To: Hon. Eric A. Cioppa, Superintendent, Maine Bureau of Insurance and Chair, Financial Condition (E) Committee
Dan Daveline, Director, Financial Regulatory Services; Gail Sciacchetano, Deputy General Counsel
From: Kevin Fry, Chair, Valuation of Securities (E) Task Force
Bob Carcano, Senior Counsel, Investment Analysis Office
Re: Response to request for an evaluation of the *Derivatives Instrument Model Regulation* (Model #282)
Date: February 23, 2016

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1. Introduction and Response – The Financial Conditions (E) Committee requested that the Valuation of Securities (E) Task Force review Model #282 and opine whether it should be retained as a model law, amended, converted to a guideline or archived. The request was made pursuant to the NAIC's Procedures for Model Law Development which suggests that adoption rates be evaluated to examine if NAIC members are committed to supporting Model #282. On the basis of the analysis discussed below, the Task Force recommends that: 1) Model #282 be retained as a Model Regulation; 2) No amendments should be made to Model #282 at this time and 3) No changes are recommended for the NAIC derivatives framework at this time.

2. Method and Conclusions – The Task Force conducted a study of the derivatives marketplace to assess changes since 2007 and the impact those changes had on insurers and their use of derivatives. Derivatives experts provided information and insights in a series of conference calls which was distilled into a report used by the Task Force to consider Model #282 (Attachment One). The most significant change since 2007, when Model #282 was last reviewed, is that whereas swap derivatives were largely unregulated then, they are now comprehensively regulated by the US. The Model provides standards for processes, systems and personnel that mitigate counterparty, operational and market risk associated with derivatives use. The introduction of federal regulation meant insurers had to comply with new law and modify processes, systems and personnel (which they already had because of Model 282) to adapt to new trading platforms and market relationships. However, no new derivative risk (and no increase in an existing risk) was identified that requires new (or more specialized) requirements in the model regulation. In addition, the Task Force determined that recently concluded revisions to NAIC reporting processes were adequate given that the study we conducted confirmed that insurers continue to use derivatives in the same way and for the same reasons as in the past. The Task Force also analyzed rates of adoption of Model #282 and provisions of the Investment of Insurers Model Law (Defined Limits Version) by states with significant derivative exposure (Attachment Two). This analysis shows nearly $1.8 trillion notional amount of derivatives, representing 96% of total U.S. insurer derivatives exposure, consistently concentrated in 13 states. The Task Force concluded that these states are the natural target and audience for Model 282. Seven of the top 10 states (by dollar weighted average) representing 90.1% notional value, adopted Model #282, a 70% adoption rate (74.5% $ weighted). When all 13 states are considered, the adoption rate is 61.5% (70.8% $ weighted), reflecting much smaller derivative use exposures of the last three states.

3. Observations – The study did not provide insight into the relative quality of individual insurer responses to federal regulation. Because impacts on insurers were significant, states with insurers that have significant exposure to derivatives would benefit from understanding both impacts and responses of individual insurers.