

## Assembly Bill No. 2203

### CHAPTER 129

An act to amend Section 1192.9 of, to add Section 1242 to, and to repeal and add Sections 1240, 1241, and 1241.1 of, the Insurance Code, relating to insurance.

[Approved by Governor July 16, 2008. Filed with  
Secretary of State July 16, 2008.]

#### LEGISLATIVE COUNSEL'S DIGEST

AB 2203, De Leon. Insurance: foreign investments.

Existing law limits foreign investments by domestic incorporated insurers. Under existing law, those insurers, if they have outstanding insurance on risks located in a foreign country, may invest in securities and investments in those foreign countries if they are substantially of the same kinds as those permitted under California law, but they may not exceed the amount the insurer is required to invest in that country, or one and one-half the amount of reserves under those contracts, whichever is greater. Existing law permits foreign investments in certain additional circumstances.

This bill would instead provide that a domestic insurer authorized to do business in a foreign jurisdiction or that has outstanding insurance on risks in that foreign jurisdiction, may acquire foreign investments from that jurisdiction or investments denominated in the currency of that jurisdiction. For those insurers authorized to do business in a foreign jurisdiction, the investment may not exceed the amount required by law, as specified, or 115% of the amount of reserves under those contracts, whichever is greater, and for domestic insurers that are not authorized to do business in a foreign jurisdiction and have outstanding insurance on risks in that foreign jurisdiction, the investment may not exceed 105% of the amount of reserves under those contracts. These investments would be classified as excess funds investments. The bill would permit foreign investments in certain additional instances.

The bill would prohibit domestic insurers from acquiring foreign investments from or located in foreign jurisdictions designated as state sponsors of terrorism by the United States Secretary of State.

The bill would prohibit, subject to exceptions, domestic insurers from acquiring an investment of more than 3% of its admitted assets in specified investments held by a single person, or more than 5% in the voting securities of a depository institution, as specified.

*The people of the State of California do enact as follows:*

SECTION 1. Section 1192.9 of the Insurance Code is amended to read:  
1192.9. Notwithstanding Section 1100, a domestic insurer may make excess funds investments in shares of an investment company, as defined in the Federal Investment Company Act of 1940, if the requirements of subdivisions (b) and (c) are satisfied. No investment made pursuant to this section that ceases to satisfy the requirements of subdivision (b) or (c) shall be retained as an excess fund investment. No domestic insurer shall invest under any provision of this code in the shares of any investment company which has more than 33.33 percent of its investments in foreign investments that do not comply with paragraph (4) of subdivision (b).

(a) The definitions in this subdivision apply to the following terms when used in this section:

(1) A mutual fund is an open-end management company as defined in Section 5(a)(1) of the Federal Investment Company Act of 1940 (15 U.S.C. Sec. 80(a)-5(a)(1)).

(2) An exchange traded fund is either an open-ended management company as defined in Section 5(a)(1) of the Federal Investment Company Act of 1940, or a unit investment trust as defined in Section 4(2) of the Federal Investment Company Act of 1940 (15 U.S.C. Sec. 80a-4(1)), that is registered under the Federal Investment Company Act of 1940 and that satisfies the terms of exemptive orders issued by the United States Securities and Exchange Commission which qualify it to be an exchange-traded fund.

(3) A fund is any investment company authorized in this section as an excess fund investment.

(b) The investment company shall:

(1) Be registered with and reporting to the United States Securities and Exchange Commission.

(2) Be domiciled in the United States with all assets held in the United States by a bank, trust company, or other authorized custodian chartered by the United States, its territories, possessions, or states.

(3) Have assets in excess of one hundred million dollars (\$100,000,000), or be affiliated with other investment companies that have, in the aggregate, assets in excess of one billion dollars (\$1,000,000,000).

(4) Have at least 66.67 percent of its investments be investments that are authorized under Article 3 (commencing with Section 1170) and Article 4 (commencing with Section 1190), except that any amount of a fund's assets may consist of foreign investments, provided that if more than 50 percent of its total investments consist of foreign investments, then the insurer's investment in that fund shall comply with the provisions of subparagraph (C) of paragraph (1) of subdivision (c), notwithstanding any other provision of this section or this code.

(5) Have at least 36 months of active investment history.

(6) Issue its shares as fully paid and nonassessable, with no preemptive, conversion, or exchange rights.

(7) Issue its shares to the insurer or to the insurer's custodian, subcustodian, or depository designated pursuant to Section 1104.9, or have its shares be retained by a bank, trust company, or other entity other than the investment company which is authorized by the United States to act as a transfer and dividend paying agent for the investment company.

(8) Provide equal rights and privileges to each share within the same class or series, and entitle each share within its class or series to vote and to participate equally in dividends and distributions declared by the investment company and in the net distributable assets of the investment company on liquidation.

(9) If it is a mutual fund, entitle shareholders to require the investment company to redeem all shares.

(10) If it is an exchange-traded fund, all of its shares are both of the following:

(A) Registered under the Federal Securities Act of 1933.

(B) Either listed and traded on a national securities exchange registered under the Securities Exchange Act of 1934 or have prices ascertained by quotations furnished through a nationwide automated quotations system approved by the Financial Industry Regulatory Authority.

(11) Have no investment policies that authorize any of the following:

(A) Borrowings to exceed  $33\frac{1}{3}$  percent of its total assets.

(B) The aggregate notional value of its derivative instruments outstanding to exceed 10 percent of its total assets.

(C) Investment in commodities or direct ownership of real estate.

(12) Have an expense ratio that does not exceed the following amounts of its average daily net asset values:

(A) For a money market fund, 100 basis points.

(B) For a bond fund, 200 basis points.

(C) For a stock or mixed stock/bond fund, 300 basis points.

(c) An insurer shall do the following:

(1) At no time make or retain an excess fund investment under the authority of this section that exceeds the following limits:

(A) An amount of its admitted assets, as reported in its most recent annual statement, that is more than any of the following:

(i) Three percent in a single investment company or 7 percent in an affiliated group of investment companies.

(ii) Twenty-five percent in all investments authorized by this section.

(B) One hundred percent of its surplus as regards policyholders, as reported in its most recent annual statement, in all investments authorized by this section.

(C) For an investment in a fund which has more than 50 percent of its assets in foreign investments, those foreign investments shall be foreign investments as defined by Section 1240 and shall be considered foreign investments, investments denominated in foreign currencies, or both, as applicable, for purposes of the limitations set forth in subdivisions (a) and (b) of Section 1241. No insurer shall invest in any such fund pursuant to any other provision of this code.

(D) An investment in any single investment company that exceeds 10 percent of the total net asset value of that investment company.

(2) Make a specific determination, pursuant to Sections 1200 and 1201, that an investment company has stated investment policies that are suitable for the insurer's investment objectives.

(d) In addition to any other remedies available under this code for any violation of this section, the commissioner may, after giving an insurer notice and an opportunity to be heard, deny credit in any financial statement filed with the commissioner for all or any part of an investment in an investment company, even if it otherwise complies with this section, if he or she finds the investment to be unsound or hazardous.

The grounds for finding an investment unsound or hazardous may include, but are not limited to, the following determinations:

(1) The investment company's investment adviser or subadviser lacks sufficient investment experience to render reliable investment advice; or lacks good professional character or good standing with any securities licensing authorities having jurisdiction over them.

(2) The portfolio turnover rate of the investment company is excessive in relation to its investment goals.

(3) The investment company's annual investment management fee, or other fees or charges incurred by the investment company or the insurer, are not reasonable when compared to charges or fees associated with similar investment companies.

(4) An investment company fails to mirror substantially any security index upon which its stated investment policy is based.

SEC. 2. Section 1240 of the Insurance Code is repealed.

SEC. 3. Section 1240 is added to the Insurance Code, to read:

1240. The following definitions shall apply in this article:

(a) "Foreign currency" means a currency other than that of the United States.

(b) "Foreign investment" means an investment in a foreign jurisdiction, or an investment in a person, real estate, or asset domiciled in a foreign jurisdiction, that is substantially of the same kind, class, and investment grade as those eligible for investment under this code, other than under Section 1210 or 1241. An investment shall not be a foreign investment if the issuing person, qualified primary credit source, or qualified guarantor is a domestic jurisdiction or a person domiciled in a domestic jurisdiction, unless both of the following apply:

(1) The issuing person is a shell business entity.

(2) The investment is not assumed, accepted, guaranteed, or insured or otherwise backed by a domestic jurisdiction or a person, that is not a shell business entity, domiciled in a domestic jurisdiction.

(c) For purposes of subdivision (b), the following definitions apply:

(1) "Shell business entity" means a business entity having no economic substance, except as a vehicle for owning interests in assets issued, owned, or previously owned by a person domiciled in a foreign jurisdiction.

(2) “Qualified guarantor” means a guarantor against which an insurer has a direct claim for full and timely payment, evidenced by a contractual right for which an enforcement action can be brought in a domestic jurisdiction.

(3) “Qualified primary credit source” means the credit source to which an insurer looks for payment as to an investment and against which an insurer has a direct claim for full and timely payment, evidenced by a contractual right for which an enforcement action can be brought in a domestic jurisdiction.

(d) “Foreign jurisdiction” means a jurisdiction other than the United States or any of its political subdivisions.

SEC. 4. Section 1241 of the Insurance Code is repealed.

SEC. 5. Section 1241 is added to the Insurance Code, to read:

1241. (a) Subject to the limitation in Section 1242, and except for those foreign investments permitted under Section 1192.95, a domestic insurer may acquire foreign investments of substantially the same type as those that an insurer is permitted to acquire pursuant to this code, if, as a result of the acquisition and after giving effect to the investment, both of the following apply:

(1) The aggregate amount of foreign investments then held by the insurer does not exceed:

(A) Twenty percent of admitted assets, for an insurer with admitted assets equal to or in excess of five hundred million dollars (\$500,000,000).

(B) Five percent of admitted assets, for an insurer with admitted assets less than five hundred million dollars (\$500,000,000).

(2) The aggregate amount of foreign investments then held by the insurer in a single foreign jurisdiction does not exceed:

(A) Ten percent of admitted assets, for any foreign jurisdiction that has a sovereign debt rating of SVO 1.

(B) Three percent of admitted assets, for any foreign jurisdiction that has a sovereign debt rating lower than SVO 1.

(b) Subject to the limitations of Section 1242, an insurer may acquire investments denominated in foreign currencies, whether or not they are foreign investments acquired under subdivision (a) of this section, or additional foreign currency exposure as a result of the termination or expiration of a hedging transaction as defined in Section 1211 with respect to investments denominated in a foreign currency, if the following requirements are met:

(1) The aggregate amount of investments then held by an insurer under this subdivision denominated in foreign currencies does not exceed:

(A) Ten percent of admitted assets, for an insurer described in subparagraph (A) of paragraph (1) of subdivision (a).

(B) Three percent of admitted assets, for an insurer described in subparagraph (B) of paragraph (1) of subdivision (a).

(2) The aggregate amount of investments then held by an insurer under this subdivision denominated in the foreign currency of a single foreign jurisdiction does not exceed:

(A) Ten percent of admitted assets, for an insurer described in subparagraph (A) of paragraph (1) of subdivision (a) for a foreign jurisdiction that has a sovereign debt rating of SVO 1 or 3 percent of admitted assets as to any other foreign jurisdiction.

(B) Three percent of admitted assets, for an insurer described in subparagraph (B) of paragraph (1) of subdivision (a).

(3) An investment shall not be considered denominated in a foreign currency if the acquiring insurer enters into one or more contracts in transactions permitted under Section 1211 and the business entity counterparty agrees under the contract or contracts to exchange all payments made on the foreign currency denominated investment for United States currency at a rate that effectively insulates the investment cashflows against future changes in currency exchange rates during the period the contract or contracts are in effect.

(c) In addition to investments permitted under subdivisions (a) and (b), a domestic insurer that is authorized to do business in a foreign jurisdiction, and that has outstanding insurance, annuity, or reinsurance contracts on lives or risks resident or located in that foreign jurisdiction and denominated in the foreign currency of that jurisdiction may acquire foreign investments respecting that jurisdiction, subject to the limitations of Section 1242. However, investments made under this subdivision in obligations of foreign governments, their political subdivisions, and government-sponsored enterprises shall not be subject to the limitations of Section 1242 if those investments carry an SVO rating of 1 or 2. The aggregate amount of investments acquired by the insurer shall not exceed the greater of the following:

(1) The amount that the insurer is required by the law of the foreign jurisdiction to invest in the foreign jurisdiction.

(2) One hundred fifteen percent of the amount of the insurer's reserves, net of reinsurance and other obligations under the contracts.

(d) In addition to investments permitted under subdivisions (a) and (b), an insurer that is not authorized to do business in a foreign jurisdiction, but that has outstanding insurance, annuity, or reinsurance contracts on lives or risks resident or located in that foreign jurisdiction and denominated in the foreign currency of that jurisdiction may acquire foreign investments respecting that jurisdiction, and may acquire investments denominated in the currency of that jurisdiction subject to the limitations of Section 1242. However, investments made under this subdivision in obligations of foreign governments, their political subdivisions, and government-sponsored enterprises shall not be subject to the limitations of Section 1242 if those investments carry an SVO rating of 1 or 2. The aggregate amount of investments acquired by the insurer shall not exceed 105 percent of the amount of the insurer's reserves, net of reinsurance and other obligations under the contracts on lives or risks resident or located in the foreign jurisdiction.

(e) The investments acquired under this section shall be subject to Sections 1200, 1201, and 1202.

(f) Nothing in this section shall in any way restrict or limit Canadian investments otherwise permitted by this code. Canadian investments acquired under other sections of this code shall not be considered foreign investments for purposes of the limitations set forth in this section.

(g) Investments made pursuant to Section 1192.9 in investment companies shall be governed by this article to the extent specified in Section 1192.9.

SEC. 6. Section 1241.1 of the Insurance Code is repealed.

SEC. 7. Section 1241.1 is added to the Insurance Code, to read:

1241.1. (a) No domestic insurer shall acquire any investment respecting a foreign jurisdiction, or any investment denominated in the currency of that foreign jurisdiction, if that jurisdiction is designated as a state sponsor of terrorism by the United States Secretary of State pursuant to Section 6(j) of the Export Administration Act, Section 40 of the Arms Export Control Act, and Section 620A of the Foreign Assistance Act.

(b) If any investment made pursuant to Section 1241 later becomes prohibited by this section, that investment shall not be retained as an investment made pursuant to this code.

SEC. 8. Section 1242 is added to the Insurance Code, to read:

1242. (a) (1) Except as otherwise specified in Section 1241, a domestic insurer shall not acquire directly or indirectly through an investment subsidiary, an investment under Section 1241 if, as a result of and after giving effect to the investment, the insurer would hold more than 3 percent of its admitted assets in investments of all kinds issued, assumed, accepted, insured, or guaranteed by a single person, or 5 percent of its admitted assets in investments in the voting securities of a depository institution or any company that controls the institution.

(2) The 3 percent limitation in paragraph (1) shall not apply to the aggregate amounts insured by a single financial guaranty insurer with the highest generic rating issued by a nationally recognized statistical rating organization.

(b) A domestic insurer shall not acquire, directly or indirectly through an investment subsidiary, an investment under Section 1241 if, as a result of and after giving effect to the investment, the insurer's aggregate medium and lower grade investments do not comply with the limitations of Section 1196.1.