



BUREAU OF INSURANCE

September 30, 1999

Administrative Letter 1999 - 11

TO: All domestic insurers and other companies subject to Article 4 (§ 38.2-1317 et seq.) of Chapter 13 of Title 38.2 of the Code of Virginia

RE: Custodians for Insurers' Securities Portfolio

Code of Virginia § 38.2-1318 B states that in the process of conducting examinations, the examiners shall observe, to the extent practicable, the guidelines and procedures set forth in the Examiners Handbook adopted by the National Association of Insurance Commissioners. The guidelines and procedures of the Examiners Handbook include the substantive procedures that are utilized to verify the assets and establish the liabilities that are reported in financial statements filed with the Bureau of Insurance.

The procedures for examining an insurer's investment portfolio require the verification of securities. In order to verify the existence of securities, the Examiners Handbook requires that the securities be (i) maintained in a manner that will allow the examiner to perform an actual inspection and count or (ii) held pursuant to a custodial or safekeeping agreement with a bank, trust company, or securities depository. When the securities are held at a bank, trust company, or securities depository, the examiners can accept certified confirmations as a verification of existence in lieu of an actual inspection and count.

During past examinations, the examiners also have accepted certified confirmations from brokerage firms, if the firm was a member of the Securities Investor Protection Corporation (SIPC) and if the amount held at the brokerage firm did not exceed the SIPC insurance coverage limits (currently \$500,000). However, in light of recent fraudulent investment-related events affecting the insurance industry and certain limitations in the SIPC insurance coverage, the examiners will no longer accept certified confirmations from brokerage firms as a verification of the existence of an insurer's securities. Domestic insurers should ensure that their securities are held by a bank, trust company, or securities depository pursuant to a custodial or safekeeping agreement. In addition, the custodial or safekeeping agreement should contain the safeguards and controls that are outlined in the Examiners Handbook.

In keeping with the procedures set forth in the Examiners Handbook, examiners shall be required to verify reported investments by actual inspection and count at the offices of the insurer unless the securities are held pursuant to a safekeeping or custodial agreement with a bank, trust company, or securities depository. In those cases, certified confirmations listing and attesting to the existence of the securities will be accepted by the examiners in lieu of an actual inspection and count. Examinees having securities on deposit with brokerage firms, regardless of whether the firm is a member of the SIPC, will not be complying with appropriate annual statement instructions and other procedures adopted by the NAIC. Such companies may be subject to penalties or other actions authorized by § 38.2-218 et seq. and other applicable sections of the Code of Virginia.

Questions concerning this administrative letter should be directed to:

David H. Smith
Chief Examiner, Financial Regulation Division
SCC, Bureau of Insurance
P.O. Box 1157
Richmond, Virginia 23218
(804) 371-9061

Sincerely,

Alfred W. Gross
Commissioner of Insurance