

### §1153. General qualifications

**1. Eligible investments.** No investment, other than real property acquired under section 1156, subsection 2, paragraph D, and personal property incident to that real property or acquired under section 1156, subsection 2, paragraph E, and other than investments acquired under section 1156, subsection 2, paragraph H, subparagraph (2), may be eligible for acquisition unless it is interest bearing, interest accruing, entitled to dividends, if declared, or is otherwise income entitled and is not then in default in any respect and the insurer is entitled to receive for its exclusive account and benefit that interest or those dividends or that income.

[PL 1987, c. 399, §14 (NEW).]

**2. Bona fide hedging transactions.**

[PL 1999, c. 715, §9 (RP).]

**3. Permitted acquisitions.** Nothing in this chapter prohibits the acquisition by an insurer of:

A. Securities or property received as a dividend or pursuant to a lawful judicial or nonjudicial plan of reorganization or dissolution or pursuant to a lawful and bona fide agreement of bulk reinsurance, merger or consolidation or through the exercise of rights of conversion, stock warrants or stock options received by it in accordance with this subsection or section 1156; [PL 1987, c. 399, §14 (NEW).]

B. An investment permitted under section 1156 because that investment is convertible into other securities or stock in which the insurer is not permitted to invest under this chapter or because the insurer receives in connection with that investment stock warrants, whether detachable or nondetachable, stock options, shares of stock, property interests or other assets of any kind; or [PL 1987, c. 399, §14 (NEW).]

C. Real or personal property or any interest in that property received in satisfaction of a debt previously owing to that insurer. If any securities received by any insurer in accordance with paragraph A consist in whole or in part of stock or shares of any institution, as defined in section 1156, or of bonds or other obligations which do not meet the requirements specified in section 1156, then any of that stock or shares and any bond or obligation of that type so received shall be disposed of within 5 years from the time of its acquisition or before the expiration of any further period or periods of time as may be prescribed in writing by the superintendent or treated as a nonadmitted asset thereafter unless, at any time after acquisition, those securities have met the relevant requirements and the insurer has notified the superintendent of that fact. [PL 1987, c. 399, §14 (NEW).]

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**4. Derivative transactions.** This chapter does not prohibit an insurer from engaging in hedging transactions, income generation transactions and replication or synthetic asset transactions under the following conditions.

A. Before entering into any derivative transaction, the board of directors of the insurer shall determine that the insurer, directly or through an investment management subsidiary or affiliate, has adequate professional personnel, technical expertise and systems to implement investment practices involving derivative transactions and approve a derivative instruments use plan that:

- (1) Describes investment objectives and risk constraints, such as counter-party exposure amounts;
- (2) Defines permissible transactions including identification of the risks that may be hedged, the assets or liabilities that may be replicated and permissible types of income generation transactions; and
- (3) Requires compliance with internal control procedures. [PL 1999, c. 715, §10 (NEW).]

- B. The insurer shall establish written internal control procedures that provide for:
- (1) A quarterly report to the board of directors that reviews:
    - (a) All derivative transactions entered into, outstanding or closed out;
    - (b) The results and effectiveness of the insurer's implementation of its derivative instruments use plan; and
    - (c) The credit risk exposure to each counter-party for over-the-counter derivative transactions based upon the counter-party exposure amount;
  - (2) A system for determining whether hedging, income generation or replication strategies used by the insurer have been effective;
  - (3) A system of regular reports on at least a monthly basis to management that include:
    - (a) A description of all derivative transactions entered into, outstanding or closed out during the period since the last report;
    - (b) The purpose of each outstanding derivative transaction;
    - (c) A performance review of the derivative instruments program; and
    - (d) The counter-party exposure amounts for over-the-counter derivative transactions;
  - (4) Written authorizations that identify the responsibilities and limitations of authority of persons authorized to effect and maintain derivative transactions; and
  - (5) Documentation appropriate for each transaction including:
    - (a) The purpose 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 counter-party and the counter-party exposure amount; and
    - (e) For exchange-traded derivative instruments, the name of the exchange and the name of the firm that handled the transaction. [PL 1999, c. 715, §10 (NEW).]
- C. Whenever the derivative transactions entered into under this subsection are not in compliance with this subsection or, if continued, may now or subsequently create a hazardous financial condition of the insurer that affects its policyholders, creditors or the general public, the superintendent may, after notice and an opportunity for a hearing, order the insurer to take such action as may be reasonably necessary to rectify the noncompliance or hazardous financial condition or prevent an impending hazardous financial condition from occurring. [PL 1999, c. 715, §10 (NEW).]
- D. An insurer may enter into hedging transactions under this subsection if as a result of and after giving effect to each such transaction:
- (1) The aggregate statutory financial statement value of all outstanding caps, floors, warrants not attached to another financial instrument and options other than collars purchased by the insurer pursuant to this subsection does not exceed 7.5% of its admitted assets;
  - (2) The aggregate statutory financial statement value of all outstanding warrants, caps, floors and options other than collars written by the insurer pursuant to this subsection does not exceed 3% of its admitted assets; and

(3) The aggregate potential exposure of all outstanding collars, swaps, forwards and futures entered into or acquired by the insurer pursuant to this subsection does not exceed 6.5% of its admitted assets.

With respect to hedging transactions, an insurer shall demonstrate to the superintendent upon request the intended hedging characteristics and effectiveness of the hedging transaction or combination of hedging transactions through cash-flow testing, duration analysis or other appropriate analysis. [PL 1999, c. 715, §10 (NEW).]

E. An insurer may enter into an income generation transaction if:

(1) As a result of and after giving effect to the transaction, the aggregate statutory financial statement value of admitted assets that are then subject to call or that generate the cash flows for payments required to be made by the insurer under caps and floors sold by the insurer and then outstanding under this paragraph, plus the statutory financial statement value of admitted assets underlying derivative instruments then subject to calls sold by the insurer and outstanding under this paragraph, plus the purchase price of assets subject to puts then outstanding under this paragraph does not exceed 10% of its admitted assets; and

(2) The transaction is one of the following types and meets the other requirements specified in this subparagraph that are applicable to that type of transaction:

(a) Sales of call options on assets, if the insurer holds or has a currently exercisable right to acquire the underlying assets during the entire period that the option is outstanding;

(b) Sales of put options on assets, if the insurer holds sufficient cash, cash equivalents or interests in a short-term investment pool to purchase the underlying assets upon exercise during the entire period that the option is outstanding, and has the ability to hold the underlying assets in its portfolio. If the total market value of all put options sold by the insurer exceeds 2% of the insurer's admitted assets, the insurer shall set aside pursuant to a custodial or escrow agreement cash or cash equivalents having a market value equal to the amount of its put option obligations in excess of 2% of the insurer's admitted assets during the entire period the option is outstanding;

(c) Sales of call options on derivative instruments if the insurer holds or has a currently exercisable right to acquire assets generating the cash flow to make any payments for which the insurer is liable pursuant to the underlying derivative instruments during the entire period that the call options are outstanding and has the ability to enter into the underlying derivative transactions for its portfolio; or

(d) Sales of caps and floors, if the insurer holds or has a currently exercisable right to acquire assets generating the cash flow to make any payments for which the insurer is liable pursuant to the caps and floors during the entire period that the caps and floors are outstanding. [PL 1999, c. 715, §10 (NEW).]

F. An insurer may enter into replication or synthetic asset transactions in accordance with the requirements of the purposes and procedures manual of the National Association of Insurance Commissioners or its successor publication concerning replication or synthetic asset transactions on or after the date on which the National Association of Insurance Commissioners adopts such requirements. [PL 1999, c. 715, §10 (NEW).]

G. An insurer may purchase or sell one or more derivative instruments to offset, in whole or in part, any derivative instrument previously purchased or sold, without regard to the quantitative limitations of this subsection as long as the transaction may be recognized as an offsetting transaction in accordance with generally accepted accounting principles. [PL 1999, c. 715, §10 (NEW).]

H. Each derivative instrument must be:

- (1) Traded on a qualified exchange;
- (2) Entered into with, or guaranteed by, a qualified bank or a qualified business entity;
- (3) Issued or written by or entered into with the issuer of the underlying interest on which the derivative instrument is based; or
- (4) In the case of futures, traded through a broker that is registered as a futures commission merchant under the federal Commodity Exchange Act or that has received exemptive relief from such registration under rule 30.10 promulgated under the federal Commodity Exchange Act. [PL 1999, c. 715, §10 (NEW).]

[PL 1999, c. 715, §10 (NEW).]

#### SECTION HISTORY

PL 1987, c. 399, §14 (NEW). PL 1999, c. 715, §§9,10 (AMD).

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