request letter is received by the FHLB Custodial Subgroup.
<i>February 21, 2008</i>	A conference call of the FHLB Custodial Subgroup is held to discuss potential changes to Model #295 and #298 to allow the FHLBanks to act as authorized custodians of insurance company securities.
<i>March 7, 2008</i>	The FHLB Custodial Subgroup conducts business via email to adopt a referral to the Examination Oversight (E) Task Force recommending revisions to Model #295 and #298.
<i>March 31, 2008</i>	The Examination Oversight (E) Task Force receives the referral of the FHLB Custodial Subgroup and votes to expose the proposed revisions to Model #295 and #298 for a 45-day comment period.
<i>June 1, 2008</i>	The Examination Oversight (E) Task Force adopts the proposed revisions as guideline changes to Model #295 and #298.
<i>June 2, 2008</i>	The Financial Condition (E) Committee adopts the proposed revisions as guideline changes to Model #295 and #298.

## PROJECT HISTORY - 2004

### MODEL ACT ON CUSTODIAL AGREEMENTS AND THE USE OF CLEARING CORPORATIONS (#295)

### MODEL REGULATION ON CUSTODIAL AGREEMENTS AND THE USE OF CLEARING CORPORATIONS (#298)

#### 1. Description of the Project, Issues Addressed, etc.

The Model Act to Permit the Use of Clearing Corporations and the Federal Book Entry System by Insurance Companies (the Model Act) and the Model Regulation on the Use of Clearing Corporations and Federal Book Entry by Insurance Companies (the Model Regulation) have been revised to permit the use of broker/dealers as custodian for insurance company assets. The titles of the Model Act and Model Regulation have also been revised to more clearly identify the items discussed in the models. The revised titles are the Model Act on the Use of Custodial Agreements and Clearing Corporations and the Model Regulation on the Use of Custodial Agreements and Clearing Corporations.

#### 2. Name of Group Responsible for Drafting the Model and States Participating

The Custodial Assets Working Group of the Financial Condition (E) Committee originally developed and adopted this revision. The working group includes: New York (Chair), Arkansas, Iowa, Oregon, and Texas.

#### 3. Project Authorized by What Charge and Date First Given to the Group

The 2004 charge of the working group is, "The Custodial Assets Working group will revise the appropriate model laws, acts and handbook guidance to allow broker/dealers that meet certain standards to be authorized NAIC custodians for insurance company investments."

#### 4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated

The drafting process was open as the Custodial Assets Working Group solicited comments from all interested parties, including interested regulators and industry representatives. At the 2003 Fall National Meeting, the Financial Condition (E) Committee voted to allow broker/dealers to act as custodians for insurance company assets. At that time, the Committee instructed the Custodial Assets Working Group to develop revisions to the applicable models. The revisions to the Model Act and Model Regulation were first discussed during an open conference call of the working group on November 19, 2003. At that time, the working group voted to expose the proposed revisions for comment. The revisions to the Model Act and Model Regulation were adopted during an open conference call of the working group on February 26, 2004.

#### 5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited)

The working group received comment letters from interested parties on whether broker dealers should be allowed to act as custodians for insurance companies. Comments were discussed in open forum at the Fall 2002, Winter 2002, and Spring 2003 National Meetings. The revisions to the models were exposed for a public comment for a sixty-day period. The working group discussed comments received in an open forum.

#### 6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response)

One significant issue was discussed by the working group and interested parties. One of the comment letters received discussed concern that the proposed revisions did not require broker/dealers to provide insurance coverage in excess of that provided by the Securities Investor Protection Corporation (SIPC). After some discussion, the working group voted to require that broker/dealers acting as custodians for insurance company assets hold insurance coverage in excess to that provided by SIPC in an amount equal to or greater than the largest, single insurance company customer deposit.

**7. Any Other Important Information (e.g., amending an accreditation standard)**

On January 1, 2003, the Financial Regulation Standards and Accreditation (F) Committee exposed for a two-year period the Model Act and Model Regulation as possible accreditation standards. If the revisions to the Model Act and Model Regulation are adopted by the NAIC membership, the Financial Regulation Standards and Accreditation (F) Committee will review the revised Model Act and Model Regulation for further consideration. In addition, the working group will send a referral to the Financial Examiners Handbook Technical Group to consider applicable revisions to the NAIC *Financial Condition Examiners Handbook*.