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By Electronic Delivery

Mr. David A. Stawick  
Secretary, Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, D.C. 20581

Ms. Elizabeth M. Murphy  
Secretary, Securities and Exchange Commission  
100 F Street NE  
Washington, D.C. 20549-1090

Re: Request for Comment on Definitions in Title VII of the Dodd-Frank Act;

Dear Mr. Stawick and Ms. Murphy:

The American Council of Life Insurers (“ACLI”) is a national trade association with 300 members that represent more than 90 percent of the assets and premiums of the life insurance and the annuity industry. Life insurers actively participated in the legislative dialogue concerning the examination and regulation of derivatives markets following the marketplace stresses of 2008.

ACLI submitted [input](#)<sup>1</sup> to both the Commodity Futures Trading Commission and the Securities and Exchange Commission (collectively, the “Commissions”) on the Advance Notice of Proposed Rulemaking (“ANPR”) on select “core” definitions that preceded the December 2010 proposed rulemaking (“Proposal”) to implement Title VII of the Dodd-Frank Act (the “Act”). The Proposal elicits input about several essential definitions in Title VII of the Act.

Our submission principally addresses the definitions of “Major Swap Participant” and “Major Security-Based Swap Participant,” which we refer to interchangeably throughout this letter as “MSP.” Thorough input on the Proposal is vitally important to life insurers who responsibly manage their assets and liabilities by using derivatives in accordance with state insurance laws to hedge their risks and ensure that they will be able to meet their obligations to the millions of hard-working Americans who rely upon them.

Life insurers support the Act’s goals of systemic risk reduction and transparency in the derivatives markets. Significantly, the Commissions must carefully evaluate the different regulatory structures, operations, and practices under which each financial service segment operates in order to fully and

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<sup>1</sup> See <http://sec.gov/comments/s7-16-10/s71610-62.pdf>

equitably effectuate the reform intended by Congress. These commendable goals were underscored in the legislative history supporting the Act.

Since the adoption of the Act, the Commissions have demonstrated exceptional accessibility, outreach, and transparency that constructively identified critical issues illuminating the rule implementation. We greatly appreciate these actions, especially in light of the complex substance and extremely tight deadlines imposed by the Act to complete over 90 rules or studies under Title VII within one year of enactment. ACLI welcomes the opportunity to continue a productive dialog on the Proposal with the Commissions.

## **I. Legislative Goals and Congressional Intent**

One of the core goals of Title VII of the Act was to prevent marketplace participants from engaging in irresponsible practices and excessive risk-taking in the derivatives markets.<sup>2</sup> Congress also recognized that derivatives are an important tool businesses use to manage costs and market volatility that must be preserved.<sup>3</sup> These goals were also explained in the legislative history of the Act,<sup>4</sup> which provides a framework guiding the proposed rulemaking. The Commissions are charged with balancing these interests as they implement Title VII through regulation.

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<sup>2</sup> See Senate Banking Committee [Summary](http://banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf) of Conference Report on Dodd-Frank Act at [http://banking.senate.gov/public/\\_files/070110\\_Dodd\\_Frank\\_Wall\\_Street\\_Reform\\_comprehensive\\_summary\\_Final.pdf](http://banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf)

<sup>3</sup> 124 Cong. Rec. S5904 (daily ed. July 15, 2010) (colloquy between Sen. Dodd and Sen. Lincoln.)

<sup>4</sup> For example, a July 15, 2010, colloquy between Senator Hagan and Senator Lincoln, Chair of the Senate Agriculture, Nutrition and Forestry Committee indicates that:

[I]t is the intent of the conference committee [that both the CFTC and the SEC focus on risk factors that contributed to the recent financial crisis, such as excessive leverage, under-collateralization of swap positions, and a lack of information about the aggregate size of positions....

When determining whether a person has a "substantial position," the CFTC and the SEC should consider the person's relative position in cleared versus the uncleared swaps and may take into account the value and quality of the collateral held against counterparty exposures. The committee wanted to make it clear that the regulators should distinguish between cleared and uncleared swap positions when defining what a "substantial position" would be. Similarly where a person has uncleared swaps, the regulators should consider the value and quality of such collateral when defining "substantial position." Bilateral collateralization and proper segregation substantially reduces the potential for adverse effects on the stability of the market. Entities that are not excessively leveraged and have taken the necessary steps to segregate and fully collateralize swap positions on a bilateral basis with their counterparties should be viewed differently.<sup>4</sup>

Another July 15, 2010, colloquy between Senator Dodd, Chairman of the Senate Banking Committee, and Senator Lincoln, Chair of the Senate Agriculture, Nutrition and Forestry Committee, further indicates that:

It is also important to note that few end users will be major swap participants, as we have excluded "positions held for hedging or mitigating commercial risk" from being considered as a "substantial position" under that definition....

It is also the intent of this bill to distinguish between commercial end users hedging their risk and larger, riskier market participants. Regulators should distinguish between these types of companies when implementing new regulatory requirements.

## **II. The Business of Life Insurance and Managing Commercial Risk**

Our letter suggests approaches to the definitions of key terms in Title VII that would have applicability across industries. As background to these recommendations, we provide some context about the use of derivatives in the life insurance industry, current regulation of insurers' use of derivatives, and our views on how the key terms might apply to insurance companies if our definitional suggestions are adopted.

Life insurers' financial products protect millions of individuals, families and businesses through guaranteed lifetime income, life insurance, long-term care, and disability income insurance. These products provide Americans with financial security through various stages of life and enable them to plan for their financial future, including retirement. Life insurers' obligations to policyholders are generally long-term, often extending for decades.

In order to meet their obligations to policyholders, life insurers must acquire assets that match their liabilities. Accordingly, they are major institutional investors. In 2008, life insurance industry assets of approximately \$4.6 trillion were invested across the following asset classes: corporate bonds (42%), stocks (24%), government bonds (14%), commercial mortgages (7%), and other assets (13%). With 56% of their assets invested in bonds, it is not surprising that life insurers provide the single largest source of corporate bond financing and are indispensable to American businesses and state and local governments, allowing them to cost-effectively raise capital. Moreover, in keeping with their long term liabilities, 41% of the corporate bonds purchased by life insurers had maturities of more than 20 years at time of purchase.<sup>5</sup>

Insurers use a broad range of derivatives to assist them in the core commercial activity of matching investments with their obligations to policy and contract holders. The following examples of life insurers' use of derivatives are informative. An insurer might use an interest rate swap to match a floating rate liability, such as a guaranteed investment contract, with a fixed rate asset purchased to support the liability. Many insurance liabilities, such as structured settlements, long term care insurance, and single premium immediate annuities have long durations which may extend beyond 30 years. Assets at the long end of the curve may not be available or attractive and insurers may prudently decide to invest in much shorter duration assets. However, to protect against reinvestment risk, an insurer may purchase a forward-starting interest rate swap to ensure that it can achieve the interest rate return built into the pricing of the product. Floors may be used to protect against the risk that interest rates fall below a minimum guaranteed crediting rate contained in a policy or annuity. Credit default protection may be purchased by an insurer to protect against credit losses in an asset that would generate significant realized losses if the asset were sold. Indeed, during the recent financial crisis and related freeze in the trading markets, one of the only means of protecting against further credit deterioration was the purchase of credit derivatives.

Life insurers have demonstrated the ability to use derivatives in a prudent manner. The imposition of significant federal regulation over and above the statutory or regulatory requirements in place could create unnecessary, non-economic frictional costs for delivering life insurance, long term care insurance, and retirement savings products to millions of Americans. In some instances, insurance products will need to be priced higher or removed from the market altogether if risks cannot be

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<sup>5</sup> These calculations are based on data from the NAIC and the U.S. Federal Reserve Board, Flow of Funds Accounts of the U.S. See American Council of Life Insurers, *Life Insurers Fact Book (2009)*.

hedged effectively. Ultimately, policyholders will incur greater costs or be unable to acquire these products to manage their retirement savings, estate planning, or long-term care coverage if regulation of risk-mitigating derivatives activity becomes overly burdensome.

### **III. State Regulation of Life Insurers' Use of Derivatives**

A critical factor that the Commissions should consider in determining the appropriate regulation of insurers' use of derivatives is the extent to which these activities are already regulated under state law. State insurance regulators oversee virtually every aspect of life insurers' business in the United States, including their use of derivatives.<sup>6</sup> The insurance codes of most states contain specific authorization and constraints on derivative transactions.<sup>7</sup> In all cases, an insurer must report its derivatives transactions, both OTC and exchange-traded, as part of its annual statutory accounting statements. Accordingly, life insurers' derivatives activities already benefit from significant transparency and regulation designed for risk reduction.

Appendix A to our submission highlights the scope of the National Association of Insurance Commissioners ("NAIC") Investments of Insurers Model Act regarding derivatives. Appendix B contains Schedule DB and its accompanying instructions from the NAIC Annual Statement for Life and Health Insurers. Appendix C contains pages from the NAIC Financial Condition Examiners Handbook relevant to derivatives matters. These state regulatory materials demonstrate that life insurers' use of derivatives instruments is strictly regulated, transparently reported, and specifically examined by state insurance regulators.<sup>8</sup>

Life insurer's use of derivatives predominately consists of hedging transactions to reduce risks associated with existing or anticipated assets or liabilities. Such risks include currency exchange risk (or the degree of exposure thereto) as well as the risk of change in value, yield, price, cash

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<sup>6</sup> The Commissions should carefully consider that life insurers are otherwise and substantively regulated by the states. In fact, with respect to derivatives, many insurers are doubly regulated by their domiciliary state and by New York's Department of Insurance to the extent that they conduct a substantial amount of business in New York. There is strong precedent for the Commissions to consider the 'otherwise regulated' status of certain market participants – particularly state-regulated insurers -- and consequently for it to avoid imposing unnecessary, duplicative regulations. See, e.g., CFTC Reg. 4.5 (excluding insurers from commodity pool operator status). The Commissions should proceed from the premise that otherwise regulated insurers will act in accordance with their governing laws and regulations.

<sup>7</sup> Section 18(A)(2) of the NAIC Investments of Insurers Model Act (Defined Limits Version), which has been generally followed in a majority of states, specifically requires an insurer to be able to demonstrate to its regulators "the intended hedging characteristics and the effectiveness of the derivative transaction or combination of the transactions through cash flow testing or other appropriate analysis." Section 18 of the Model Act further limits the aggregate potential exposure of swaps used in hedging transactions to not more than 6.5% of the insurer's admitted assets and also contains limits on replication transactions and income generation transactions.

<sup>8</sup> The New York insurance investment law, which governs many of the nation's largest life insurers, sets out a regime that is, in all material respects, similar to the NAIC Investment of Insurers Model Act. N.Y. Ins. Law §1410 (McKinney's 2010 Supp.) But New York law adds a requirement for a Derivatives Use Plan ("DUP") that must be approved by the New York Department of Insurance. Also, an insurer's compliance with its DUP is audited annually by an independent certified public accountant. §1410(a)(B)(5).

flow, or quantity. Use of derivatives for hedging is an essential component of the core commercial activity in which life insurers engage for the benefit of policy and contract holders.

#### **IV. Summary of Position**

Our submission offers several specific suggestions for the Commissions to consider in defining key terms in the Act. Our recommendations carefully consider the policy goals of Title VII and suggest an approach that appropriately recognizes, and encourages, business practices that do not create or contribute to risk within the financial system, and that successfully achieve mitigation of financial system risk. Likewise, it will be critical that the rulemaking does not, as an unintended consequence, discourage the appropriate and prudent use of derivatives by decreasing the availability and effectiveness of specific derivatives products or by increasing costs to derivatives end-users and their customers. We believe that our specific suggestions below effectively strike the right balance between the interests of the financial system as a whole and life insurance customers.

The potential breadth of the term "major swap participant" exemplifies the need to coordinate rulemaking implementing the Act with existing regulation. Life insurers are already subject to detailed regulatory requirements that place prudent limits on derivatives use that have the same impact as the requirements of the Act. These existing regulations reduce the likelihood that the derivatives activities of any life Insurer will be deemed to significantly impact the U.S. Financial System.

Consistent with these principles, ACLI recommends that the Commissions clarify several concepts in the definition of the "Substantial Position," "Substantial Counterparty Exposure," and "Highly Leveraged and Substantial Position" within the Proposal's three MSP tests, including:

- Flexibility in Treating Affiliates Separately or as an Aggregated Entity;
- Treatment of Managed and Insurance Company Separate Accounts;
- Hedging or Mitigating Commercial Risk;
- Expansion of Limits for the Rate Swap Category;
- Adjustments to the Definition of Aggregate Uncollateralized Outward Exposure;
- Adjustments to the Definition of Aggregate Potential Outward Exposure; and,
- Alternative Means of Determining Leverage for Financial Entities that Measure Capital on a Primary Basis other than GAAP.

ACLI believes that adjusting the Proposal consistent with the following suggestions will create a framework in which only entities that are not Swap Dealers and whose use of derivatives significantly impact the U.S. Financial System will be determined to be Major Swap participants or Major Security-Based Swap Participants.

#### **V. Statutory Background: A Foundation for Discussion**

A brief explanation of statutory definitions will establish a framework for our comments on the Proposal. Sections 721 and 761 of Title VII of the Act amended the Commodity Exchange Act and the Securities exchange Act of 1934 to establish the new terms "major swap participant" (MSP) and "major security-based swap participant" (MSBSP). The statute requires that rulemaking implementing these terms be designed in a parallel fashion to stem regulatory arbitrage.

Under the Act, an entity that is not a swap dealer would trigger characterization as an MSP under any of the three following tests:

- (1) Any entity that maintains a “substantial position” in any of the major swap categories, excluding positions held for hedging or mitigating commercial risk, and excluding positions maintained by employee benefit plans for hedging or mitigating risks inherent in a plan’s operation;
- (2) An entity whose outstanding swaps create “substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets;” or,
- (3) A “financial entity” that is “highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency” and that maintains a “substantial position” in any of the major swap categories.

Under the Act, an entity excluded from one test could nonetheless trigger one of the two other tests. All three of the tests seek to measure whether an entity’s derivatives activities could significantly impact the U.S. financial system.

The Act requires the CFTC and the SEC to define the meaning of the terms “substantial position,” “hedging or mitigating commercial risk,” “highly leveraged,” and “substantial counterparty exposure.” The status of life insurers under the Proposal is dependent upon the appropriate scope and interpretation of the MSP tests as well as the various definitions and adjustment factors for netting and collateral proposed by the Commissions. Our comments below will address each of these definitions and certain other factors.

## **VI. ACLI Recommendations on Key Elements in the MSP Definition**

### **(A) Flexibility in Treating Affiliates Separately or as an Aggregated Entity; Treatment of Managed and Insurance Company Separate Accounts**

Under the Act, MSPs are “persons” who also have certain other characteristics. The Act, in amending the Commodity Exchange and Securities Exchange Acts, did not change the definitions of “person” in those acts. The Commodity Exchange Act definition remains: “[t]he term “person” imports the plural or singular, and includes individuals, associations, partnerships, corporations, and trusts,” with no mention of subsidiaries. Similarly, the Securities Exchange Act definition (“The term “person” means a natural person, company, government, or political subdivision, agency, or instrumentality of a government.”) does not include subsidiaries.

Accordingly, we believe that the term “person” for determining MSP status should have its normal and defined statutory meaning as referring to a juridical person or entity and should not, without more, draw in affiliated entities or parent companies of a legal “person”. Further, whether MSP status should be determined within a corporate family on a consolidated or single-entity basis should be based on a good faith, determination by the potential registrant. An entity whose independent credit is accepted by other market participants, without a guaranty or credit support from a parent or other entity, should be accepted as a “person” entitled to an individualized determination of MSP status. A corporate group should also be able to elect to file and comply on a

consolidated basis if such aggregation accurately reflects its participation in the derivatives marketplace.

ACLI agrees with the Proposal to the extent it finds that swap holdings of managed accounts should not be aggregated with the swap positions of the managers. In a somewhat similar analysis, ACLI requests a clarification to the Proposal concerning swaps held by insurance company separate accounts. Separate accounts are not separate legal entities, but comprise a part of an insurance company. Under state insurance law, life insurers are permitted to establish separate accounts to fund variable life insurance contracts, variable annuities and other contracts, such as group pensions.

The legal status of separate account assets is quite different from the life insurer's general assets. In states that have enacted the NAIC Model Variable Contract Statute,<sup>9</sup> (as well as other states providing for the creation of separate accounts) the income, gains and losses of the general assets are insulated from the income, gains and losses of the separate account assets. These asset insulation provisions were included in the Model Variable Contract Statute to ensure that the market fluctuations inherent in assets funding equity based products like variable life insurance or variable annuities did not impair the insurer's ability to fulfill its obligations on its fixed insurance obligations with the life insurer's general assets. The contract owners of insurance or annuity contracts funded by the separate account are the beneficial owners of the separate account assets, not the life insurer itself. In contrast, the life insurer exclusively owns its general assets.

Accordingly, in light of the fact that separate account assets are generally insulated from the life insurer's general assets and because the separate account contract holders are the beneficial owners of the separate account assets, it is appropriate that swaps in a life insurer's separate accounts should not be aggregated with swap positions held in the life insurer's general account for purposes of the MSP definition. ACLI strongly recommends that the Proposal be amended to reflect this approach.

## **(B) Hedging or Mitigating Commercial Risk**

The Proposal defines the scope of the exclusion for "hedging or mitigating commercial risk" to include derivatives activity that is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks result from a fluctuation in interest, currency, or foreign exchange rate exposure attributable to an entity's assets or liabilities, or the potential change in the:

- Value of assets that the entity owns, produces, manufactures, possesses, or merchandises in the ordinary course of business,
- Liabilities that an entity incurs,
- Services that an entity provides or purchases, or
- Value in any of the three items above attributable to foreign exchange rate movements.

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<sup>9</sup> NAIC Model Regulation Service Vol. II at 260-1 (2010).

The exclusion would not apply to any speculative positions. Under the Proposal, a marketplace participant can fulfill the exclusion for hedging or mitigating commercial risk if the underlying function is “commercial in nature.”<sup>10</sup> This designation is particularly important for life insurers whose derivatives positions are generally longer dated hedges that match with the insurers’ long-dated assets and liabilities, and support life insurers’ core commercial activity of fulfilling long-term obligations to customers.

This interpretation correctly reflects the statutory policy of the Act as well as prior interpretations of the CFTC. In particular, we emphasize that the treatment of financial institutions as “commercial enterprises”:

- Comports with both existing CFTC regulation 1.3(z) and its codification in Section 737(c) of the Act;
- Reflects an extension of the CFTC’s existing practice in the regulated futures markets and avoids inconsistent treatment of the same activity in the futures market and in the OTC market;
- Gives economically appropriate recognition to the fact that there is no fundamental difference between a life insurer reducing its risk by the use of derivatives transactions and any other commercial enterprise (be it an automaker or an oil company) doing the same thing;
- Tracks the specific exclusion of financial entities from the definition of a commercial end-user. Absent that exclusion, the definition would catch all entities hedging or mitigating “commercial risk”. We submit that Congress clearly determined that it must expressly exclude financial entities, because the term “commercial risk” encompasses financial risks; and,
- Properly acknowledges that insurance regulators permit life insurers to hedge or mitigate risk through the use of derivatives in accordance with applicable state insurance law (which may include an insurance company’s derivatives use plan).

ACLI strongly supports the proposed exclusion from the MSP definition for “hedging or mitigating commercial risk.”<sup>11</sup> The exclusion is appropriately available irrespective of an entity’s classification

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<sup>10</sup> 75 Fed. Reg. 244 at 80194, n. 125.

Under the Proposal, the following activities would not be treated as hedging underlying activity that is “commercial in nature”:

Taking positions “primarily to take an outright view on the direction of the market, including positions held for short-term resale, or to obtain arbitrage profits. Swap positions that hedge other positions that are themselves held of the purpose of speculation or trading are also speculative trading positions.” Also excluded are “swap positions that are held for the purpose of investing are, for example, those positions that are held primarily to obtain an appreciation in value of the swap position itself, without regard to using the swap to hedge an underlying risk.” 75 Fed. Reg. 244 at 80195, n. 128.

<sup>11</sup> See ACLI letter of [comment](#) on the Advance Notice of Proposed Rulemaking at 3.

as a financial or non-financial entity. It includes an appropriately broad range of derivatives activities that do not create a substantial risk to the financial system, which is the legislation's core benchmark. Life insurer's responsible management of asset and liability risks primarily through collateralized hedging transactions reduces risk to the financial system and fulfills the exclusion.<sup>12</sup> The Proposal aptly includes a broad range of functions within the ambit of activities that constitute hedging or mitigating commercial risk.

In a manner paralleling the proposed rule, ACLI's submission on the ANPR recommended that the term "commercial risk" be construed to include risks of financial as well as non-financial end-users of derivatives. In the pending Proposal, the Commissions properly avoided the unfounded presumption that a company does not hedge or mitigate commercial risk simply because an entity is a financial company.

The Proposal's approach to commercial risk is important to life insurers as significant end-users of derivatives used to prudently manage the commercial risks associated with both their obligations to policyholders and the assets in their investment portfolios necessary to satisfy such liabilities. Although they are "financial" entities, life insurers' use of derivatives is similar in many ways to derivatives usage by manufacturers seeking to ensure that they can satisfy a promise to deliver a product at a specific price over a period of years. Life insurers use derivatives to ensure that they can satisfy their promises to their customers in the future by hedging interest rate, currency, equity and credit risks in the market.

Efficient and cost-effective access to the derivatives markets is fundamental to life insurers' ability to responsibly manage these same types of risks confronting manufacturers. Life insurers' core commercial activity is creating liabilities to policyholders and purchasing assets to cover those liabilities. The definition of commercial risk proposed by the Commissions in Section 1.3(ttt) of the Proposal appears to be broad enough to encompass these types of risks, and is properly not linked to an entity's industry classification. This approach is functionally reasonable and should be unequivocally incorporated in the final MSP rule, in fulfillment of the Act's purpose.

### **(C) Expansion of Limits for Rate Swap Category Needed**

The CFTC has requested comment as to whether the Rate Swap Category should be divided into two categories, one for swaps based on interest rates, inflation rates and other monetary rates, and a separate category for swaps based on rates of exchange between different currencies, and if a separate category is suggested, in what category cross currency rates should be considered. ACLI believes that creation of four proposed major swap categories and the definition of those categories reflects the broad categories of swaps entered into by market participants and supports creation of a single Rate Swap category. In ACLI's view, creation of a separate category for cross currency swaps could lead to confusion among market participants who may feel obligated to bifurcate cross currency swaps between the Rates and Currency Major Swap Categories. It is our fundamental belief that the risk in Cross Currency Swaps is measured by the difference in interest rates in two currencies and should properly be considered in the Rate Swap Category. However, the limit for

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<sup>12</sup> In general, state insurance law restricts life insurers in the maintenance of speculative positions in derivatives, and strictly governs the type and amount of derivatives transactions permitted. See NAIC Investments of Insurers Model Act and the NAIC Derivatives Instruments Model Regulation, which are summarized in the attached Appendix A. These constraints further reduce the likelihood that life insurers' derivatives transactions will significantly impact the U.S. financial markets.

the Rate Category should be raised to avoid penalizing or providing a disincentive to U.S. firms with large international businesses that want to diversify their credit portfolios and prudently manage risks of currency exposures.

ACLI is fully supportive of the Aggregate Uncollateralized Outward Exposure Limits and Aggregate Potential Outward Exposure Limits for Credit Swaps, Equity Swaps and Other Commodity Swaps set forth in Section 1.3 (sss) (1)(ii),(iii) and (iv). We are, however, concerned that Aggregate Uncollateralized Outward Exposure Limits and Aggregate Potential Outward Exposure Limits for Rate Swaps, set forth in Section 1.3 (sss) (1)(i) (A) and (B) and Section 1.3(uuu)(1)(i) and (ii) are insufficiently broad to appropriately measure the derivatives market for all Rate Swaps, including Cross Currency Swaps which exceeded \$434 Trillion as of June 30, 2010.<sup>13</sup> This amount is greater than 90% of all derivatives reported in the ISDA Market Survey.<sup>14</sup> We recommend that the limits in Section 1.3(sss)(1)(i)(A) and (B) be increased to \$4 billion and \$8 billion, respectively, with corresponding increases to the limits in Section 1.3(uuu)(1)(i) and (ii) to \$7 billion and \$14 billion, respectively. This methodology is consistent with the one specified in proposed in Sections 240.3a67-5(a)(1) and (2). It is also consistent with the fundamental proposition that the Commissions should establish a threshold that is sufficiently high to capture only entities whose derivatives activities can significantly impact the U.S. financial system.<sup>15</sup> In fulfillment of this important goal, ACLI recommends the adjustments set forth above.

#### **(D) Adjustments to the Definition of Aggregate Uncollateralized Outward Exposure Needed**

Under the substantial position test, derivatives exposure is netted against collateral posted to secure the derivative in calculating the governing thresholds for substantial position. Additionally, the position is computed on a net basis, taking into account all contractual arrangements between the entity and a single counterparty regarding netting, including master netting agreements.

ACLI strongly endorses the approach proposed in the definition of “Aggregate Uncollateralized Outward Exposure” concerning netting arrangements. This correctly implements Congressional intent in the Act. Section 1a(33)(B) of the Act clarified that in defining “substantial position,” the Commissions should establish a threshold “that [it] determines to be prudent for the effective monitoring, management and oversight of entities that are systemically important or can significantly impact the financial system of the United States.” The same section of the Act also provided guidance that the Commissions should consider an entity’s relative position in uncleared swaps as opposed to cleared swaps and take into consideration the value and quality of collateral held against counterparty exposures. In general, the Proposal succeeds in properly capturing this legislative guidance, and appropriately provides a reduction for contractual netting and collateralization requirements, which are already in place to mitigate counterparty risk.<sup>16</sup>

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<sup>13</sup> See ISDA Mid-Year Market Survey 2010.

<sup>14</sup> *Id.*

<sup>15</sup> The use of the term “systemic risk” in Title VII should only relate to entities that pose a systemic risk because of their derivatives activities; entities that pose a systemic risk for other reasons are already regulated under Title I of the Act.

<sup>16</sup> The majority of life insurers’ over-the-counter derivatives transactions do incorporate credit support annexes and require the exchange of high quality collateral between the parties, thereby significantly reducing, if not eliminating, counterparty exposure. It is also worth noting that many state insurance codes require life insurers to aggregate their derivatives exposure to particular counterparties with other investment exposures to the same counterparty. For example, a life insurer that owned bonds issued by J.P. Morgan

ACLI recommends additional clarifications to Section 1.3(sss)(2) in order to provide full credit for collateral consistent with the credit support agreements (CSAs) in place between market participants that provide flexibility for market participants to utilize a wide range of high quality collateral that contains haircuts/reductions in value agreed between market participants under CSAs between such market participants.

The Proposal currently requests comment on whether certain types of collateral that can not be readily valued should be excluded from the test and whether certain haircuts dictated by applicable regulations should be mandated in calculation of current outward exposure. ACLI believes strongly that such collateral should be included in the MSP Tests and that market participants should be permitted the flexibility to manage such collateral using agreed industry-standard collateral types and haircuts. In order to promote consistency, ACLI suggests use of market standard definitions of collateral types such as those found in the “Collateral Asset Definitions”<sup>17</sup> published by the International Swaps and Derivatives Association.

The use of investment assets as collateral has become essential to the pricing of various life insurance company products and the structuring of the asset portfolio that supports that pricing. Presently, life insurers invest a significant portion of their funds in high quality fixed-income assets, including corporate bonds and asset-backed securities in accordance with the investment guidelines and prudential standards prescribed by the insurance regulators. The income generated from these investments is significant to such life insurers’ business model and continued operation because it allows such insurers to lower the cost of insurance offered to customers.

In the event life insurers are not permitted to continue to post a wide range of collateral as margin, such insurers will be presented with the dilemma of either reducing their hedging programs or restructuring their investment portfolio. Either would be extremely unfortunate. Reducing hedging programs would expose the insurer to avoidable and potentially expensive market risks which could have adverse effects on the insurer’s business model. Ultimately, the opportunity cost of limiting the type or value of eligible collateral would be borne by hardworking Americans who rely on life insurers for cost effective insurance and retirement products that ensure a stable financial future.

#### **(E) Adjustments to the Definition of Aggregate Potential Outward Exposure Needed**

ACLI strongly supports the 0.2 multiplier for swaps that are subject to daily mark-to-market margining or are cleared by a registered clearing agency or derivatives clearing organization as set forth in Section 1.3(sss)(3)(iii)(A) of the Proposal, and the additional proposed adjustment for netting arrangements. ACLI submits the added recommendation that Section 1.3(sss)(ii)(A)(4) should be revised to include the net present value of premiums related to any purchased option in addition to credit default swaps that are mentioned specifically in this section in order to be consistent with the language of Section 1.3(sss)(ii)(A)(3) that does not distinguish among major swap categories.

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Chase Bank, N.A. (“JPM”) and had derivatives transactions with JPM would have to combine those exposures. Because most state codes contain single issuer limits, the use of collateral to offset counterparty exposure in derivatives transactions becomes essential to remain under those limits.

<sup>17</sup> See [http://www.isda.org/c\\_and\\_a/pdf/isdacollateralassetdef.pdf](http://www.isda.org/c_and_a/pdf/isdacollateralassetdef.pdf)

Consistent with our submission on the ANPR, ACLI supports the Proposal's use of a quarterly cycle to measure the threshold amount of exposure for identifying Major Swap Participants. The Proposal's quarterly cycle of measurement properly obviates inapplicable MSP status due to market conditions on a given day. ACLI recommends, however, that the one year reassessment period for a market participant that qualifies as an MSP should be shortened to two consecutive quarters of satisfaction of the MSP Tests in order to no longer be considered as an MSP.

**(F) Alternative Means of Determining Leverage for Financial Entities that Measure Capital on a Primary Basis other than GAAP**

The proposed threshold for a financial entity that is "highly leveraged" and holds a "substantial position" in a major swap category uses another approach to measuring swap positions. Under the Proposal, this test applies to specified financial entities. The Proposal borrows the definition of financial entity from the Act amendments to Section 2(h)(7) of the Commodity Exchange Act and from 3C(g)(3) of the Securities Exchange Act of 1934. Under this approach, the statutory definition of a "financial entity" for purposes of the third MSP test could include a commodity pool, private fund, employee benefit plan, or an entity predominantly engaged in the business of banking.

The release proposes two alternative ratios of total liabilities to equity for determining whether a financial entity is highly leveraged under the third test of MSP: leverage in excess of 8 to 1, or leverage in excess of 15 to 1, measured on the last day of the applicable fiscal quarter. The 15 to 1 ratio is drawn from the definition of "highly leveraged" in Title I of the Act as it would apply to bank holding companies or nonblank financial companies supervised by the Fed. The alternative lower 8 to 1 leverage ratio was proposed because the CFTC and the SEC were not certain that the same highly leveraged (15 to 1) ratio was necessarily appropriate for the third test of MSP.

In adopting the Act, Congress clearly intended to more closely regulate highly leveraged entities, such as hedge funds, engaging primarily in speculative transactions. This intent is reflected in the fact that entities subject to capital requirements set by the federal banking agencies will not be deemed MSPs under the third MSP test. Similarly, the Commissions should more broadly consider whether business entities in compliance with other state or federally-mandated minimum capital requirements can be appropriately classified as "highly leveraged." The bank centric measures of leverage reflected in the third test do not necessarily provide a functional or relevant yardstick of highly leveraged for all financial entities. For example, in the case of insurance companies, insurance regulators are charged with overseeing the financial strength of life insurers and do impose such minimum capital requirements, which we believe would prevent any insurance company that is in compliance with such requirements from being found to be highly leveraged.<sup>18</sup>

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<sup>18</sup> For example, the colloquy between Senator Hagan and Senator Lincoln states that:

In addition, it may be appropriate for the CFTC and the SEC to consider the nature and current regulation of the entity when designating an entity a major swap participant or a major security-based swap participant. For instance, entities such as registered investment companies and employee benefit plans are already subject to extensive regulation relating to their usage of swaps under other titles of the U. S. Code. They typically post collateral, are not overly leveraged and may not pose the same types of risks as unregulated major swap participants. See 124 Cong. Rec. S5904 (daily ed. July 15, 2010) (colloquy between Sen. Hagan and Sen. Lincoln).

The reasoning reflected in the above quoted colloquy applies equally to the extensive state insurance laws and regulations governing life insurers. Appendix A summarizes explicit limitations and guidelines on life

**(G) Definition of “highly-leveraged”**

Under the Proposal, leverage for life insurance companies would be calculated in the same way as for all other financial entities and by using the same generally accepted accounting principles. This one-size-fits-all approach overlooks some essential business differences and could, as an unintended consequence, define many life insurers as highly leveraged when, economically, they are not.

• **Accounting System.**

One very significant difference is that all insurance companies use statutory accounting for the annual reports filed with the state insurance commissioners rather than U.S. generally accepted accounting principles (GAAP). Statutory accounting is a recognized *Other Comprehensive Basis of Accounting* which is used by all insurance companies and exclusively by many mutual and fraternal insurance companies. GAAP conversion, which would be required to calculate leverage under the proposed final rule, constitutes a significant undertaking, and would require a multi-million dollar expense and a multi-year effort. When considering the Act, the Senate Banking Committee twice indicated legislative intent against such mandated conversion to GAAP.<sup>19</sup> Rather than require

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insurers’ use of derivatives. Comprehensive reserving and risk-based capital standards under state insurance laws also apply to life insurers.

<sup>19</sup> The legislative history of the Act at Section 16(a) and (b) [Capital Levels of Bank and Savings and Loan Holding Companies] unequivocally expressed opposition to mandated conversion to GAAP financial statements in the following instances:

Senate Banking Committee Report. S.3217, § 616(b), amends Home Owners’ Loan Act § 10(g)(1) to expressly authorize the Director of the OTS (which will be succeeded by the Board) to issue regulations and orders relating to capital requirements for savings and loan holding companies. This raised a question how this might be applied to mutual insurers and fraternal that only report their financial condition using statutory accounting practices. This concern was addressed, in part, by the following Senate Banking Committee statement of intent contained in the Senate Report on S.3217:

It is the intent of the Committee that in issuing regulations relating to capital requirements of bank holding companies and savings and loan holding companies under this section, the Federal Reserve **should take into account the regulatory accounting practices and procedures applicable to, and capital structure of, holding companies that are insurance companies (including mutuals and fraternal), or have subsidiaries that are insurance companies.** S. Rep. No. 176, 111th Cong, 2nd Sess. at 89 [emphasis added].

Section 616(d) [Source of Strength by Bank and Savings and Loan Holding Company] evidenced a similar position. S.3217, § 616(c), adds a new FDIA § 38A which (i) requires that the appropriate Federal banking agency for a savings and loan holding company to require such company to serve as a source of financial strength for its depository institution subsidiary, and (ii) permits the agency to require the company to submit a report for purposes of assessing the ability of the company to comply with this requirement and enforcing compliance with this requirement. This also raised a question how this might be applied to mutual insurers and fraternal that only report their financial condition using statutory accounting practices. This concern was

GAAP conversion, the Commissions should either use the risk-based capital ratio discussed below or allow insurers to use their statutory accounting statements and with appropriate adjustments to the definitions of liabilities and equity and impose a leverage ratio that is appropriate given the generally more conservative nature of statutory accounting.

• **Differences in Insurance Company Liabilities**

One example of an appropriate adjustment is the exclusion from insurance company balance sheets of Separate Account assets and Separate Account liabilities. Insurance companies often hold “separate accounts” which are not separate legal entities, but whose assets are segregated as if they were separate companies and from which the general account is fully insulated. Separate accounts are accounted for by adding a line to the asset side of the balance sheet and a liability of the exact equal amount. Whenever both an asset and a liability of equal amount are added to a balance sheet, net worth is unaffected, but the ratio of liabilities to equity increases. In this case, an insurance company with separate accounts is in fact not more leveraged since the company is not at risk for the investment performance of the separate account assets. Instead, any decline is offset by an equal decline in the separate account liability. To avoid distorting insurance company leverage, the amount of the separate account liability should be subtracted from other liabilities before calculating the liability/equity ratio.

Another difference in insurance company liabilities of a traditional life insurer is the nature of its biggest liability, policy reserves. Policy reserves are an estimate of a distant death benefit, not the amount a living policyholder would receive (that is the policy’s guaranteed cash value). This makes them very different from a bank’s liabilities which represent the present right of a bank depositor to immediately withdraw his deposit. Insurance company liabilities are very different and should not be treated identically to other liabilities.

• **Definition of Equity under Statutory Accounting**

Statutory Accounting also does not use the term “equity” to describe an insurer’s net worth. Instead, the term “Surplus” is used and this is calculated by subtracting the amount of liabilities from the amount of assets and further reducing it by an Asset Valuation Reserve (AVR). AVR is a statutory accounting provision that allocates a portion of surplus to a reserve for potential decline in asset values. This reserve is reported as a liability for statutory reporting. For the purposes of measuring whether an insurance company is highly leveraged “Equity” should include the AVR.

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also addressed, in part, by the following Senate Banking Committee statement of intent contained in the Senate Report on S.3217:

It is the intent of the Committee that such companies will be permitted to provide financial reporting to the AFBA utilizing the accounting method they currently employ in reporting their financial information. More specifically, **nothing in this provision is intended to mandate that insurance companies otherwise subject to alternative regulatory accounting practices and procedures use GAAP reporting.** S. Rep. No. 176, 111th Cong, 2nd Sess. at 89 [emphasis added].

Another important factor to be considered in analyzing insurance companies that use statutory accounting is that statutory accounting requires insurers to expense policy acquisition costs (thereby reducing surplus) in the year the policy is issued, rather than amortize them over the expected policy life as GAAP requires. This, along with other factors, typically results in statutory surplus being less than GAAP equity.

• **Liability/Equity Ratio**

For GAAP-reporting or statutory-reporting insurance companies, we oppose universal application of both the proposed 15 to 1 and 8 to 1 ratios since they could cause even investment grade financial entities to be erroneously labeled “highly leveraged.” Instead, if a liability/equity ratio is used at all, different standards should be set for each type of financial entity based on further study, taking into account the differences between various types of financial institutions. Financial institutions conduct very different businesses and the liabilities of, for example, a traditional life insurer and a hedge fund, are very different in nature. For this reason, the Commissions should either set a ratio that is industry appropriate after making adjustments to liability and equity calculations or instead use an existing regulatory tool. An alternative rule for the insurance industry is risk-based capital.

• **Risk-Based Capital Alternative**

In the Proposal, the Commissions rejected a risk-based approach to avoid adding complexity and costs to companies subject to these regulations. This inappropriately ignores the different risks that assets and liabilities represent when they are used by financial institutions with differing business models. There is an existing risk-based approach that could be used: state insurance commissioners’ use of the risk-based capital (RBC) tool to measure insurer solvency risk. This deference to existing regulators would be similar to the statutory exception for persons that are “not subject to capital requirements established by an appropriate Federal banking agency.” Use of the RBC system obviously avoids any concerns about incremental costs and complexity since all insurers currently calculate this measure. The Commissions could use an RBC cut off level that has a parallel level of risk to the liabilities/equity ratio used for non-insurance companies.

In the insurance industry, Risk-Based Capital (RBC) is calculated by applying factors to various asset, premium, claim, expense, and reserve items representing various risks to which a company is exposed. The National Association of Insurance Commissioners (NAIC) formula for life insurer risk-based capital also includes modeling the risk of the company under interest rate changes over many alternative interest rate scenarios for certain products.

RBC is usually expressed as a risk-based capital ratio. This is the total capital of the company (as determined by the RBC formula) divided by the company’s risk-based capital (as determined by the formula). For example a company with a 200% RBC ratio has capital equal to twice its risk based capital.

The amount of capital required by state regulators for insurance companies is based on RBC formulas developed by the NAIC.<sup>20</sup> The NAIC has separate formulas for life insurers, property and

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<sup>20</sup> See NAIC Life RBC Instructions (2008); Statement of the Life Risk-Based Capital Working Group at NAIC Proceedings (1993) Vol IA at 557, which established the seminar foundation for the model RBC model law; NAIC RBC Newsletters [http://www.naic.org/1financial\\_reporting/rbc/rbc\\_newsletters.htm](http://www.naic.org/1financial_reporting/rbc/rbc_newsletters.htm).

casualty insurers and health insurers. Each of the formulas is constantly under review for refinement, improvement in factors, and updating for new risks.

The RBC system is based on statutory financial statements, rather than financial statements prepared under GAAP standards. Every year every life insurer calculates its capital based on the RBC formula. It also calculates the capital required for risk, the “Company Action Level RBC.” The ratio of a company’s capital to its “Company Action Level RBC” equates to its RBC ratio. The NAIC system mandates specific actions to be taken by the company or the state insurance regulator if this ratio declines. If the ratio is less than 200%, or less than 250% with a negative trend, a capital plan is required. If the ratio is between 70% and 100%, the regulator has the option of taking control of the insurer. If the ratio is below 70%, the regulator is required to place the insurer under control.

Like the risk standards applied to the banking industry, the RBC standards applied to life insurers provides a valuable and conceptually parallel measure of a life insurer’s risk. As such, the NAIC life insurer RBC ratio is a more appropriate benchmark for use in the proposed definitions of substantial counterparty risk because it isolates factors that are uniquely relevant to financial risks faced by life insurers. Exclusively incorporating risk standards developed for the banking industry into the Proposal built is inappropriate because it would measure the life insurers’ financial risks poorly. The NAIC RBC ratio is a superior, effective benchmark tailored to the specific financial risks relevant to assessing the financial and risk status of life insurers.

The Act exempts financial entities that are “subject to capital requirements established by an appropriate Federal banking agency” from the definition of “highly leveraged.” Those banking agencies use a risk-based capital test as one of their regulatory tools. A joint study by the Federal Reserve System and the National Association of Insurance Commissioners, while noting important differences between the banking and insurance risk-based capital systems, concluded that “both RBC regimes set capital standards that are reasonably calculated, verifiable, and easily interpreted by industry participants.”<sup>21</sup> Given the statutory deference to the banking regulators and their use of a risk-based capital scheme, it would be consistent with banking regulation to use a risk-based capital metric, rather than a liability/equity ratio to measure the financial system’s exposure to insurance company risk. Accordingly, ACLI recommends that the mechanics of the threshold calculation should be enlarged to include NAIC RBC methodology for life insurers.

- **Financial Entity Subject to Capital Requirements Established by an Appropriate Federal Banking Authority**

Under the third MSP test, an entity is excluded from coverage if it is “subject to a capital requirement established by an appropriate Federal banking agency.” This exclusion reflects Congressional intent that any systemic risk attendant to such an entity’s leverage is best addressed by the entity’s primary federal prudential regulator.

Under Federal banking law, bank holding company systems and financial holding company systems are subject to consolidated regulation including capital requirements and leverage ratios. In addition, companies that become subject to regulation as “systemically important financial institutions” will be subject to similar regulation on a consolidated basis under Section 165 of the

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<sup>21</sup> Report of the National Association of Insurance Commissioners (NAIC) and the Federal Reserve System Joint Subgroup on Risk-Based Capital and Arbitrage (2002) at 11.

Act. Since the subsidiaries of these regulated entities are or will become subject to these requirements, we request that the Commissions clarify that this exclusion will apply to (1) persons which are members of a bank or financial holding company system subject to regulation and capital requirements on a consolidated basis under federal banking law, (2) persons which are individually or as part of a consolidated group subject to regulation as systemically important financial institutions by the Federal Reserve under Title I of Dodd Frank, and (3) any other persons which are or become, individually or as part of a consolidated group, subject to a capital requirement established by a Federal banking regulator.

## **VI. ACLI's Comments Fulfill Congressional Intent and Responsible Market Behavior**

ACLI's recommended refinements and clarifications generally will ensure that end-users in any segment of the economy, who are employing prudent risk management practices to avoid contribution to systemic risk, will not be deemed MSPs. As applied to the insurance industry, most, if not all, insurers will not be deemed to be MSPs. This result should not be seen as a *de facto* insurance industry exemption, but rather a reflection of the fact that most, if not all insurers, transact derivatives under collateralized agreements that provide for the netting of exposures across major swap categories in order to satisfy existing regulatory requirements for the usage in a controlled and prudent usage of derivatives. In addition, these definitions do not create unintended loopholes inviting exploitation by entities that would contort themselves to fit into a certain industry in order to avoid regulation as an MSP. Consistent with Congressional intent, it is not the label on the company that causes it to fall outside the definition of an MSP, but rather the actual practices it employs with respect to its utilization of derivatives. ACLI's recommendations fully embrace the risk-based approach contained in both the statute and legislative history and achieve a reasonable balance of the policy interests reflected in the adoption of the Act.

## **VII. Conclusion**

Through state insurance oversight, life insurers' derivatives activities are already subject to effective monitoring, management and oversight. Indeed, the entire insurance regulatory regime is designed to ensure insurer solvency and protect the interests of policy and contract holders. We respectfully submit that life insurers engaging in such activities in compliance with state law are highly unlikely to produce risk having the potential to significantly impact the financial system of the United States. We acknowledge that a life insurer could be deemed systemically important in other parts of the Act outside of Title VII. However, its derivatives positions alone should not be the cause of such classification, not because it is a life insurer, but because of the prudent, well-regulated, commercial risk-mitigating nature of the activities in which it is engaged.<sup>22</sup>

On several occasions, representatives of the Commissions have informally indicated that only 10-12 entities should trigger the MSP and MSBSP definitions under the Proposal.<sup>23</sup> Life insurers find

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<sup>22</sup> It is important to distinguish between regulated life insurance companies and entities affiliated with life insurance companies. AIG's challenges during the financial crisis arose in its derivatives dealer which was not part of its regulated life insurance companies. Indeed, the regulated domestic insurance companies proved to be a source of financial stability and value for the AIG enterprise, due in substantial part to detailed substantive insurance regulation that precludes speculative derivatives positions, imposes significant reserving and risk-based capital requirements, and requires transparent reporting of derivatives positions.

<sup>23</sup> See, e.g. informal comments of CFTC Chairman Gary Gensler at DC Bar Association luncheon on November 18, 2010, that focused on implementation of Title VII of the Act.

these views reassuring as a barometer of intended scope. In order to achieve a final regulation that achieves this limited level of penetration, however, several aspects of the Proposal need refinement and clarification, as recommended on our submission. We recognize that the Commissions developed the Proposal under extreme time deadlines and understand that the Proposal will be revised further before adoption in final form, within the statutory deadline.

In conclusion, therefore, we ask the Commissions to carefully consider the negative impact on life insurers and their policyholders if the regulations implementing Title VII do not strike an appropriate balance of all of the policy interests reflected in the Act. We believe our recommendations on the MSP and MSBSP definitions in Title VII of the Act can assist the Commissions in developing an effective and equitable approach to these objectives.

ACLI greatly appreciates your attention to our views. If any questions develop, please let me know.

Sincerely,

A handwritten signature in cursive script that reads "Carl B. Wilkerson".

Carl B. Wilkerson

## The Use of Derivative Financial Instruments by Life Insurers Under State Insurance Law

Carl B. Wilkerson, Vice President & Chief Counsel- Securities & Litigation  
American Council of Life Insurance

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### I. The National Association of Insurance Commissioners (NAIC) Investments of Insurers Model Acts Govern Derivatives Transactions by Life Insurers

- A. Purpose of Investment Law Provisions, as noted in the NAIC Investments of Insurers Model Act (*Defined Limits Version*) (1996):
1. The development of regulation of the investments of insurers requires an analysis of the complexities, uncertainties, 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. NAIC Model Reporting Service, Vol. II, Section 1, at 280-1.
  2. It also requires an analysis of how to safeguard the financial condition of domestic insurers and at the same time to permit domestic insurers to be competitive with insurer's domiciled in other states and with other financial industries that operate under different regulatory regimes. *Id.*
  3. The NAIC advises each state to determine through independent study which methods are best suited to its needs and whether its existing regulatory structure may be improved by using provisions of model laws recommended by the National Association of Insurance Commissioners (NAIC) or existing regulatory structures in other states or industries. *Id.*
  4. This model law is not considered by the NAIC to exhaust regulatory methods to address the regulation of investments of insurers. Nor is this model law recommended by the NAIC to be used as a standard for the examination of insurers unless *substantially similar* provisions are found in the statutes and regulations of the state of domicile of the insurer. *Id.* (emphasis added).
- B. The NAIC has addressed these goals with two different approaches:
1. The NAIC Investments of Insurers Model Act (*Defined Limits Version*) sets forth specific limits on insurers investments, including derivatives, and is discussed below.
  2. A second alternate choice exists in the NAIC Investments of Insurers Model Act (*Defined Standards Version*) which implements modern portfolio management practices.
    - a. The Defined Standards version serves as an alternative to the Defined Limits version of the Investments of Insurers Model Act

which requires that investments be made only in assets that are specifically identified and with quantitative limits for assets invested in each category.

- b. The Defined Standards version provides a “prudent person” approach to investments that implements modern portfolio theory, and establishes the following type of investment authority:
  - (1) An insurer is obligated to fulfill the “minimum asset requirement” as that term is defined in the model act.
    - (a) The minimum asset requirement is made up of an insurer’s liabilities and what is called the “financial security benchmark.”
    - (b) This benchmark equals either the company’s minimum capital surplus as required by statute or the authorized control level risk-based capital which applies to the insurer as set forth in the risk-based capital law of the state, whichever is greater; and,
  - (2) An insurer invests its assets after fulfilling the minimum asset requirement according to a prudence standard. The Defined Standards version establishes factors that must be evaluated and considered by the insurer in determining whether its investment portfolio is prudent.

**C. Overview of the Investments of Insurers Model Act (Defined Limits Version) and its application to derivatives**

**1. Scope**

- a. That applies only to investments and investment practices of domestic insurers and United States branches of alien insurers entered through the individual states.
- b. The Act does not apply to investments for separate accounts of an insurer except to the extent the provisions of the NAIC Model Holding Compact so provide.

**2. Purpose to the defined limits version**

- a. The purpose of this Act is to protect the interests of insureds by promoting insurer solvency and financial strength. This will be accomplished through the application of investment standards that facilitate a reasonable balance of the following objectives:
  - (1) To preserve principal;
  - (2) To assure reasonable diversification as to type of

investment, issuer and credit quality; and

- (3) To allow insurers to allocate investments in a manner consistent with principles of prudent investment management to achieve an adequate return so that obligations to insureds are adequately met and financial strength is sufficient to cover reasonably foreseeable contingencies.

### 3. **Treatment of Derivatives**

- a. Article II Section 18 governs derivative transactions
- b. The NAIC Commentary indicates that derivatives by insurers should be limited to hedging and, to a limited extent, income generation transactions.

### 4. **Definitions**

- a. "Derivative instrument" [ Article I, Section 2 (V)] means an agreement, option, instrument or a series or combination thereof:
  - (1) 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
  - (2) 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.
- b. "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 and any agreements, options or instruments permitted under regulations adopted under Section 8. *Id.*
- c. "Derivative transaction" means a transaction involving the use of one or more derivative instruments. [Article I, Section 2 ( W)].

### 5. Substantive provisions permitting life insurers to engage in derivative transactions.

#### a. **General conditions**

- (1) Limitations on Hedging Transactions
  - (a) An insurer may use derivative instruments under

Section 18 of the Model Act to engage in hedging transactions and certain income generation transactions, as these terms may be further defined in regulations promulgated by the commissioner.

- (b) An insurer shall be able to demonstrate to the commissioner the intended hedging characteristics and the ongoing effectiveness of the derivative transaction or combination of the transactions through cash flow testing or other appropriate analyses.
- (2) An insurer may enter into hedging transactions under Section 18 of the Model Act if, as a result of and after giving effect to the transaction :
- (a) The aggregate statement value of options, caps, floors and warrants not attached to another financial instrument purchased and used in hedging transactions does not exceed seven and one half percent (7.5%) of its admitted assets;
  - (b) The aggregate statement value of options, caps and floors written in hedging transactions does not exceed three percent (3%) of its admitted assets; and
  - (c) The aggregate potential exposure of collars, swaps, forwards and futures used in hedging transactions does not exceed six and one-half percent (6.5%) of its admitted assets.
- (3) **Limitations on Income Generation Transactions**
- (a) An insurer may only enter into the following types of income generation transactions if as a result of and after giving effect to the transactions, the aggregate statement value of the fixed income assets that are subject to call or that generate the cash flows for payments under the caps or floors, plus the face value of fixed income securities underlying a derivative instrument subject to call, plus the amount of the purchase obligations under the puts, does not exceed ten percent (10%) of its admitted assets:
    - i) Sales of covered call options on non-callable fixed income securities, callable fixed income securities if the option expires by its terms prior to the end of the

noncallable period or derivative instruments based on fixed income securities;

- ii) Sales of covered call options on equity securities, if the insurer holds in its portfolio, or can immediately acquire through the exercise of options, warrants or conversion rights already owned, the equity securities subject to call during the complete term of the call option sold;
- iii) Sales of covered puts on investments that the insurer is permitted to acquire under this Act, if the insurer has escrowed, or entered into a custodian agreement segregating, cash or cash equivalents with a market value equal to the amount of its purchase obligations under the put during the complete term of the put option sold; or
- iv) Sales of covered caps or floors, if the insurer holds in its portfolio the investments generating the cash flow to make the required payments under the caps or floors during the complete term that the cap or floor is outstanding.

(4) **Counterparty Exposure**

- (a) An insurer shall include all counterparty exposure amounts in determining compliance with the limitations of Section 10 of the Model Act, which governs diversification standards and certain foreign investments.
- (b) Additional Transactions
  - i) Pursuant to regulations to implement the Model Act which may promulgated under the authority of Section 8, the insurance commissioner may approve additional transactions involving the use of derivative instruments in excess of the limits imposed by Section 8(B) or for other risk management purposes under regulations promulgated by the commissioner, but replication transactions shall not be permitted for other than *risk management* purposes.

- (c) Definition: "Counterparty Exposure Amount" means:
- i) 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")
  - ii) 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.
  - iii) If over-the-counter derivative instruments are entered into under 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:
    - a) The market value of the over-the-counter derivative instruments entered into under 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 under the agreement, the liquidation of which would result in a final cash payment

by the insurer to the business entity.

a. **Written Agreement and Conditions Required Under the Act**

- (1) The insurer shall enter into a written agreement for all transactions authorized in this section other than dollar roll transactions.
  - (a) "Dollar roll transaction" means two (2) simultaneous transactions with different settlement dates no more than ninety-six (96) days apart, so that in the transaction with the earlier settlement date, an insurer sells to a business entity, and in the other transaction the insurer is obligated to purchase from the same business entity, substantially similar securities of the following types:
    - i) Asset-backed securities issued, assumed or guaranteed by the Government National Mortgage Association, the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation or their respective successors; and
    - ii) Other asset-backed securities referred to in Section 106 of Title I of the Secondary Mortgage Market Enhancement Act of 1984 (15 U.S.C. s 77r- 1), as amended.
- (2) The written agreement shall require that each transaction terminate no more than one year from its inception or upon the earlier demand of the insurer.
- (3) The agreement shall be with the business entity counterparty.

D. **NAIC Derivative Instruments Model Regulation, NAIC Model Reporting Service, Volume III at 282-1(1996).**

1. This model regulation was adopted together with the NAIC Investments of Insurers Model Act (Defined *Limits* Version).
2. It provides additional guidance and clarification for application of the model law.
3. **Selected provisions**
  - a. Guidelines and Internal Control Procedures are set forth at Section 4

- (1) 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:
  - (a) Address investment or, if applicable, underwriting objectives, and risk constraints, such as credit risk limits;
  - (b) 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
  - (c) Require compliance with internal control procedures.
- (2) An insurer shall have a system for determining whether a derivative instrument used for hedging has been effective.
- (3) 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.

**b. Documentation Requirements are set forth at Section 5**

- (1) 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.
- (2) **Trading Requirements** are set forth at Section 6, which mandates that 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.

4. **Overview of the Defined Standards Version of the NAIC Investments of Insurers Model Act**

- a. This Model Act is premised on specific capital standards, and provides a framework in which these standards relate to the investment laws, and established consequences for failure to meet capital standards. To the extent an insurer's investment program is imprudent, the insurer is deemed unsound.
- b. The minimum financial security benchmark and the minimum asset requirement jointly form the foundation for regulating life insurer investments according to a modern portfolio or prudence standard.
  - (1) These twin tools allow a high level of investment discretion above the minimum asset requirement while still providing meaningful regulatory protections for policyholders and claimants from adverse investment management.
  - (2) Section 3 of the Defined Standards Proposal creates limitations and restrictions on investments counted toward the minimum asset requirement; Assets in excess of the minimum asset requirement would not be subject to these limitations and restrictions and may be invested according to the insurer's individual written investment policy.
- c. Three philosophies to capital requirements are central to the Act's approach to regulating investments according to a prudence standard.
  - (1) The Act's "minimum capital" (for stock insurance companies) and "minimum surplus" (for mutual insurance companies) ensure financial stability at the inception of a new insurance enterprise. The amount of capital or surplus needed depends on what types of business the insurer intends to conduct, and are established based on the information the insurer gives the insurance commissioner at the time of formation. See, Annotations to Section 3 of NAIC Investments of Insurers Model Act

(Defined Standards Version) at 17 (1997).

- (2) The “minimum financial security benchmark” measures the minimum capital requirements of an established enterprise, and expand as the financial needs to the enterprise expand, but may also contract with them. *Id.*
  - (3) The “proper surplus” appropriate for a particular company’s operation is determined by the insurer’s board of directors in consultation with management. *Id.*
- d. The fundamental enforcement mechanism under the defined standards proposal appears in Section 11 which provides that if an insurer does not meet the minimum asset requirement, then under Section 11D, the insurer may be deemed to be in financially hazardous condition, and the commissioner may initiate liquidation and rehabilitation proceedings against the insurer. *Id.* at 21.

**(5) Status of Investments of Insurers Model Acts in the States**

- (A) A state by state chart follows this section.

INVESTMENTS OF INSURERS MODEL ACT

STATE	LAWS AND REGULATIONS
Alabama	ALA. CODE §§ 27-41-1 to 27-41-41 (1977/1993) (Life).
Alaska	ALASKA ADMIN. CODE tit. 3, §§ 21.201 to 21.399 (2001/2005). ALASKA STAT. §§ 21.21.010 to 21.21.420 (1966/2001) (Includes authority to adopt regulations consistent with defined limits version).
Arizona	ARIZ. REV. STAT. ANN. §§ 20-531 to 20-561 (1954/2000).
Arkansas	ARK. CODE ANN. §§ 23-63-801 TO 23-63-841 (1959/2009).
California	CAL. INS. CODE §§ 1170 to 1212 (1935/2009). CAL. CODE REGS. Tit. 10, §§ 2690.90 to 2690.94 (2007); BULLETIN 95-5A (1995).
Colorado	COLO. REV. STAT. §§ 10-3-213 to 10-3-242 (1969/2000).
Connecticut	CONN. GEN. STAT. §§ 38a-102 to 38a-102i (1991/2009); BULLETIN FS-14c-00 (2000).
Delaware	DEL. CODE ANN. Tit. 18, §§ 1301 to 1332 (1953/2002).
District of Columbia	D.C. CODE §§ 31-1371.01 to 31-1375.01 (2002).
Florida	FLA. STAT. §§ 625.301 to 625.340 (1959/1993).
Georgia	GA. CODE ANN. §§ 33-11-50 to 33-11-67 (2000).
Guam	GUAM GOV'T. CODE § 43166 (1951).
Hawaii	HAW. REV. STAT. §§ 431:6-101 to 431:6-501 (1987/2009); §§431:6-601 to 431:6-602 (1987/2008).
Idaho	IDAHO CODE ANN. §§ 41-701 to 41-736 (1961/2006).
Illinois	215 ILL. COMP. STAT. 5/126.1 to 5/126.32 (1997). ILL. ADMIN. CODE tit. 50, §§ 806.10 to 806.60 (1998/2001). Company Bulletin 92-2 (1992).
Indiana	IND. CODE §§ 27-1-12-2 to 27-1-12-3.5 (1935/2004) (Life); §§ 27-1-13-3 to 27-1-13-3.5 (1935/2004) (P/C).
Iowa	IOWA CODE §§ 511.8 to 511.8A (1868/2000) (Life); § 515.35 (1868/1997) (P/C). IOWA ADMIN. CODE r. 191-93.6; BULLETIN 2008-18 (2008).

INVESTMENTS OF INSURERS MODEL ACT

STATE	LAWS AND REGULATIONS
Kansas	KAN. STAT. ANN. §§ 40-2a01 to 40-2a28 (1972/2005) (P/C); §§ 40-2b01 to 40-2b29 (1972/2005) (Life).
Kentucky	KY. REV. STAT. ANN. §§ 304.7-010 to 304.7-473 (2000).
Louisiana	LA. REV. STAT. ANN. §§ 22:581 to 22:601 (2007/2010).
Maine	ME. REV. STAT. ANN. Tit. 24-A, §§ 1101 to 1137 (1969/2000) (P/C); §§ 1151 to 1161 (1987/2000) (Life).
Maryland	MD. CODE ANN., INS §§ 5-501 to 5-512 (1922/2003) (Life); §§ 5-601 to 5-609 (1943/1997) (P/C); MD. ADMIN. CODE CH. 650 §§ 1 to 011 (1998/2008).
Massachusetts	MASS. GEN. LAWS. Ch. 175 §§ 63 to 68 (1817/1996).
Mississippi	MISS. CODE ANN. §§83-19-51 to 83-19-55 (1892/2010).
Missouri	MO. REV. STAT. §§ 375.325 TO 375.355 (1939/2002); §§ 375.532 TO 375.534 (1991/2005) (All insurers); §§ 376.300 to 376.311 (1939/2002) (Life) §§ 376.311, 379.083 (1997/2002); § 375.345 (2002); MO. CODE REGS. ANN. Tit. 20, § 200-12.020 (2009).
Montana	MONT. CODE ANN. §§ 33-12-101 to 33-12-312 (1999/2001).
Nebraska	NEB. REV. STAT. §§ 44-5101 to 44-5154 (1991/2009).
Nevada	NEV. REV. STAT. §§682A.010 to 682A.290 (1971/2003).
New Hampshire	N. H. REV. STAT. ANN. §§ 402:27 to 402:29-d (1917/1991) (All insurers); §§ 411-A:37 (1978/1990) (Life).
New Jersey	N.J. STAT. ANN. §§ 17:24-1 to 17:24-16 (1902/1995) (P/C); §§ 17B:20-1 to 17B:20-8 (1971/2005) (Life).
New Mexico	N.M. STAT. ANN. §§ 59A-9-1 to 59A-9-27 (1984/1988).
New York	N.Y. INS. LAW §§ 1401 to 1413 (1984/2008). N.Y. COMP. CODES R. & REGS. Tit. 11, §§ 178.0 to 178.10 (Regulation 168) (2001).
North Carolina	N.C. GEN. STAT. §§ 58-7-165 to 58-7-205 (1991/2005).
North Dakota	N.D. CENT. CODE §§ 26.1-05-18 to 26.1-05-22 (1983/2001).

INVESTMENTS OF INSURERS MODEL ACT

STATE	LAWS AND REGULATIONS
Ohio	OHIO REV. CODE ANN. §§ 3907.14 to 3907.141; §§ 3925.20 to 3925.21 (1953/2001) (Life); §§ 3925.05 to 3925.06 (1953) (P/C).
Oklahoma	OKLA. STAT. tit. 36, §§ 1601 to 1629 (1957/2005).
Oregon	OR. REV. STAT. §§ 733.510 to 733.780 (1959/2006).
Pennsylvania	40 PA. STAT. ANN. §§ 504.1 to 506.1 (1986/2004) (Life).
Puerto Rico	P. R. LAWS ANN. tit. 26, §§ 648-662 (2003).
Rhode Island	R.I. GEN. LAWS §§ 27-11-1 to 27-11-3 (1947/1956); §§ 27-11.1 to 27-11.1-8 (1984/2002).
South Carolina	S.C. CODE ANN. §§ 38-12-10 to 38-12-510 (2002).
South Dakota	S.D. CODIFIED LAWS §§ 58-27-1 to 58-27-111 (1966/2005); S.D. ADMIN. R. 20:06:26:01 (2005/2008). S.D. ADMIN. R. 20:06:26:01 (1995/2008).
Tennessee	TENN. CODE ANN. §§ 56-3-301 to 56-3-409 (1907/1998) (Life); §§ 56-3-401 to 56-3-409 (1979/1984) (P/C).
Texas	TEX. INS. CODE ANN. §§ 424.001 to 424.218 (2005/2007).
Utah	UTAH CODE ANN. §§ 31A-18-101 to 31A-18-110 (1985/2006).
Vermont	VT. STAT. ANN. tit. 8, §§ 3461 to 3472 (1967/2000).
Virginia	VA. CODE ANN. §§ 38.2-1400 to 38.2.1447 (1986/2002).
Washington	WASH. REV. CODE ANN. §§ 48.13.010 to 48.13.360 (1947/2004).
West Virginia	W. VA. CODE §§ 33-8-1 to 33-8-32 (1957/2004).
Wisconsin	WIS. STAT. §§ 620.01 to 620.25 (1971/1992).
Wyoming	WYO. STAT. ANN. §§ 26-7-101 to 26-7-116 (1967/2001).

## SCHEDULE DB

### DERIVATIVE INSTRUMENTS

All derivatives, regardless of maturity date, are to be reported on Schedule DB. Forward commitments where a Company cannot determine at the inception of the contract, with certainty, if delivery will be made at the earliest opportunity are essentially forward contracts and should be reported on Schedule DB.

This schedule should be used to report derivative instruments (including insurance futures and options on insurance futures). Specific accounting procedures for each derivative instrument will depend on the definition below and documented intent that best describes the instrument. Uses of derivative instruments that are reported in this schedule include hedging, income generation and other. State investment laws and regulations should be consulted for applicable limitations and permissibility on the use of derivative instruments. If the derivative strategy meets the definition of hedging as outlined in paragraph 7 of SSAP No. 86, Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions, then the underlying derivative transactions composing that strategy should be reported in that category of Schedule DB. If the underlying derivative strategy does not meet the definition of hedging, then the underlying derivative transactions composing that strategy should be reported as either income generation or other.

### **DEFINITIONS OF DERIVATIVE INSTRUMENTS**

A hedge transaction is “Anticipatory” if it relates to:

- a. A firm commitment to purchase assets or incur liabilities, or
- b. An expectation (but not obligation) to purchase assets or incur liabilities in the normal course of business.

“*Underlying Interest*” means the asset(s), liability(ies), or other interest(s) underlying a Derivative Instrument, including, but not limited to, any one or more securities, currencies, rates, indices, commodities, Derivative Instruments, or other financial market instruments.

“*Option*” means an agreement giving the buyer the right to buy or receive, sell or deliver, enter into, extend or terminate, or effect a cash settlement based on the actual or expected price, level, performance, or value of, one or more Underlying Interests.

“*Cap*” means an agreement obligating the seller to make payments to the buyer, each payment under which is based on the amount, if any, that a reference price, level, performance, or value of one or more Underlying Interests exceed a predetermined number, sometimes called the strike/cap rate or price.

“*Floor*” means an agreement obligating the seller to make payments to the buyer, each payment under which is based on the amount, if any, that a predetermined number, sometimes called the strike/floor rate or price exceeds a reference price, level, performance or value of one or more Underlying Interests.

“*Collar*” means an agreement to receive payments as the buyer of an Option, Cap or Floor and to make payments as the seller of a different Option, Cap or Floor.

“*Swap*” means an agreement to exchange or net payments at one or more times based on the actual or expected price, level, performance, or value of one or more Underlying Interests.

“*Forward*” means an agreement (other than a Future) to make or take delivery of, or effect a cash settlement based on the actual or expected price, level, performance, or value of, one or more Underlying Interests.

“*Future*” means an agreement traded on an exchange, Board of Trade, or contract market, to make or take delivery of, or effect a cash settlement based on the actual or expected price, level, performance, or value, one or more Underlying Interests.

*“Insurance Futures Contract”* means a futures contract based on an underlying index of performance of insurance contracts (policies) or factors relating thereto, or such other definition as may be specified under the statutes, regulations and administrative rulings of a particular state.

*“Insurance Futures Option”* means a put or call option on an Insurance Futures contract.

*“Insurance Futures Call Option”* means a contract under which the holder has the right to purchase the underlying insurance futures contract covered by the option at a stated price (strike price) on or before a fixed expiration date.

*“Insurance Futures Put Option”* means a contract under which the holder has the right to sell the underlying insurance futures contract covered by the option at a stated price (strike price) on or before a fixed expiration date.

*“Option Premium”* means the consideration paid (received) for the purchase (sale) of an Insurance Future Option.

*“Margin Deposit”* means a deposit that an insurer is required to maintain with a broker with respect to the underlying Insurance Futures Contracts purchased.

#### **GENERAL INSTRUCTIONS FOR SCHEDULE DB**

Each derivative instrument should be reported in Parts A, B, C, or D according to the nature of the instrument, as follows:

Part A: Options\*, Caps, Floors and Insurance Futures Options Owned

Part B: Options\*, Caps, Floors and Insurance Futures Options Written

Part C: Collars, Swaps and Forwards\*\*

Part D: Futures Contracts and Insurance Futures Contracts Open

\* Warrants acquired in conjunction with public or private debt or equity that are more appropriately reported in other schedules do not have to be reported in Schedule DB.

\*\* Forward commitments that are not derivative instruments (for example, the commitment to purchase a GNMA security two months after the commitment date, or a private placement six months after the commitment date) should be disclosed in the Notes to Financial Statements rather than on Schedule DB.

Part E should be used to report the counterparty exposure, (i.e., the exposure to credit risk on derivative instruments) to each counterparty (or guarantor as appropriate).

**SCHEDULE DB – PART A**  
**SECTIONS 1, 2, AND 3**

**GENERAL INSTRUCTIONS**

In each Section, separate derivative instruments into the following categories:

<u>Category</u>	<u>Line Number</u>
Call Options:	
Hedging .....	0199999
Other .....	0399999
Subtotal – Call Options .....	0499999
Put Options:	
Hedging .....	0599999
Other .....	0799999
Subtotal – Put Options .....	0899999
Caps:	
Hedging .....	0999999
Other .....	1199999
Subtotal – Caps .....	1299999
Floors:	
Hedging .....	1399999
Other .....	1599999
Subtotal – Floors .....	1699999
Insurance Futures Call Options:	
Hedging .....	1799999
Other .....	1999999
Subtotal – Insurance Futures Call Options .....	2099999
Insurance Futures Put Options	
Hedging .....	2199999
Other .....	2399999
Subtotal – Insurance Futures Put Options .....	2499999
Totals:	
Subtotal – Hedging .....	2599999
Subtotal – Other .....	2799999
Total .....	9999999

Column 1 – Description

Give a complete and accurate description of the derivative instrument, including description of underlying securities, currencies, rates, indices, commodities, derivative instruments, or other financial market instruments. Forward exchange rate must be stated as: Fx Currency per US\$ (Fx/US\$). Where leveraging is a feature of the payment terms, the multiplier effect will be clearly presented in the description. Two or more lines may be used to report a derivative instrument if such presentation provides a more accurate description.

Column 2 – Number of Contracts or Notional Amount

Where instrument positions are traded based on number of contracts, such as exchange traded options, show the number of contracts. For other instruments, such as caps and floors, show the notional amount (i.e., the amount upon which the next cash payment is based). Notional amount should be based on current U.S. equivalent of the amount receivable from the counterparty as of the (purchase/sale/reporting) date.

- Column 3 – Date of Maturity, Expiry or Settlement  
 Show the date of maturity, expiry, or settlement, as appropriate.
- Column 4 – Strike Price, Rate or Index  
 Show the strike price, rate, or index for which an option could be exercised or which would trigger a cash payment on a cap or floor. Forward exchange rate must be stated as: Fx Currency per US\$ (Fx/US\$).
- Column 5 – Date of Acquisition  
 Show the date of the original transaction. The reporting entity may summarize on one line all identical derivative instruments with the same exchange or counterparty showing the date of last acquisition, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).
- Column 6 – Exchange or Counterparty  
 If exchange traded, show the name of the exchange, Board of Trade, or contract market. If OTC traded, show the counterparty or guarantor upon whose credit the insurer relies.
- Column 7 – Cost/Option Premium  
 Indicate the cost of the instrument purchased. For insurance futures, indicate the consideration paid for the purchase of the instrument.

**SCHEDULE DB – PART A – SECTION 1**

**OPTIONS, CAPS, FLOORS AND INSURANCE FUTURES OPTIONS OWNED**  
**DECEMBER 31 OF CURRENT YEAR**

Column 8 – Book Value

Book value is the sum of cost plus cumulative increase (decrease) by adjustment in book value.

Column 9 – \* Column

Insert “\*” in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.

Insert “#” in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.

Insert “@” in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

Column 10 – Statement Value

Instruments shall be valued as follows, providing the transaction is permitted by law or regulations of an insurer’s state of domicile:

a. For Hedges of Items Carried at Amortized Cost

(i) Value at amortized cost, (or alternatively at cost if less than one year maturity).

(ii) If during the life of the instrument, it is no longer effective as a hedge, valuation at amortized cost ceases and the instrument shall be valued at current market value (marked to market).

b. For Hedges of Items Carried at Market Value

Value at current market price (marked to market).

c. For Hedges Adjusting the Basis of the Hedged Item

The book value of an instrument may be used to adjust the basis of the hedged item directly. In this case the statement value of the instrument would be zero.

d. For Other Derivative Transactions

Value at current market price (marked to market).

e. For Insurance Options

Column 11 – Fair Value

Fair value can be obtained from any one of five sources:

- a. Public Market Quotes
- b. Fair Value Provided by Broker
- c. Management Estimate
- d. Pricing Service
- e. Pricing Matrix

Column 12 – Increase (Decrease) by Adjustment

This represents the current year's amortization of the initial cost. For insurance futures options, this represents the current year's increase or decrease in the market value.

Column 13 – Used to Adjust Basis of Hedged Item

This represents the amortized book value used to adjust the basis of the hedged item(s) during the current year.

Column 14 – Other Investment/Miscellaneous Income

Include current year earned income on caps and floors. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued). For insurance futures options, this represents any increase or decrease (in the value of the instruments) that corresponds to incurred losses for the current reporting period.

**SCHEDULE DB – PART A – SECTION 3**

**OWNED OPTIONS, CAPS, FLOORS AND INSURANCE FUTURES OPTIONS TERMINATED  
DURING CURRENT YEAR**

- Column 8 – Indicate Exercise, Expiration, Maturity or Sale  
Indicate the cause of termination.
- Column 9 – Termination Date  
Show the date in which the contract/agreement was terminated. Companies may summarize on one line all identical instruments with the same exchange or counterparty, using the latest termination date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).
- Column 10 – Book Value  
Book value is the sum of cost plus cumulative increase (decrease) by adjustment in book value.
- Column 11 – \* Column  
Insert “\*” in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.  
Insert “#” in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.  
Insert “@” in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.
- Column 12 – Consideration Received on Terminations  
Show the amount of consideration received.
- Column 13 – Increase (Decrease) by Adjustment  
This represents the current year’s amortization of the initial cost.
- Column 14 – Gain (Loss) on Termination - Recognized  
This represents gain (loss) on termination that is not deferred or used to adjust basis of hedged items.
- Column 15 – Gain (Loss) on Termination - Used to Adjust Basis of Hedged Item  
This represents the gain (loss) on termination that was used to adjust the basis of a hedged item in the current year. It includes the book value of premiums that were allocated to the purchase cost on exercise of an option.
- Column 16 – Gain (Loss) on Termination - Deferred  
This represents the gain (loss) on termination that was deferred over yearend.  
This equals consideration received less book value at termination.
- Column 17 – Other Investment/Miscellaneous Income  
Include current year earned income on caps and floors. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued).

**SCHEDULE DB – PART B**  
**SECTIONS 1, 2, AND 3**

**GENERAL INSTRUCTIONS**

In each Section, separate derivative instruments into the following categories:

<u>Category</u>	<u>Line Number</u>
Call Options:	
Hedging .....	0199999
Income Generation .....	0299999
Other.....	0399999
Subtotal – Call Options .....	0499999
Put Options:	
Hedging .....	0599999
Income Generation .....	0699999
Other.....	0799999
Subtotal – Put Options.....	0899999
Caps:	
Hedging .....	0999999
Income Generation .....	1099999
Other.....	1199999
Subtotal – Caps.....	1299999
Floors:	
Hedging .....	1399999
Income Generation .....	1499999
Other.....	1599999
Subtotal – Floors .....	1699999
Insurance Futures Call Options:	
Hedging .....	1799999
Income Generation .....	1899999
Other.....	1999999
Subtotal – Insurance Futures Call Options .....	2099999
Insurance Futures Put Options:	
Hedging .....	2199999
Income Generation .....	2299999
Other.....	2399999
Subtotal – Insurance Futures Put Options .....	2499999
Totals:	
Subtotal – Hedging .....	2599999
Subtotal – Income Generation .....	2699999
Subtotal – Other .....	2799999
Total.....	9999999

Column 1 – Description

Give a complete and accurate description of the derivative instrument, including a description of underlying securities, currencies, rates, indices, commodities, derivative instruments or other financial market instruments. Forward exchange rate must be stated as: Fx Currency per US\$ (Fx/US\$). Where leveraging is a feature of the payment terms, the multiplier effect will be clearly presented in the description. Two or more lines may be used to report a derivative instrument if such presentation provides a more accurate description.

- Column 2 – Number of Contracts or Notional Amount
- Where instrument positions are traded based on number of contracts, such as exchange traded options, show the number of contracts. For other instruments, such as caps and floors, show the notional amount (i.e., the amount upon which the next cash payment is based). Notional amount should be based on current U.S. equivalent of the amount receivable from the counterparty as of the (purchase/sale/reporting) date.
- Column 3 – Date of Maturity, Expiry or Settlement
- Show the date of maturity, expiry or settlement, as appropriate.
- Column 4 – Strike Price, Rate or Index
- Show the strike price, rate or index for which an option could be exercised or which would trigger a cash payment on a cap or floor. Forward exchange rate must be stated as: Fx Currency per US\$ (Fx/US\$).
- Column 5 – Date of Issuance/Purchase
- Show the date of the original transaction. The reporting entity may summarize on one line, all identical derivative instruments used in hedging transactions with the same exchange or counterparty showing the date of last transaction, but only if the instruments are identical in their terms; e.g., type, maturity, expiry or settlement, and strike price, rate or index. Similarly, the reporting entity may summarize on one line, all identical derivative instruments used in income generation transactions with the same exchange or counterparty inserting last transaction date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).
- Hedging and income generation derivative instruments for which the alternative accounting treatment is chosen should be summarized separately.
- Column 6 – Exchange or Counterparty
- If exchange traded, show the name of the exchange, Board of Trade, or contract market. If OTC traded, show the counterparty or guarantor upon whose credit the insurer relies.
- Column 7 – Consideration Received
- Indicate the consideration received for sale of the instrument written.

**SCHEDULE DB – PART B – SECTION 1**

**OPTIONS, CAPS, FLOORS AND INSURANCE FUTURES OPTIONS WRITTEN AND  
IN FORCE DECEMBER 31 OF CURRENT YEAR**

Column 8 – Book Value

Book value is the sum of consideration received plus cumulative increase (decrease) by adjustment in book value, if any.

Income Generation Transactions

For covered calls and covered puts, book value equals consideration received. For covered caps and floors, book value is the sum of consideration received plus cumulative increase (decrease) by adjustment in book value, if any.

Column 9 – \* Column

Insert “\*” in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.

Insert “#” in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.

Insert “@” in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

Column 10 – Statement Value

Hedging Transactions

Instruments shall be valued as follows providing the transaction is permitted by law or regulations of an insurer’s state of domicile (for more complete and detailed explanation, see the NAIC *Accounting Practices and Procedures Manual*):

a. For Hedges of Items Carried at Amortized Cost

(i) Value at amortized cost, (or alternatively at cost if less than one year maturity).

(ii) If during the life of the instrument, it is no longer effective as a hedge, valuation at amortized cost ceases and the instrument shall be valued at current market value (marked to market) and changes will be recognized currently.

b. For Hedges of Items Carried at Market Value

Value at current market price (marked to market) and changes will be recognized currently.

c. For Hedges Adjusting the Basis of the Hedged Item (Fixed Income Only)

The book value of an instrument may be used to adjust the basis of the hedged item directly. Prior to entering into the transaction, the insurer must state its intent to use this alternative and may not change methods while the transaction remains open.

### Income Generation Transactions

- a. If Underlying/Covering Item Carried at Amortized Cost:
  - (i) For covered puts and calls, value at consideration received.
  - (ii) For covered caps and floors, value at amortized value. If less than one year maturity to from date of acquisition, item may be carried at consideration received (unamortized).
- b. If Underlying/Covering Item Carried at Market Value:
  - (i) Value at current market price (marked to market) and changes will be recognized currently.
- c. If Adjusting the Basis of the Underlying/Covering Item (Fixed Income Only):
  - (i) The book value of a call option may be used to adjust the basis of the underlying/covering asset directly if the call option has a maturity of greater than one year from date of acquisition.

### Other Derivative Transactions

Instruments shall be valued at current market price (marked to market). For insurance options, this statement value represents the value as of December 31, of the prior year.

Column 11 – Fair Value

Fair value can be obtained from any one of five sources:

- a. Public Market Quotes
- b. Fair Value Provided by Broker
- c. Management Estimate
- d. Pricing Service
- e. Pricing Matrix

Column 12 – Increase (Decrease) by Adjustment

This represents the current year's amortization of the initial proceeds.

Column 13 – Used to Adjust Basis

Hedging Transactions:

This represents the consideration used to adjust the basis of the hedged item(s) during the current year.

Income Generation Transactions:

This represents the consideration used to adjust the basis of the underlying/covering asset during the current year.

Column 14 – Other Investment/Miscellaneous Income

Hedging Transactions:

Include current year incurred interest expense on caps and floors. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued).

Income Generation Transactions:

Include current year incurred interest expense on caps and floors as a negative number. The reporting entity should keep records for more detailed reporting of expense (i.e. incurred versus paid).

Other Derivative Transactions:

Include current year incurred interest expense on caps and floors as a negative number.

**SCHEDULE DB – PART B – SECTION 3**

**WRITTEN OPTIONS, CAPS, FLOORS AND INSURANCE FUTURES OPTIONS TERMINATED  
DURING CURRENT YEAR**

- Column 8 – Indicate Exercise, Expiration, Maturity, or Closing Purchase Transaction
- Indicate the cause of termination.
- Column 9 – Termination Date
- Show the date in which the contract/agreement was terminated. Companies may summarize on one line all identical derivative instruments used in hedging transactions with the same exchange or counterparty, using the latest termination date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index). Similarly, the reporting entity may summarize on one line, all identical derivative instruments used in income generation transactions with the same exchange or counterparty using the latest termination date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).
- Hedging and income generation derivative instruments, for which the alternative accounting treatment is chosen, should be summarized separately.
- Column 10 – Book Value
- Hedging Transactions:
- Book value is the sum of consideration received plus cumulative increase (decrease) by adjustment in book value, if any.
- Income Generation Transactions:
- For covered calls and covered puts, book value equals consideration received. For covered caps and floors, book value is the sum of consideration received plus cumulative decrease by adjustment in book value, if any.
- Other Derivative Transactions:
- For other derivative transactions, book value equals consideration received.
- Column 11 – \* Column
- Insert “\*” in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.
- Insert “#” in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.
- Insert “@” in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

- Column 12 – Consideration Paid on Termination  
Show the amount of consideration paid.
- Column 13 – Increase/(Decrease) by Adjustment  
This represents the current year's amortization of the initial proceeds.  
This equals book value at termination less consideration paid on termination.
- Column 14 – Gain (Loss) on Termination - Recognized  
This represents gain (loss) on termination that is not deferred or used to adjust basis of hedged or underlying/covering items.
- Column 15 – Gain (Loss) on Termination - Used to Adjust Basis  
Hedging Transactions:  
This represents the gain (loss) on termination that was used to adjust the basis of a hedged item in the current year. It includes the book value of premiums that were allocated to the sale proceeds on exercise of an option.  
Income Generation Transactions:  
This represents the gain (loss) on termination that was used to adjust the basis of an underlying/covering item in the current year. It includes the book value of premiums that were allocated to the sale proceeds on exercise of an option.
- Column 16 – Gain (Loss) on Termination - Deferred  
This represents the gain (loss) on termination that was deferred over yearend.
- Column 17 – Other Investment/Miscellaneous Income  
Hedging Transactions:  
Include current year incurred interest expense on caps and floors. The reporting entity should keep records for more detailed reporting of income (i.e., paid versus accrued).  
Income Generation Transactions:  
Include current year incurred interest expense on caps and floors as a negative number. The reporting entity should keep records for more detailed reporting of expense (i.e. paid versus accrued).  
Other Derivative Transactions:  
Include current year incurred interest expense on caps and floors as a negative number.

**SCHEDULE DB – PART C**  
**SECTIONS 1, 2 AND 3**

**GENERAL INSTRUCTIONS**

In each Section, separate derivative instruments into the following categories:

	<u>Category</u>	<u>Line Number</u>
Collars:		
	Hedging.....	0199999
	Other .....	0399999
	Subtotal – Collars.....	0499999
Swaps:		
	Hedging.....	0599999
	Other .....	0799999
	Subtotal – Swaps.....	0899999
Forwards:		
	Hedging.....	0999999
	Other .....	1199999
	Subtotal – Forwards .....	1299999
Totals:		
	Subtotal – Hedging.....	2599999
	Subtotal – Other .....	2799999
Total.....		9999999

Column 1 – Description

Give a complete and accurate description of the derivative instrument, including description of underlying securities, currencies, rates, indices, commodities, derivative instruments or other financial market instruments. Forward exchange rate must be stated as: Fx Currency per US\$ (Fx/US\$). Where leveraging is a feature of the payment terms, the multiplier effect will be clearly presented in the description. Two or more lines may be used to report a derivative instrument if such presentation provides a more accurate description.

Column 2 – Notional Amount

Where instrument positions are traded based on number of contracts, such as exchange traded options or futures, show the number of contracts. For other instruments, such as swaps, show the notional amount (i.e., the amount upon which the next cash payment is based).

Column 3 – Date of Maturity, Expiry or Settlement

Show the date of maturity, expiry or settlement, as appropriate.

Column 4 – Strike Price, Rate, or Index Rec (Pay)

Show the price, rate or index relative to which profits and losses on the transaction are determined (such as (paid) and received interest rate on an interest rate swap), or that is locked in, as under a currency forward. Forward exchange rate must be stated as: Fx Currency per US\$ (Fx/US\$).

- Column 5 – Date of Opening Position or Agreement
- Show the date of the original transaction. The reporting entity may summarize on one line, all identical instruments with the same exchange or counterparty using the latest termination date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).
- Column 6 – Exchange or Counterparty
- If exchange traded, show the name of the exchange, Board of Trade, or contract market. If OTC traded, show the counterparty or guarantor upon whose credit the insurer relies.
- Column 7 – Cost or (Consideration Received)
- Indicate the cost or (consideration received), if any.

**SCHEDULE DB – PART C – SECTION 1**

**COLLAR, SWAP AND FORWARDS OPEN**  
**DECEMBER 31 OF CURRENT YEAR**

Column 8 – Book Value

Book value is the sum of cost paid or consideration received plus cumulative increase (decrease) by adjustment in book value.

Column 9 – \* Column

Insert “\*” in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.

Insert “#” in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.

Insert “@” in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

Column 10 – Statement Value

Instruments shall be valued as follows providing the transaction is permitted by law or regulations of an insurer’s state of domicile.

a. For Hedges of Items Carried at Amortized Cost:

(i) Value at amortized cost, (or alternatively at cost if less than one year maturity).

(ii) If during the life of the instrument, it is no longer effective as a hedge, valuation at amortized cost ceases and the instrument shall be valued at current market value (marked to market) and changes will be recognized currently.

b. For Hedges of Items Carried at Market Value

Value at current market price (marked to market) and changes will be recognized currently.

c. For Hedges Adjusting the Basis of the Hedged Item

The book value of an instrument may be used to adjust the basis of the hedged item directly. In this case the statement value of the instrument would be zero.

d. For Other Derivatives Transactions

Value at current market price (marked to market) and changes will be recognized currently.

- Column 11 – Fair Value
- Fair value can be obtained from any one of five sources:
- a. Public Market Quotes
  - b. Fair Value Provided by Broker
  - c. Management Estimate
  - d. Pricing Service
  - e. Pricing Matrix
- Column 12 – Increase (Decrease) by Adjustment
- This represents the current year’s amortization of the initial cost or proceeds.
- Column 13 – Used to Adjust Basis of Hedged Item
- This represents the amortized book value used to adjust the basis of the hedged item(s) during the current year.
- Column 14 – Other Investment/Miscellaneous Income
- Include current year earned income on collars and swaps. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued).
- Column 15 – Potential Exposure
- Potential Exposure is a statistically derived measure of the potential increase in derivative instrument credit risk exposure, for derivative instruments which generally do not have an initial cost paid or consideration received, resulting from future fluctuations in the underlying interests upon which derivative instruments are based.
- For collars, swaps and forwards, the Potential Exposure = 0.5% x “Notional Amount” x Square root of (Remaining Years to Maturity).

**SCHEDULE DB – PART C – SECTION 3**  
**COLLAR, SWAP AND FORWARDS TERMINATED**  
**DURING CURRENT YEAR**

- Column 8 – Indicate Exercise, Expiration, Maturity or Sale  
Indicate the cause of termination.
- Column 9 – Termination Date  
Show the date in which the contract/agreement was terminated. Companies may summarize on one line all identical instruments with the same exchange or counterparty, using the latest termination date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).
- Column 10 – Book Value  
Book value is the sum of cost plus cumulative increase (decrease) by adjustment in book value.
- Column 11 – \* Column  
Insert “\*” in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.  
Insert “#” in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.  
Insert “@” in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.
- Column 12 – Consideration Received or (Paid) on Termination  
Show the amount of consideration received or paid.
- Column 13 – Increase/(Decrease) by Adjustment  
This represents the current year’s amortization of the initial cost or proceeds.
- Column 14 – Gain (Loss) on Termination - Recognized  
This represents gain (loss) on termination that is not deferred or used to adjust the basis of hedged items.
- Column 15 – Gain (Loss) on Termination - Used to Adjust Basis of Hedged Item  
This represents the gain (loss) on termination that was used to adjust the basis of a hedged item in the current year.
- Column 16 – Gain (Loss) on Termination - Deferred  
This represents the gain (loss) on termination that was deferred over yearend.  
This equals consideration received less book value at termination.
- Column 17 – Other Investment/Miscellaneous Income  
Include current year earned income on collars and swaps. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued).

**SCHEDULE DB – PART D**  
**SECTIONS 1, 2 AND 3**

**GENERAL INSTRUCTIONS**

In each Section, separate derivative instruments into the following categories:

<u>Category</u>	<u>Line Number</u>
Long Futures:	
Hedging .....	0199999
Other .....	0399999
Subtotal – Long Futures .....	0499999
Short Futures:	
Hedging .....	0599999
Other .....	0799999
Subtotal – Short Futures .....	0899999
Insurance Futures Call Options:	
Hedging .....	1799999
Other .....	1999999
Subtotal – Insurance Futures Call Options .....	2099999
Insurance Futures Put Options:	
Hedging .....	2199999
Other .....	2399999
Subtotal – Insurance Futures Put Options .....	2499999
Totals:	
Subtotal – Hedging .....	2599999
Subtotal – Other .....	2799999
Total .....	9999999

At the end of each Section, list, in alphabetical sequence, brokers with whom cash deposits have been made.

- Column 1 – Description
- Give a complete and accurate description of the derivative instrument, including description of underlying securities, currencies, rates, indices, commodities, derivative instruments or other financial market instruments. Forward exchange rate must be stated as: Fx Currency per US\$ (Fx/US\$). Where leveraging is a feature of the payment terms, the multiplier effect will be clearly presented in the description. Two or more lines may be used to report a derivative instrument if such presentation provides a more accurate description.
- Column 2 – Number of Contracts
- Show the number of contracts.
- Column 3 – Maturity Date
- Show the date of maturity.

**SCHEDULE DB – PART D – SECTION 1**

**FUTURES CONTRACTS AND INSURANCE FUTURES CONTRACTS OPEN**  
**DECEMBER 31 OF CURRENT YEAR**

- Columns 4 and 5 – Original Value & Current Value
- Column 4 (Original Value) and 5 (Current Value) –
- Represent the original or current value of open contracts even though this amount was not paid or received in cash. It equals (# of contracts) x (underlying value per contract) x (price per contract).
- Column 6 – Variation Margin
- On long contracts, it is the difference between Current Value minus Original Value (Column 5 – Column 4). On short contracts, it is the difference between Original Value minus Current Value (Column 4 – Column 5).
- Column 7 – Date of Opening Position
- Show the date of the original transaction. Summarize on one line and use the date of last transaction for instruments with the same exchange sign.
- Column 8 – Exchange or Counterparty
- Show the name of the exchange, Board of Trade, or contract market.
- Column 9 – Cash Deposit
- Show at the end of this section the amount of outstanding cash deposits at December 31, by broker, in alphabetical sequence.
- Column 10 – Variation Margin Information - Recognized
- This represents the variation margin recognized as an unrealized or realized gain (loss) or as investment income from inception of the contract.
- Column 11 – Variation Margin Information - Used to Adjust Basis of Hedged Item
- This represents the variation margin used to adjust the basis of a hedged item.
- Column 12 – Variation Margin Information - Deferred
- This represents the variation margin that has been deferred from inception of the contract.
- Column 13 – Potential Exposure
- Potential Exposure is a statistically derived measure of the potential increase in derivative instrument credit risk exposure, for derivative instruments which generally do not have an initial cost paid or consideration received, resulting from future fluctuations in the underlying interests upon which derivative instruments are based.
- For futures, the Potential Exposure = (Initial Margin per contract on the valuation date, set by the exchange on which contract trades) x (the number of contracts open on the valuation date).

**SCHEDULE DB – PART D – SECTION 2**

**FUTURES CONTRACTS AND INSURANCE FUTURES CONTRACTS OPENED  
DURING CURRENT YEAR**

Column 4 – Original Value

Original value represents the original value of the contracts purchased or sold even though this amount was not paid or received in cash. It equals (# of contracts) x (underlying value per contract) x (price per contract).

Column 5 – Date of Opening Position

Show the date of the original transaction. Companies may summarize on one line all identical instruments with the same exchange using the date of last transaction.

Column 6 – Exchange or Counterparty

Show the name of the exchange, Board of Trade, or contract market.

Column 7 – Net Additions to Cash Deposits

Show at the end of this section the net additions of cash deposits during the year, by broker, in alphabetical sequence.

**SCHEDULE DB – PART D – SECTION 3**

**FUTURES CONTRACTS AND INSURANCE FUTURES CONTRACTS TERMINATED  
DURING CURRENT YEAR**

- Column 4 and 5 – Original Value & Termination Value
- Column 4 (Original Value) and 5 (Termination Value) –
- Represent the original or termination value of terminated contracts even though this amount was not paid or received in cash. It equals (# of contracts) x (underlying value per contract) x (price per contract) less commission on terminated contracts.
- Column 6 – Variation Margin
- On long contracts it is the difference between Termination Value minus Original Value (Column 5 – Column 4). On short contracts it is the difference between Original Value minus Termination Value (Column 4 – Column 5).
- Column 7 – Date of Opening Position
- Show the date of the original transaction. Summarize on one line and use the date of last transaction for instruments with the same exchange sign.
- Column 8 – Exchange or Counterparty
- Show the name of the exchange, Board of Trade, or contract market.
- Column 9 – Net Reduction to Cash Deposits
- Show at the end of this section the net reductions of cash deposits during the year by broker, in alphabetical sequence.
- Column 10 – Termination Date
- Show the date in which the contract was terminated. Summarize on one line and use the date of last transaction for instruments with the same exchange sign, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement).
- Column 11 – Variation Margin Information – Gain (Loss) Recognized
- This represents the total variation margin that was recognized as realized or unrealized gain (loss), or as investment income from inception of the contract.
- Column 12 – Variation Margin Information – Gain (Loss) Used to Adjust Basis of Hedged Item
- This represents the variation margin that was used to adjust the basis of a hedged item. It includes the variation margin that was allocated to the purchase cost or sales proceeds when delivery was taken or made on the underlying items of the futures contract.
- Column 13 – Variation Margin Information – Gain (Loss) Deferred
- This represents the variation margin that was deferred over yearend.

**SCHEDULE DB – PART E – SECTION 1**

**COUNTERPARTY EXPOSURE FOR DERIVATIVE INSTRUMENTS OPEN**  
**DECEMBER 31 OF CURRENT YEAR**

Counterparty Exposure to any one counterparty is the exposure to credit risk associated with the use of derivative instruments with that counterparty. This part displays the statement value exposure and market value exposure to each counterparty, net of collateral. Also displayed is the total potential exposure for each counterparty for Schedule DB, Parts C and D.

On the first line, show the aggregate sum for exchange traded derivatives. On subsequent lines, show separately six groups of OTC (over-the-counter) derivative counterparties by SVO Rating. Within each group, list the counterparties in alphabetical order. For each counterparty with a master agreement, show on a second line, if applicable, totals for derivative instruments not covered by the master agreement, and use additional lines as needed if multiple master agreements with the counterparty exist that do not provide for netting of offsetting amounts by the insurer against the counterparty upon termination in the event that the counterparty defaults. Show subtotals for each group.

If an insurer has any detail lines reported for any of the following required groups, it shall report the subtotal amount of the corresponding group with the specified subtotal line number appearing in the same manner and location as the pre-printed total.

Aggregate Sum of Exchange Traded Derivatives.....	0199999
Total NAIC 1 Designation.....	0299999
Total NAIC 2 Designation.....	0399999
Total NAIC 3 Designation.....	0499999
Total NAIC 4 Designation.....	0599999
Total NAIC 5 Designation.....	0699999
Total NAIC 6 Designation.....	0799999
Total.....	0899999

Column 1 – Description Counterparty or Exchange Traded

On the first line, show the phrase: Exchange Traded. On subsequent lines, show the name of the counterparty.

Column 2 – Master Agreement (Yes or No)

Show XXX for the aggregate reporting of Exchange Traded derivatives. For OTC Counterparties, indicate yes if:

1. The insurer has a written International Swaps and Derivatives Association (ISDA) master agreement with the counterparty that provides for the netting of offsetting amounts by the insurer against the counterparty upon termination in the event that the counterparty defaults, or if such netting provisions of an ISDA master agreement are either incorporated by reference in transaction confirmations or are otherwise contractual provisions to which derivative instrument confirmations with the counterparty are subject, or if the insurer has a written non – ISDA master agreement with the counterparty that provides for the netting of offsetting amounts or the right of offset by the insurer against the counterparty upon termination in the event that the counterparty defaults; and
2. The domiciliary jurisdiction of such counterparty is either within the United States or if not within the United States, is within a foreign (non-United States) jurisdiction listed in the *Purposes and Procedures* Manual of the NAIC Securities Valuation Office as eligible for netting.

Column 3 – Fair Value of Acceptable Collateral

Leave blank for the aggregate reporting of Exchange Traded derivatives. For OTC Counterparties, show the market value of acceptable collateral pledged by the counterparty.

“Acceptable collateral” means cash, cash equivalents, securities issued or guaranteed by the United States or Canadian governments or their government-sponsored enterprises, letters of credit, publicly traded obligations rated 1 by the SVO, government money market mutual funds, and such other items as may be defined as acceptable collateral in the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*. For purposes of this definition, the term “letter of credit” means a clean, irrevocable and unconditional letter of credit issued or confirmed by, and payable and presentable at, a financial institution on the list of financial institutions meeting the standards for issuing such letter of credit published pursuant to the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*. The letter of credit must have an expiration date beyond the term of the subject transaction.

Statement values that are debit balances on the balance sheet are positive numbers; those that are credit balances are negative numbers.

Column 4 – Contracts with Statement Value > 0 (i.e., debit balance on balance sheet)

On the first line, show the aggregate sum for exchange traded derivatives that have a positive statement value. For futures, this equals deferred variation margin losses (Part D, Section 1, Column 12); plus the sum of all cash deposits with brokers (Part D, Section 1, Column 9). On subsequent lines, show the sum of the statement values of all derivative instruments with the counterparty that have a positive statement value.

Column 5 – Contracts with Statement Value < 0 (i.e., credit balance on balance sheet)

On the first line, show the sum of the statement values in parentheses ( ) of all exchange traded derivatives that have a negative statement value. For Futures, this equals deferred variation margin gains (Part D, Section 1, Column 12). For written options, caps and floors on Part B, the positive statement values will be shown here in parentheses ( ). On subsequent lines, show the sum of the statement values in parentheses ( ) of all derivative instruments with the counterparty that have a negative statement value.

Column 6 – Exposure Net of Collateral

For the aggregate reporting of exchange traded derivatives, show amount in Column 4. For OTC Counterparties, if no master agreement is in place, show the sum of the statement values of all derivative instruments with the counterparty, which have a positive statement value, less any Acceptable Collateral (Column 4 – Column 3). If a master agreement is in place, show the net sum of the statement values of all derivative instruments with the counterparty, less any acceptable collateral (Column 4 + Column 5 – Column 3). This amount should not be less than zero.

Market values that would be debit balances on the balance sheet are positive numbers; those that would be credit balances are negative numbers.

Column 7 – Contracts With Fair Values > 0 (i.e., would be a debit balance on the balance sheet)

On the first line, show the sum of the market values of all exchange traded derivatives that have a positive market value. For futures, this equals the sum of all cash deposits with brokers (Part D, Section 1, Column 9). On subsequent lines, show the sum of the market values of all derivative instruments with the counterparty that have a positive market value.

- Column 8 – Contracts With Fair Values < 0 (i.e., would be a credit balance on the balance sheet)
- On the first line, show the sum of the market values in the parentheses ( ) of all exchange traded derivatives that have a negative market value. For futures this equals zero. For written options, caps and floors on Part B, the positive market values will be shown here in parentheses ( ). On subsequent lines, show the sum of the market values in parentheses ( ) of all derivative instruments with the counterparty that have a negative market value.
- Column 9 – Exposure Net of Collateral
- For the aggregate reporting of exchange traded derivatives, show amounts in Column 7. For OTC counterparties, if no master agreement is in place, show the sum of the market values of all derivative instruments with the counterparty which have a positive market value, less any acceptable collateral (Column 7 – Column 3). If a master agreement is in place, show the net sum of the market values of all derivative instruments with the counterparty, less any acceptable collateral (Column 7 + Column 8 – Column 3). This amount should not be less than zero.
- Column 10 – Potential Exposure
- Show the potential exposure for Parts C and D for exchange traded derivatives in aggregate and for each OTC counterparty.
- Column 11 – Off-Balance Sheet Exposure
- For Exchange Traded Derivatives, show Column 10.
- For OTC counterparties:
- If Column 2 = yes; show [Column 4 + Column 5 – Column 3 + Column 10] – Column 6 but not less than zero.
- If Column 2 = no; show Column 10.
- Optional: If there is no master netting agreement, companies may still encounter double counting in cases where a premium is received for an off balance sheet derivative transaction, such as an interest rate swap. In such cases, report “no” in Column 2 and calculate off balance sheet exposure on a contract-by-contract basis using the first formula.

ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
**SCHEDULE DB - PART A - SECTION 1**

Showing all Options, Caps, Floors and Insurance Futures Options Owned December 31 of Current Year

1	2	3	4	5	6	7	8	9	10	11	12	13	14
Description	Number of Contracts or Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index	Date of Acquisition	Exchange or Counterparty	Cost/Option Premium	Book Value		Statement Value	Fair Value	Increase/ (Decrease) by Adjustment	Used to Adjust Basis of Hedged Item	Other Investment/ Miscellaneous Income
2599999 Subtotal - Hedging Transactions								XXX					
2799999 Subtotal - Other Derivative Transactions								XXX					
9999999 Totals								XXX					

**SCHEDULE DB - PART A - SECTION 2**

Showing all Options, Caps, Floors and Insurance Futures Options Acquired During Current Year

1	2	3	4	5	6	7
Description	Number of Contracts or Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index	Date of Acquisition	Exchange or Counterparty	Cost/Option Premium
2599999 Subtotal - Hedging Transactions						
2799999 Subtotal - Other Derivative Transactions						
9999999 Totals						

**ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
SCHEDULE DB - PART A - SECTION 3**

Showing all Owned Options, Caps, Floors and Insurance Futures Options Terminated During Current Year

1 Description	2 Number of Contracts or Notional Amount	3 Date of Maturity, Expiry or Settlement	4 Strike Price, Rate or Index	5 Date of Acquisition	6 Exchange or Counterparty	7 Cost/Option Premium	8 Indicate Exercise, Expiration, Maturity or Sale	9 Termination Date	10 Book Value	11 *	12 Consideration Received on Terminations	13 Increase/ (Decrease) by Adjustment	Gain/(Loss) on Termination			17 Other Investment/ Miscellaneous Income	
													14 Recognized	15 Used to Adjust Basis of Hedged Item	16 Deferred		
2599999 Subtotal - Hedging Transactions																	
2799999 Subtotal - Other Derivative Transactions							XXX	XXX		XXX							
9999999 Totals							XXX	XXX		XXX							

**SCHEDULE DB - PART B - SECTION 1**

Showing all Options, Caps, Floors and Insurance Futures Options Written and In-Force December 31 of Current Year

1 Description	2 Number of Contracts or Notional Amount	3 Date of Maturity, Expiry or Settlement	4 Strike Price, Rate or Index	5 Date of Issuance/ Purchase	6 Exchange or Counterparty	7 Consideration Received	8 Book Value	9 *	10 Statement Value	11 Fair Value	12 Increase/ (Decrease) by Adjustment	13 Used to Adjust Basis	14 Other Investment/ Miscellaneous Income
2599999 Subtotal - Hedging Transactions									XXX				
2699999 Subtotal - Income Generation Transactions									XXX				
2799999 Subtotal - Other Derivative Transactions									XXX				
9999999 Totals									XXX				

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**ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
SCHEDULE DB - PART B - SECTION 2**

Showing all Options, Caps, Floors and Insurance Futures Options Written During Current Year

1	2	3	4	5	6	7
Description	Number of Contracts or Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index	Date of Issuance/Purchase	Exchange or Counterparty	Consideration Received
2599999 Subtotal - Hedging Transactions						
2699999 Subtotal - Income Generation Transactions						
2799999 Subtotal - Other Derivative Transactions						
9999999 Totals						

**SCHEDULE DB - PART B - SECTION 3**

Showing all Written Options, Caps, Floors and Insurance Futures Options Terminated During Current Year

1	2	3	4	5	6	7	8	9	10	11	12	13	Gain/(Loss) on Termination			17
													14	15	16	
Description	Number of Contracts or Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index	Date of Issuance/Purchase	Exchange or Counterparty	Consideration Received	Indicate Exercise, Expiration, Maturity or Closing Purchase Transaction	Termination Date	Book Value	Consideration Paid on Terminations	Increase/(Decrease) by Adjustment	Recognized	Used to Adjust Basis	Deferred	Other Investment/Miscellaneous Income	
2599999 Subtotal - Hedging Transactions																
2699999 Subtotal - Income Generation Transactions							XXX	XXX		XXX						
2799999 Subtotal - Other Derivative Transactions							XXX	XXX		XXX						
9999999 Totals							XXX	XXX		XXX						

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ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
**SCHEDULE DB - PART C - SECTION 1**

Showing all Collar, Swap and Forwards Open December 31 of Current Year

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Description	Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index Rec (Pay)	Date of Opening Position or Agreement	Exchange or Counterparty	Cost or (Consideration Received)	Book Value		Statement Value	Fair Value	Increase/ (Decrease) by Adjustment	Used to Adjust Basis of Hedged Item	Other Investment/ Miscellaneous Income	Potential Exposure
2599999 Subtotal - Hedging Transactions								XXX						
2799999 Subtotal - Other Derivative Transactions								XXX						
9999999 Totals								XXX						

**SCHEDULE DB - PART C - SECTION 2**

Showing all Collar, Swap and Forwards Opened During Current Year

1	2	3	4	5	6	7
Description	Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index Rec (Pay)	Date of Opening Position or Agreement	Exchange or Counterparty	Cost or (Consideration Received)
2599999 Subtotal - Hedging Transactions						
2799999 Subtotal - Other Derivative Transactions						
9999999 Totals						

EN 1

ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
**SCHEDULE DB - PART C - SECTION 3**

Showing all Collar, Swap and Forwards Terminated During Current Year

1 Description	2 Notional Amount	3 Date of Maturity, Expiry or Settlement	4 Strike Price, Rate or Index Rec (Pay)	5 Date of Opening Position or Agreement	6 Exchange or Counterparty	7 Cost or (Consideration Received)	8 Indicate Exercise, Expiration, Maturity or Sale	9 Termination Date	10 Book Value	11 Consideration Received or (Paid) on Terminations	13 Increase/ (Decrease) by Adjustment	Gain/(Loss) on Termination			17 Other Investment/ Miscellaneous Income	
												14 Recognized	15 Used to Adjust Basis of Hedged Item	16 Deferred		
2599999 Subtotal - Hedging Transactions							XXX	XXX	XXX							
2799999 Subtotal - Other Derivative Transactions							XXX	XXX	XXX							
9999999 Totals							XXX	XXX	XXX							

**SCHEDULE DB - PART D - SECTION 1**

Showing all Futures Contracts and Insurance Futures Contracts Open December 31 of Current Year

1 Description	2 Number of Contracts	3 Maturity Date	4 Original Value	5 Current Value	6 Variation Margin	7 Date of Opening Position	8 Exchange or Counterparty	9 Cash Deposit	Variation Margin Information			13 Potential Exposure
									10 Recognized	11 Used to Adjust Basis of Hedged Item	12 Deferred	
2599999 Subtotal - Hedging Transactions							XXX	XXX				
2799999 Subtotal - Other Derivative Transactions							XXX	XXX				
9999999 Totals							XXX	XXX				

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**ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
SCHEDULE DB - PART D - SECTION 2**

Showing all Futures Contracts and Insurance Futures Contracts Opened During Current Year

1 Description	2 Number of Contracts	3 Maturity Date	4 Original Value	5 Date of Opening Position	6 Exchange or Counterparty	7 Net Additions to Cash Deposits
2599999 Subtotal - Hedging Transactions				XXX	XXX	
2799999 Subtotal - Other Derivative Transactions				XXX	XXX	
9999999 Totals				XXX	XXX	

**SCHEDULE DB - PART D - SECTION 3**

Showing all Futures Contracts and Insurance Futures Contracts Terminated During Current Year

1 Description	2 Number of Contracts	3 Maturity Date	4 Original Value	5 Termination Value	6 Variation Margin	7 Date of Opening Position	8 Exchange or Counterparty	9 Net Reduction to Cash Deposits	10 Termination Date	11 Variation Margin Information		
										11 Gain (Loss) Recognized	12 Gain (Loss) Used to Adjust Basis of Hedged Item	13 Gain (Loss) Deferred
2599999 Subtotal - Hedging Transactions						XXX	XXX		XXX			
2799999 Subtotal - Other Derivative Transactions						XXX	XXX		XXX			
9999999 Totals						XXX	XXX		XXX			

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# Examiners Handbook



*National Association of Insurance Commissioners*

# Financial Condition

	Exam Obj.	Identified Risk	Examiner/ Completion Date	Work Paper Ref.
15.	Scan the cash receipts/disbursements journal and bank statements for unusual debits or credits.			
	CO AC			
16.	Test whether account balances and disclosures comply with the NAIC <i>Accounting Practices and Procedures Manual</i> and <i>Annual Statement Instructions</i> .			
	PD			
17.	Review the Notes to the Financial Statements and General Interrogatories and evaluate the completeness of information.			
	PD			
18.	Consider the reasonableness of accrued interest and interest received during the year based on prior years.			
	VA			
19.	Select a sample of interest payments included on the bank statements. Trace those amounts to the cash receipts journal.			
	CO AC			
20.	Trace the total accrued interest to the detailed investment income exhibit and balance sheet.			
	CO AC			
21.	Trace the total interest received to the detailed investment income exhibit.			
	CO AC			
22.	Ensure that the net amounts of all cash accounts are reported jointly. If in the aggregate the insurer has a net negative cash balance, ensure that the amount is reported as a negative asset and not recorded as a liability, in accordance with SSAP No. 2, paragraph 5.			
	AC VA			
<p><u>Aggregate Write-ins for Invested Assets / Liabilities (Derivative Instruments)</u> ← <b>Elements of NAIC Financial Examiners Handbook Regarding Derivatives Start Here</b></p>				
1.	Review available independent audit reports and management letters for evidence of inappropriate hedge accounting practices.			
	AC			
2.	Obtain contracts that the insurer has entered into and agree them to the documentation provided in the insurer's records and Schedule DB.			
	EX OB/OW			



	Exam Obj.	Identified Risk	Examiner/Completion Date	Work Paper Ref.
9.	Verify that the insurer has properly documented derivative instruments opened during the year, derivative instruments terminated, expired or exercised during the year and derivative instruments open at quarter-end in accordance with SSAP No. 86, paragraphs 34-36.			
10.	Select a sample of transactions and test whether all significant terms (e.g., maturity, expiration or settlement date, contractual payments, purchase and sale price) were specified and documented, and whether the amounts and terms are consistent with those established by the insurer's hedging techniques.	CO AC		
11.	Select a sample of values from Schedule DB and trace to appropriate source documents.	CO AC		
12.	Test transactions settled after year-end for recording in the proper period.	CT		
13.	Verify that disclosure requirements for derivative contracts in accordance with SSAP 86, paragraph 53 have been met.	PD		
<b><u>Other Invested Assets</u></b>				
1.	Review investment committee minutes and determine whether investment transactions have been properly authorized.	EX		
2.	Review available independent audit reports and management letters for joint ventures, partnerships and limited liability companies in which the insurer has an interest.	AC		
3.	Make inquiries to ascertain any conflicts of interest or improprieties affecting the directors, officers or employees of the company. (Review conflict of interest statements.)	CM		



# Examiners Handbook



*National Association of Insurance Commissioners*

**Financial Condition**

	Exam Obj.	Identified Risk	Examiner/ Completion Date	Work Paper Ref.
15.	Scan the cash receipts/disbursements journal and bank statements for unusual debits or credits.			
	CO AC			
16.	Test whether account balances and disclosures comply with the NAIC <i>Accounting Practices and Procedures Manual</i> and <i>Annual Statement Instructions</i> .			
	PD			
17.	Review the Notes to the Financial Statements and General Interrogatories and evaluate the completeness of information.			
	PD			
18.	Consider the reasonableness of accrued interest and interest received during the year based on prior years.			
	VA			
19.	Select a sample of interest payments included on the bank statements. Trace those amounts to the cash receipts journal.			
	CO AC			
20.	Trace the total accrued interest to the detailed investment income exhibit and balance sheet.			
	CO AC			
21.	Trace the total interest received to the detailed investment income exhibit.			
	CO AC			
22.	Ensure that the net amounts of all cash accounts are reported jointly. If in the aggregate the insurer has a net negative cash balance, ensure that the amount is reported as a negative asset and not recorded as a liability, in accordance with SSAP No. 2, paragraph 5.			
	AC VA			
<p><u>Aggregate Write-ins for Invested Assets / Liabilities (Derivative Instruments)</u> ← <b>Elements of NAIC Financial Examiners Handbook Regarding Derivatives Start Here</b></p>				
1.	Review available independent audit reports and management letters for evidence of inappropriate hedge accounting practices.			
	AC			
2.	Obtain contracts that the insurer has entered into and agree them to the documentation provided in the insurer's records and Schedule DB.			
	EX OB/OW			



	Exam Obj.	Identified Risk	Examiner/Completion Date	Work Paper Ref.
9.	Verify that the insurer has properly documented derivative instruments opened during the year, derivative instruments terminated, expired or exercised during the year and derivative instruments open at quarter-end in accordance with SSAP No. 86, paragraphs 34-36.			
10.	Select a sample of transactions and test whether all significant terms (e.g., maturity, expiration or settlement date, contractual payments, purchase and sale price) were specified and documented, and whether the amounts and terms are consistent with those established by the insurer's hedging techniques.	CO AC		
11.	Select a sample of values from Schedule DB and trace to appropriate source documents.	CO AC		
12.	Test transactions settled after year-end for recording in the proper period.	CT		
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<b><u>Other Invested Assets</u></b>				
1.	Review investment committee minutes and determine whether investment transactions have been properly authorized.	EX		
2.	Review available independent audit reports and management letters for joint ventures, partnerships and limited liability companies in which the insurer has an interest.	AC		
3.	Make inquiries to ascertain any conflicts of interest or improprieties affecting the directors, officers or employees of the company. (Review conflict of interest statements.)	CM		

ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
**SCHEDULE DB - PART A - SECTION 1**

Showing all Options, Caps, Floors and Insurance Futures Options Owned December 31 of Current Year

1	2	3	4	5	6	7	8	9	10	11	12	13	14
Description	Number of Contracts or Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index	Date of Acquisition	Exchange or Counterparty	Cost/Option Premium	Book Value		Statement Value	Fair Value	Increase/ (Decrease) by Adjustment	Used to Adjust Basis of Hedged Item	Other Investment/ Miscellaneous Income
2599999 Subtotal - Hedging Transactions								XXX					
2799999 Subtotal - Other Derivative Transactions								XXX					
9999999 Totals								XXX					

**SCHEDULE DB - PART A - SECTION 2**

Showing all Options, Caps, Floors and Insurance Futures Options Acquired During Current Year

1	2	3	4	5	6	7
Description	Number of Contracts or Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index	Date of Acquisition	Exchange or Counterparty	Cost/Option Premium
2599999 Subtotal - Hedging Transactions						
2799999 Subtotal - Other Derivative Transactions						
9999999 Totals						

ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
**SCHEDULE DB - PART A - SECTION 3**

Showing all Owned Options, Caps, Floors and Insurance Futures Options Terminated During Current Year

1 Description	2 Number of Contracts or Notional Amount	3 Date of Maturity, Expiry or Settlement	4 Strike Price, Rate or Index	5 Date of Acquisition	6 Exchange or Counterparty	7 Cost/Option Premium	8 Indicate Exercise, Expiration, Maturity or Sale	9 Termination Date	10 Book Value	11 *	12 Consideration Received on Terminations	13 Increase/ (Decrease) by Adjustment	Gain/(Loss) on Termination			17 Other Investment/ Miscellaneous Income	
													14 Recognized	15 Used to Adjust Basis of Hedged Item	16 Deferred		
2599999 Subtotal - Hedging Transactions																	
2799999 Subtotal - Other Derivative Transactions							XXX	XXX			XXX						
9999999 Totals							XXX	XXX			XXX						

**SCHEDULE DB - PART B - SECTION 1**

Showing all Options, Caps, Floors and Insurance Futures Options Written and In-Force December 31 of Current Year

1 Description	2 Number of Contracts or Notional Amount	3 Date of Maturity, Expiry or Settlement	4 Strike Price, Rate or Index	5 Date of Issuance/ Purchase	6 Exchange or Counterparty	7 Consideration Received	8 Book Value	9 *	10 Statement Value	11 Fair Value	12 Increase/ (Decrease) by Adjustment	13 Used to Adjust Basis	14 Other Investment/ Miscellaneous Income
2599999 Subtotal - Hedging Transactions									XXX				
2699999 Subtotal - Income Generation Transactions									XXX				
2799999 Subtotal - Other Derivative Transactions									XXX				
9999999 Totals									XXX				

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**ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
SCHEDULE DB - PART B - SECTION 2**

Showing all Options, Caps, Floors and Insurance Futures Options Written During Current Year

1	2	3	4	5	6	7
Description	Number of Contracts or Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index	Date of Issuance/Purchase	Exchange or Counterparty	Consideration Received
2599999 Subtotal - Hedging Transactions						
2699999 Subtotal - Income Generation Transactions						
2799999 Subtotal - Other Derivative Transactions						
9999999 Totals						

**SCHEDULE DB - PART B - SECTION 3**

Showing all Written Options, Caps, Floors and Insurance Futures Options Terminated During Current Year

1	2	3	4	5	6	7	8	9	10	11	12	13	Gain/(Loss) on Termination			17
													14	15	16	
Description	Number of Contracts or Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index	Date of Issuance/Purchase	Exchange or Counterparty	Consideration Received	Indicate Exercise, Expiration, Maturity or Closing Purchase Transaction	Termination Date	Book Value	Consideration Paid on Terminations	Increase/(Decrease) by Adjustment	Recognized	Used to Adjust Basis	Deferred	Other Investment/Miscellaneous Income	
2599999 Subtotal - Hedging Transactions																
2699999 Subtotal - Income Generation Transactions							XXX	XXX		XXX						
2799999 Subtotal - Other Derivative Transactions							XXX	XXX		XXX						
9999999 Totals							XXX	XXX		XXX						

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ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
**SCHEDULE DB - PART C - SECTION 1**

Showing all Collar, Swap and Forwards Open December 31 of Current Year

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15		
Description	Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index Rec (Pay)	Date of Opening Position or Agreement	Exchange or Counterparty	Cost or (Consideration Received)	Book Value		Statement Value	Fair Value	Increase/ (Decrease) by Adjustment	Used to Adjust Basis of Hedged Item	Other Investment/ Miscellaneous Income	Potential Exposure		
2599999 Subtotal - Hedging Transactions								XXX								
2799999 Subtotal - Other Derivative Transactions								XXX								
9999999 Totals								XXX								

**SCHEDULE DB - PART C - SECTION 2**

Showing all Collar, Swap and Forwards Opened During Current Year

1	2	3	4	5	6	7
Description	Notional Amount	Date of Maturity, Expiry or Settlement	Strike Price, Rate or Index Rec (Pay)	Date of Opening Position or Agreement	Exchange or Counterparty	Cost or (Consideration Received)
2599999 Subtotal - Hedging Transactions						
2799999 Subtotal - Other Derivative Transactions						
9999999 Totals						

EN1

ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
**SCHEDULE DB - PART C - SECTION 3**

Showing all Collar, Swap and Forwards Terminated During Current Year

1 Description	2 Notional Amount	3 Date of Maturity, Expiry or Settlement	4 Strike Price, Rate or Index Rec (Pay)	5 Date of Opening Position or Agreement	6 Exchange or Counterparty	7 Cost or (Consideration Received)	8 Indicate Exercise, Expiration, Maturity or Sale	9 Termination Date	10 Book Value	11 Consideration Received or (Paid) on Terminations	13 Increase/ (Decrease) by Adjustment	Gain/(Loss) on Termination			17 Other Investment/ Miscellaneous Income	
												14 Recognized	15 Used to Adjust Basis of Hedged Item	16 Deferred		
2599999 Subtotal - Hedging Transactions							XXX	XXX	XXX							
2799999 Subtotal - Other Derivative Transactions							XXX	XXX	XXX							
9999999 Totals							XXX	XXX	XXX							

**SCHEDULE DB - PART D - SECTION 1**

Showing all Futures Contracts and Insurance Futures Contracts Open December 31 of Current Year

1 Description	2 Number of Contracts	3 Maturity Date	4 Original Value	5 Current Value	6 Variation Margin	7 Date of Opening Position	8 Exchange or Counterparty	9 Cash Deposit	Variation Margin Information			13 Potential Exposure
									10 Recognized	11 Used to Adjust Basis of Hedged Item	12 Deferred	
2599999 Subtotal - Hedging Transactions							XXX	XXX				
2799999 Subtotal - Other Derivative Transactions							XXX	XXX				
9999999 Totals							XXX	XXX				

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**ANNUAL STATEMENT FOR THE YEAR 2009 OF THE  
SCHEDULE DB - PART D - SECTION 2**

Showing all Futures Contracts and Insurance Futures Contracts Opened During Current Year

1 Description	2 Number of Contracts	3 Maturity Date	4 Original Value	5 Date of Opening Position	6 Exchange or Counterparty	7 Net Additions to Cash Deposits
2599999 Subtotal - Hedging Transactions				XXX	XXX	
2799999 Subtotal - Other Derivative Transactions				XXX	XXX	
9999999 Totals				XXX	XXX	

**SCHEDULE DB - PART D - SECTION 3**

Showing all Futures Contracts and Insurance Futures Contracts Terminated During Current Year

1 Description	2 Number of Contracts	3 Maturity Date	4 Original Value	5 Termination Value	6 Variation Margin	7 Date of Opening Position	8 Exchange or Counterparty	9 Net Reduction to Cash Deposits	10 Termination Date	Variation Margin Information		
										11 Gain (Loss) Recognized	12 Gain (Loss) Used to Adjust Basis of Hedged Item	13 Gain (Loss) Deferred
2599999 Subtotal - Hedging Transactions						XXX	XXX		XXX			
2799999 Subtotal - Other Derivative Transactions						XXX	XXX		XXX			
9999999 Totals						XXX	XXX		XXX			

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