THE ASSOCIATION OF GLOBAL CUSTODIANS

The Bank of New York
Brown Brothers Harriman
The Chase Manhattan Bank
Citibank, N.A.
Deutsche Bank AG
Investors Bank & Trust Company
Mellon Trust/Boston Safe Deposit & Trust Company
The Northern Trust Company
State Street Bank and Trust Company

Counsel to the Association:
Baker & McKenzie
815 Connecticut Avenue, N.W.
Washington, D.C. 20006

Telephone: 202/452-7013
Facsimile: 202/452-7074

May 11, 2001

VIA AIR COURIER

Julie Gann
National Association of
Insurance Commissioners
2301 McGee Street
Suite 800
Kansas City, Missouri 64108-2604

RE: Proposed Amendment to Section 2.B(15) of the Model Regulation on the Use of Clearing Corporations and Federal Reserve Book-entry System By Insurance Companies

Dear Ms. Gann:

This letter is submitted on behalf of the Association of Global Custodians ("Association"), an informal group of nine banks that are major providers of global custody services to U.S. institutional investors.[1/] On March 15, 2001, the Association submitted a comment letter (a copy of which is enclosed herewith) concerning a proposed amendment to Section 2.B(15) of the Model Regulation on the Use of Clearing Corporations and Federal Reserve Book-entry System By Insurance Companies ("Model Regulation") promulgated by the National Association of Insurance Commissioners ("NAIC"). At its March 26, 2001 meeting, the NAIC's Financial Examiners Handbook Technical Group ("FEHTG") proposed substantial revisions to Section 2.B(15) and recommended those revisions to the Examination Oversight (E)

1/ The members of the Association are The Bank of New York, Boston Safe Deposit & Trust Company, Brown Brothers Harriman & Co., The Chase Manhattan Bank, Citibank, N.A., Deutsche Bank AG, Investors Bank & Trust Company, The Northern Trust Company, and State Street Bank and Trust Company.

Task Force ("Task Force"). The Task Force has invited public comment on the revised proposal, and this letter responds to that invitation.

The revised proposal would require that the agreement between an insurance company and its custodian contain the following provision --

> The custodian shall provide written notification to the commissioner in the insurer's state of domicile if the custodial agreement with the insurer has been terminated. This termination notification shall be remitted to the commissioner within three (3) days of the custodial dissolution.

In the Association's view, the revised proposal is a significant improvement over the prior proposal. The new approach would avoid many of the burdens and ambiguities that were inherent in the prior proposal and that are discussed in our March 15 comment letter. We appreciate the FEHTG's recognition of those problems and its willingness to respond to our concerns. If the Task Force believes that direct reporting to state insurance commissioners by insurer custodians is necessary, the revised proposal is a far more workable approach than was its predecessor.

However, for the reasons set forth in our March 15 letter, the Association continues to believe that the Model Regulation should not impose reporting requirements of any type on custodian banks. In particular, as stated in our earlier letter, the Association believes that the best means of deterring asset theft by insurer management lie in increasing the resources of state insurance commissioners and in subjecting small insurers to stronger internal control requirements. Attempting to impose oversight responsibilities on bank custodians by requiring reporting of contract terminations would not materially increase the safety of assets or alert regulators to defalcations. [2/]

2/ Like the prior proposal, the new version is unlikely to be effective in curbing abuses, such as are alleged to have occurred in the Frankel case. Custody contract terminations are almost never symptomatic of fraud. In the vast majority of cases, the termination of a custody account is merely the result of the client's view that it can obtain better asset servicing or more favorable pricing from another provider. Moreover, insurers often hold their liquid assets in several accounts, and the termination of one account may entail only a minor readjustment of an insurer's overall asset deployment. For these reasons, the revised proposal -- like the earlier version -- is likely to prove more of a burden than a benefit to state insurance commissioners. Reporting will be a common occurrence as insurers terminate custody arrangements for routine purposes. Insurance departments will be forced to choose between devoting

If, despite these concerns, the Task Force nonetheless decides to proceed with the proposed amendment to Section 2.B(15), we would suggest that two modifications be made:

- First, the phrase "within three (3) days of the custodial dissolution" is vague and subject to varying interpretations. In particular, "custodial dissolution" has no generally accepted meaning in the industry and could be construed as referring to the date on which notice of termination is received by the custodian or to the date -- generally 30 or 60 days after receipt of the notice -- on which the custodial account is actually closed. The Association recommends that this phrase be changed to "within three (3) business days of the receipt by the custodian of the insurer's written notice of termination." This language will avoid ambiguity and afford earlier notice to the state regulator than would notice that does not occur until the actual "dissolution." 3/

---

scarce resources to investigating all termination reports in order to identify the tiny fraction that might be even indicative of embezzlement or simply permitting the termination reports to accumulate unread. Further, as noted in our prior letter, even if account terminations were, on rare occasions, red flags signaling possible misconduct by insurance company controlling persons, it is difficult to see what would be accomplished by after-the-fact reports. By the time an insurance commissioner's staff received a termination report and somehow determined that it was not routine, many weeks would have passed. Strengthening internal controls aimed at preventing improper transactions, rather than requiring post-hoc notices, would appear to be the more fruitful course of action.

3/ In light of the facts of the Frankel case, we have assumed that the NAIC is not seeking to require that insurance commissioners receive notice when the custodian bank, rather than the insurer, initiates a termination. Termination by the custodian would not, of course, be evidence of efforts by the insurer to misappropriate assets held in custody. If the NAIC concludes that it does wish to require that insurance commissioners receive notice of termination by the custodian bank, we would recommend that, in addition to the modifications proposed above, the following sentence be added at the end of Section 2.B(15):

> "In the case of termination by the custodian, notice shall be sent within three (3) business days of the issuance by the custodian of its notice of termination to the insurer."

- Second, proposed Subsections 2.E through 2.I of the Model Regulation should be deleted. These subsections contain various definitions of terms that appeared in the prior version of the proposal. Since these terms are no longer included in the proposal, the definitions should also be deleted.

* * *

The Association appreciates the opportunity to comment on the revised proposal. As noted above, while we disagree philosophically with the revised proposal, it is a major improvement over the prior version and far more workable. We are grateful to the FEHTG for its responsiveness to our concerns and to the Task Force for its consideration of our comments.

We would of course be happy to discuss our comments with you and your colleagues, or to provide any additional information concerning our views that you may require. If you have questions, please feel free to contact me.

Best regards.

Sincerely,

Daniel L. Goelzer
Counsel to the Association
of Global Custodians

Enclosure: Letter, dated March 15, 2001, to Annette Knief, Financial Services Manager National Association of Insurance Commissioners, from Daniel L. Goelzer (on behalf of the Association of Global Custodians)