§ 1410. Derivative transactions and derivative instruments. (a) For purposes of this section, except subsection (k) of this section, an insurer shall mean a domestic life insurer, a domestic property/casualty insurer, a domestic reciprocal insurer, a domestic mortgage guaranty insurer, a domestic co-operative property/casualty insurance corporation or a domestic financial guaranty insurer.

(b) (1) An insurer may only engage in derivative transactions pursuant to and in compliance with the requirements of this section. Any insurer subject to the provisions of subsection (c) of section one thousand four hundred three of this article shall also comply with the requirements set forth in such subsection relative to derivative transactions authorized by this section.

(2) An insurer may use derivative instruments under this section to engage in hedging transactions, replication transactions, and for certain limited income generation transactions authorized pursuant to this section.

(3) Prior to entering into any derivative transaction authorized pursuant to this section:

(A) the board of directors of the insurer or a committee thereof charged with the responsibility for supervising investments shall: (i) authorize such transactions, (ii) assure that all individuals conducting, monitoring, controlling and auditing derivative transactions are suitably qualified and have appropriate levels of knowledge and experience, and (iii) approve a derivative use plan for such transactions or an amendment to a previously adopted derivative use plan. If such determinations are made by a committee of such a board, the minutes of the committee reflecting such determinations shall be recorded and a report thereon shall be submitted to the board of directors for its review at such board's next meeting;

(B) the insurer shall submit a written derivative use plan or amendment thereto to the superintendent for approval; and

(C) the superintendent shall approve the insurer's written derivative plan for engaging in derivative transactions and investment practices related to derivative transactions. The plan shall specify guidelines as to the quality, maturity and diversification of derivative investments and other specifications, including investment strategies, asset/liability management practices, its liquidity needs and its

capital and surplus as they relate to the derivative use plan. The board of directors or a committee thereof charged with the responsibility for supervising investments shall determine at least quarterly whether all derivative transactions have been made in accordance with delegations, standards, limitations and investment objectives prescribed in the insurer's derivatives use plan. If such determinations are made by a committee of such a board, the minutes of the committee reflecting such determinations shall be recorded and a report thereon shall be submitted to the board of directors for its review at such board's next meeting.

(D) (i) Within ninety days of receipt of a derivative use plan application, the superintendent shall, in writing, approve, submit a detailed list to the insurer requesting all additional information necessary to make a determination on the plan, or deny such plan; otherwise, such plan shall be deemed approved. Any denial issued by the superintendent shall state the reasons for such disapproval. If an insurer does not provide the additional information requested by the superintendent, within forty-five days of receipt of such request, then such plan shall be deemed denied. Such forty-five day limit for providing such additional information may be extended at the option of the superintendent.

(ii) In the event that an insurer properly submits the additional information requested by the superintendent, then such plan shall be deemed approved sixty days after receipt of such information by the superintendent, unless the insurer is notified in writing prior to such date that the filing has been denied. Such denial shall state the reasons for such disapproval. Notwithstanding anything to the contrary in this section, the superintendent may, at any time, before a plan is approved, affirmatively approved or denied, raise objections to the plan that is based on the requirements of this chapter.

(iii) The superintendent shall, as soon as practicable, but no later than sixty days after receipt of a plan, notify the insurer if its filing is incomplete or fails to comply with applicable statutory or regulatory requirements. Such notice shall indicate that the filing is being returned with no action by the superintendent and that the period for the superintendent's substantive review has not commenced.

(4) An insurer which engages in hedging transactions or replication transactions as authorized pursuant to this section shall:

(A) only maintain its position in any outstanding derivative instrument used as part of a hedging transaction or replication transaction for as long as the hedging transaction or replication transaction, as the case may be, continues to be effective; and

(B) be able to demonstrate to the superintendent, upon request, that any derivative transaction entered into and involving a hedging transaction or replication transaction, at the point of inception is and, for as long as the derivative transaction remains outstanding, continues to be, an effective hedging or replication transaction.

(5) An insurer which enters into derivative transactions as authorized pursuant to this section shall be required to include, as part of the evaluation of accounting procedures and internal controls required to be filed pursuant to subsection (b) of section three hundred seven of this chapter, a statement describing the assessment by the independent certified public accountant of the internal controls relative to derivative transactions. If the internal controls relative to derivative transactions are determined to be deficient, the insurer shall require the accountant to include in the evaluation a description of such deficiencies and the insurer shall append to the evaluation a description of any remedial actions taken or proposed to be taken to correct these deficiencies, if such actions are not already described in the accountant's report.

(c)(1) An insurer may enter into hedging transactions pursuant to this section if, as a result of and after giving effect to the transaction:

(A) the aggregate statement value of options, swaptions, caps, floors and warrants purchased pursuant to this section does not exceed seven and one-half percent of its admitted assets;

(B) the aggregate statement of value of options, swaptions, caps and floors written pursuant to this section does not exceed three percent of its admitted assets; and

(C) the aggregate potential exposure of collars, swaps, forwards and futures entered into and options, swaptions, caps and floors written pursuant to this section does not exceed six and one-half percent of its admitted assets.

(2) Transactions entered into to effectively hedge the currency risk of investments denominated in a currency other than United States dollars, pursuant to subsection (f) of section one thousand four hundred

five of this article, shall not be included in the limits under paragraph one of this subsection.

(d) An insurer may enter into income generation transactions under this section only through the sale of call options on securities, provided that the insurer holds, or can immediately acquire through the exercise of options, warrants or conversion rights already owned, the underlying securities during the entire period the option is outstanding.

(e) An insurer may purchase or sell one or more derivative instruments to offset any derivative instrument previously purchased or sold, as the case may be, without regard to the quantitative limitations of subsection (c) of this section provided that such derivative instrument is an exact offset to the original derivative instrument being offset.

(f)(1) The counterparty exposure under an over the counter derivative instrument entered into by an insurer authorized to engage in transactions pursuant to this section shall be deemed to be an obligation of the institution to which the insurer is exposed to credit risk and shall be included in determining compliance with any single or aggregate quantitative limitation on investments made by an insurer under this chapter.

(2) Notwithstanding any single or aggregate quantitative limitation on investments made by an insurer under this chapter, an insurer may only transact an over the counter derivative instrument with:

(A) a qualified counterparty; or

(B) a counterparty other than a "qualified counterparty" if, after giving effect to that transaction, the aggregate counterparty exposure of the insurer under one or more over the counter derivative instruments to:

(i) that non-qualified counterparty does not exceed one percent of the insurer's admitted assets; and

(ii) all counterparties, other than qualified counterparties, does not exceed three percent of the insurer's admitted assets.

(3) For purposes of this section:

(A) a "qualified counterparty" is a counterparty which has an investment grade rating from at least one nationally recognized statistical rating organization or a designation of one from the Securities Valuation Office of the National Association of Insurance

Commissioners, or any successor office established by the National Association of Insurance Commissioners, and with which the insurer has entered into a master agreement, together with a credit support annex or other documentation providing for the collateralization of the counterparty's obligations to the insurer under the master agreement, if that collateral documentation provides for (i) daily margin and collateral settlement, in cash or investment grade securities, between the parties, (ii) a minimum transfer amount of no more than one million dollars, and (iii) a requirement that collateral be provided by the counterparty from the first dollar of exposure, subject to the minimum transfer amount;

(B) "aggregate counterparty exposure" means the sum of: (i) the aggregate statement value of options, swaptions, caps, floors, and warrants purchased; and (ii) the aggregate potential exposure of collars, swaps, forwards and futures entered into;

(C) "over the counter derivative instrument" means a derivative instrument which is authorized under this chapter other than a derivative instrument (i) cleared through a United States or foreign derivatives clearinghouse, or (ii) traded on or through a United States or foreign exchange providing derivatives clearing services;

(D) "derivatives clearinghouse" means a derivatives clearing organization registered with the Commodity Futures Trading Commission or the Securities and Exchange Commission or, if not so registered, is a foreign clearinghouse regulated, supervised and examined by a regulatory authority in a foreign jurisdiction approved by the superintendent;

(E) "master agreement" means a written master agreement relating to derivatives transactions that 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 jurisdiction approved by the superintendent as eligible for netting; and

(F) "minimum transfer amount" means an amount below which a daily margin and collateral settlement is not required.

(g) For the purposes of this section, "admitted assets" means the assets, as shown on the insurer's last annual statement filed with the superintendent, which conform to the requirements of section one thousand three hundred one of this chapter, except that a domestic life

insurer shall include assets held in separate accounts established under section four thousand two hundred forty of this chapter to the extent of amounts allocated to such separate accounts pursuant to paragraph three of subsection (a) of section four thousand two hundred forty of this chapter, and shall exclude investments in subsidiaries referred to in subsection (c) of section one thousand seven hundred four of this chapter.

(h) The superintendent shall promulgate regulations to:

(1) define terms used in this section that are not otherwise defined;

(2) establish the content of the derivative use plan to be submitted by an insurer to the superintendent pursuant to this section;

(3) establish effective management oversight standards, including quarterly reporting to the board of directors or a committee thereof charged with the responsibility for supervising investments, for transactions authorized pursuant to this section;

(4) require that the insurer establish adequate systems of internal control and reporting to ensure that derivative transactions are properly supervised and that transactions are in accordance with the insurer's authorized policies and procedures;

(5) establish documentation and reporting requirements for transactions authorized pursuant to this section;

(6) establish appropriate accounting standards for derivative transactions authorized pursuant to this section; and

(7) the provisions of this section shall not be deemed to authorize the superintendent to promulgate any rule or regulation, circular letter or directive, that in any way expands the superintendent's authority to (i) approve or regulate an insurer's entire investment portfolio or investment strategy, or (ii) impose standards on corporate governance that are either stricter or contrary to the provisions contained in this article or the business corporation law.

(i) For purposes of other provisions of this chapter, derivative instruments and derivative transactions entered into under this section shall be deemed to be investments, provided that if this section conflicts with any other provisions of this chapter, the provisions of this section shall prevail.

(j) The superintendent may order an insurer to cease effecting and maintaining transactions authorized by this section upon a finding that

continued operations hereunder could be detrimental to the best interests of the policyholders or the public.

(k) Any foreign insurer engaging in derivative transactions and derivative instruments shall be subject to and comply with all the provisions of this section. However, a foreign insurer may engage in derivative transactions not authorized by this section provided that: (1) such insurer is authorized to engage in such transactions pursuant to its domestic state law; (2) such insurer includes the intent to engage in such derivative transactions in the derivative use plan submitted to and approved by the superintendent pursuant to paragraph three of subsection (b) of this section; (3) the transactions are not deemed, by the superintendent, to be potentially detrimental to the policy holders or the public in this state; and (4) the insurer complies with subsection (a) of section one thousand four hundred thirteen of this article after the surplus to policyholders is reduced by the amount of all derivative transactions not authorized by this section in accordance with the measurement standards of paragraph one of subsection (c) of this section. For purposes of this subsection, a foreign insurer shall include foreign insurers as defined in paragraph twenty-one of subsection (a) of section one hundred seven of this chapter, foreign fraternal benefit societies, and accredited reinsurers.

(l) An insurer may enter into replication transactions provided that:

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

(2) the asset being replicated is subject to all provisions and limitations (including quantitative limits) on the making thereof specified in this chapter with respect to investments by the insurer, as if the transaction constituted a direct investment by the insurer in the asset being replicated; and

(3) as a result of giving effect to the replication transaction, the aggregate statement value of all assets being replicated does not exceed ten percent of the insurer's admitted assets.