

## MODEL ACT ON CUSTODIAL AGREEMENTS AND THE USE OF CLEARING CORPORATIONS

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### Section 1. Purpose

The purpose of this Act is to authorize domestic insurance companies to utilize modern systems for holding and transferring securities without physical delivery of securities certificates, subject to appropriate regulations of the commissioner.

### Section 2. Definitions

As used in this act, the term

- A. “Clearing corporation” means a corporation as defined in [Section 8-102(a)(5) of the Uniform Commercial Code], except that with respect to securities issued by institutions organized or existing under the laws of any foreign country or securities used to meet the deposit requirements pursuant to the laws of a foreign country as a condition of doing business therein, clearing corporation may include a corporation which is organized or existing under the laws of any foreign country and is legally qualified under such laws to effect transactions in securities by computerized book-entry. Clearing corporation also includes “Treasury/Reserve Automated Debt Entry Securities System” and “Treasury Direct” book-entry securities systems established pursuant to 31 U.S.C. § 3100 *et seq.*, 12 U.S.C. pt. 391 and 5 U.S.C. pt. 301.
- B. “Custodian” means a national bank, state bank, trust company or broker/dealer which participates in a clearing corporation.
- C. “Securities” means instruments as defined in [Section 8-102(a)(15) of the Uniform Commercial Code].

### Section 3. Use of Book-Entry Systems

- A. Notwithstanding any other provision of law, a domestic insurance company may deposit or arrange for the deposit of securities held in or purchased for its general account and its separate accounts in a clearing corporation. When securities are deposited with a clearing corporation, certificates representing securities of the same class of the same issuer may be merged and held in bulk in the name of the nominee of such clearing corporation with any other securities deposited with such clearing corporation by any person, regardless of the ownership of such securities, and certificates representing securities of small denominations may be merged into one or more certificates of larger denominations. The records of any custodian through which an insurance company holds securities in a clearing corporation shall at all times show that such securities are held for such insurance company and for which accounts thereof. Ownership of, and other interests in, such securities may be transferred by bookkeeping entry on the books of such clearing corporation without physical delivery of certificates representing such securities.
- B. The Commissioner of Insurance is authorized to promulgate rules and regulations governing the deposit by insurance companies of securities with clearing corporations, including establishing standards for national banks, state banks, trust companies and brokers/dealers to qualify as custodians for insurance company securities.

**Section 4. Deposit of Securities by Domestic Insurance Companies**

Section \_\_\_\_\_ is amended by adding thereto a new paragraph as follows:

Notwithstanding any other provision of law, the securities qualified for deposit under this section may be deposited with a clearing corporation. Securities deposited with a clearing corporation and used to meet the deposit requirements set forth in this section shall be under the control of the Commissioner and shall not be withdrawn by the insurance company without the approval of the Commissioner. Any insurance company holding securities in such manner shall provide to the Commissioner evidence issued by its custodian through which such insurance company has deposited such securities in a clearing corporation, in order to establish that the securities are actually recorded in an account in the name of the custodian and that the records of the custodian reflect that such securities are held subject to the order of the Commissioner.

**Drafting Note:** Certain terms used in Section 4 are defined in Section 2 of this model Act.

**Section 5. Deposit of Securities by Foreign Insurance Companies**

Section \_\_\_\_\_ is amended by adding thereto a new paragraph as follows:

Notwithstanding any other provision of law, securities eligible for deposit under the insurance law of this state relating to deposit of securities by an insurance company as a condition of commencing or continuing to do an insurance business in this state may be deposited with a clearing corporation. Securities deposited with a clearing corporation and used to meet the deposit requirements under the insurance laws of this state shall be under the control of the Commissioner and shall not be withdrawn by the insurance company without the approval of the Commissioner. Any insurance company holding such securities in such manner shall provide to the Commissioner evidence issued by its custodian in order to establish that the securities are actually recorded in an account in the name of the custodian and evidence that the records of the custodian reflect that such securities are held subject to the order of the Commissioner.

**Drafting Note:** Certain terms used in Section 5 are defined in Section 2 of this Model Act.

**Section 6. Effective Date**

This Act shall become effective on [insert date].

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*Chronological Summary of Action (all references are to the Proceedings of the NAIC).*

*1981 Proc. I 47, 50, 175, 245, 246, 247-249 (adopted).*

*1981 Proc. II 27, 35, 309, 393, 395, 412-413 (amended and reprinted).*

*2004 Proc. 1<sup>st</sup> Quarter 926-927, 1049 1061-1063 (amended and reprinted, adopted by parent committee).*

*2004 Proc. 2<sup>nd</sup> Quarter 51 (adopted by Plenary).*

*2008 Proc. 3<sup>rd</sup> Quarter 3-359 to 3-364 (guideline amendments adopted).*

## MODEL ACT ON CUSTODIAL AGREEMENTS AND THE USE OF CLEARING CORPORATIONS

The NAIC amended this model during the 2008 Fall National Meeting. These amendments were adopted as guidelines under the NAIC's model laws process. The 2008 3rd Quarter Guideline Amendments are highlighted in grey.

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**This chart is intended to provide readers with additional information to more easily access state statutes, regulations, bulletins or administrative rulings related to the NAIC model. Such guidance provides readers with a starting point from which they may review how each state has addressed the model and the topic being covered. The NAIC Legal Division has reviewed each state's activity in this area and has determined whether the citation most appropriately fits in the Model Adoption column or Related State Activity column based on the definitions listed below. The NAIC's interpretation may or may not be shared by the individual states or by interested readers.**

**This chart does not constitute a formal legal opinion by the NAIC staff on the provisions of state law and should not be relied upon as such. Nor does this state page reflect a determination as to whether a state meets any applicable accreditation standards. Every effort has been made to provide correct and accurate summaries to assist readers in locating useful information. Readers should consult state law for further details and for the most current information.**

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**KEY:**

**MODEL ADOPTION:** States that have citations identified in this column adopted the most recent version of the NAIC model in a **substantially similar manner**. This requires states to adopt the model in its entirety but does allow for variations in style and format. States that have adopted portions of the current NAIC model will be included in this column with an explanatory note.

**RELATED STATE ACTIVITY:** Examples of Related State Activity include but are not limited to: older versions of the NAIC model, statutes or regulations addressing the same subject matter, or other administrative guidance such as bulletins and notices. States that have citations identified in this column **only** (and nothing listed in the Model Adoption column) have **not** adopted the most recent version of the NAIC model in a **substantially similar manner**.

**NO CURRENT ACTIVITY:** No state activity on the topic as of the date of the most recent update. This includes states that have repealed legislation as well as states that have never adopted legislation.

NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Alabama	ALA. CODE § 27-6-3 (1981) (Department deposits).	ALA. CODE § 27-41-4 (1981).
Alaska		ALASKA STAT. § 21.21.410 (1997/2007).
American Samoa	NO CURRENT ACTIVITY	
Arizona		ARIZ. REV. STAT. ANN. § 20-537 (1959/1980).
Arkansas		ARK. CODE ANN. § 23-69-134 (1959/1999).
California		CAL. INS. CODE § 1194.5 (1983); § 1104.9 (1988/1996).
Colorado	COLO. REV. STAT. §§ 10-3-1201 to 10-3-1203 (1983); COLO. AGENCIES REGS. § 3-1-16 (2006) (portions of model).	
Connecticut	NO CURRENT ACTIVITY	
Delaware	NO CURRENT ACTIVITY	
District of Columbia	NO CURRENT ACTIVITY	

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<b>NAIC MEMBER</b>	<b>MODEL ADOPTION</b>	<b>RELATED STATE ACTIVITY</b>
Florida	FLA. STAT. § 628.511 (1982).	
Georgia		GA. CODE ANN. § 33-11-10 (1960/1993).
Guam	NO CURRENT ACTIVITY	
Hawaii	NO CURRENT ACTIVITY	
Idaho	IDAHO CODE ANN. §§ 41-2869 to 41-2871 (1981).	IDAHO CODE ANN. § 41-804 (1961/2004) (Department deposits).
Illinois		215 ILL. COMP. STAT. 5/404.1 (1983) (Department deposits).
Indiana	IND. CODE § 27-1-20-8 (1981).	
Iowa	IOWA CODE § 511.8(21) (1982/1985) (Department deposits).	
Kansas		KAN. STAT. ANN. §§ 40-2a20; § 40-2b20 (1986/1996).
Kentucky	KY. REV. STAT. ANN. § 304.7-360 (1982).	
Louisiana		LA. REV. STAT. ANN. § 22:39 (1979/2004).
Maine		ME. REV. STAT. ANN. tit. 24-A, § 3408 (1969/1981).
Maryland	NO CURRENT ACTIVITY	
Massachusetts	NO CURRENT ACTIVITY	
Michigan	NO CURRENT ACTIVITY	
Minnesota		MINN. STAT. § 60A.11 (10) to (11) (1967/2008); § 61A.282 (1) (1982/2011); § 60A.10 (1967/1986) (Department deposits).



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NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Mississippi	MISS. CODE ANN. §§ 83-67-1 to 83-67-5 (2001).	
Missouri	NO CURRENT ACTIVITY	
Montana	MONT. CODE ANN. §§ 33-3-451 to 33-3-453 (2003).	
Nebraska		NEB. REV. STAT. § 44-5109 (1991/2005) (Includes definitions from model act and regulation).
Nevada	NO CURRENT ACTIVITY	
New Hampshire	NO CURRENT ACTIVITY	
New Jersey		N.J. STAT. ANN. §§ 17:20-1 to 17:20-4 (1990); §§ 17B:18-37 to 17B:18-40 (1990) (Department deposits).
New Mexico	N.M. STAT. ANN. § 59A-3 (1984); § 59A-10-3 (1984) (Department deposits).	
New York	NO CURRENT ACTIVITY	
North Carolina	NO CURRENT ACTIVITY	
North Dakota		N.D. CENT. CODE § 26.1-05-35 (1987) (Authorizes commissioner to promulgate regulations).
Northern Marianas	NO ACTION TO DATE	
Ohio		OHIO REV. CODE ANN. §§ 3901.51 to 3901.52 (1990/2004).
Oklahoma	OKLA. STAT. tit. 36, § 1628 (1983).	
Oregon	NO CURRENT ACTIVITY	
Pennsylvania	NO CURRENT ACTIVITY	

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NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Puerto Rico	NO CURRENT ACTIVITY	
Rhode Island		R.I. GEN. LAWS § 27-1-5 (1986/1990).
South Carolina	NO CURRENT ACTIVITY	
South Dakota		S.D. CODIFIED LAWS §§ 58-27-78 to 58-27-84 (1983/1997).
Tennessee	TENN. CODE ANN. § 56-3-112 (1980); § 56-2-104 (1935/2013); § 56-2-117 (1980/1984) (Department deposits).	
Texas		TEX. INS. CODE ANN. § 21.39-B (1975).
Utah	UTAH CODE ANN. § 31A-2-206 (1985/1986) (Department deposits).	BULLETIN 2008-6 (2008).
Vermont	NO CURRENT ACTIVITY	
Virgin Islands	NO CURRENT ACTIVITY	
Virginia	NO CURRENT ACTIVITY	
Washington	WASH. REV. CODE ANN. §§ 48.13.450 to 48.13.490 (2000) (portions of model).	
West Virginia	W. VA. CODE §§ 33-8A-1 to 33-8A-8 (2002/2005) (Combines model act and regulation).	
Wisconsin		WIS. STAT. § 601.13 (1969/1980) (Department deposits).
Wyoming	WYO. STAT. ANN. §§ 26-8-201 to 26-8-204 (2004).	

## MODEL ACT ON CUSTODIAL AGREEMENTS AND THE USE OF CLEARING CORPORATIONS

### Proceedings Citations

Cited to the Proceedings of the NAIC

When amendments to the model were adopted in 2004, the title of the model was changed to reflect the changes. Since the focus was on various types of clearing corporations, it seemed reasonable that the title would include a reference to clearing corporations. The title was changed from the Model Act to Permit the Use of Clearing Corporations and Federal Reserve Book-Entry System By Insurance Companies to the Model Act on Custodial Agreements and the Use of Clearing Corporations. **2004 Proc. 1<sup>st</sup> Quarter 1065.**

#### Section 1. Purpose

In 1975 the examination manual was revised to permit the use of book-entry accounts, which were available from the Federal Reserve Bank. **1975 Proc. II 214-215.**

It was suggested that a committee be formed to look into the possibility of drafting a model law on book entry procedures. **1975 Proc. II 244.**

A review of existing state laws disclosed possible statutory impediments to book entry. Some state laws required that domestic insurers maintain some or all of their assets within the domiciliary state. There was also a requirement in many states for a deposit with a state officer as a condition for doing business in the state. **1977 Proc. I 213.**

At a May 1978 meeting of state regulators concerned with insurers' financial matters, one regulator suggested that the book-entry system for maintaining securities was rapidly expanding, and recommended the NAIC reactivate the committee to consider the issue. **1978 Proc. II 217.**

In June 1978 a committee was appointed to consider potential problems with the book-entry system, and a possible NAIC response. **1978 Proc. II 215.**

A 1979 advisory committee report stated that a paper work crisis had developed ten years prior to that time where increases in trading volume had produced a flow of paper work that was too great to be handled expeditiously. Systems in place were inadequate to support the volume of trading. The report followed the steps of a typical paper transaction and a typical clearing corporation transaction. The report also detailed safety features and other protections built into the system. The advisory committee saw this technology as an opportunity to improve the efficiency of their investment operations through the reduction of securities handling. **1979 Proc. II 229-236.**

#### Section 2. Definitions

A. When an NAIC committee was appointed to consider the need for a model law on the book-entry system, one of the committee members explained exactly what was involved. Purchases, sales and maturities of the securities are recorded by computer. Under normal conditions, certificates are not issued to the purchasers. In the program for corporate stocks and bonds, the corporate securities owned by insurers are deposited directly or indirectly with the corporation; which records all the securities on computers. **1976 Proc. I 272.**

A suggestion was made during consideration of the model law that the NAIC become a depository. The clearing corporation thus formed could be tailored to the needs of the insurance industry and the NAIC Examinations Subcommittee could prescribe in advance the precise tests to be followed and the output they would accept for examination purposes. Automating the counting process of examiners would save significant sums, and NAIC examinations strengthened in the meantime. **1979 Proc. I 295.**

The definition of a clearing corporation was modified when amendments were adopted in June of 1981. The initial model only referred to the Uniform Commercial Code. **1981 Proc. II 409.**

When drafting revisions to add broker/dealers to the list of permissible custodians, a reference was added to the Treasury/Reserve Automated Debt Entry Securities System (TRADES) as included in federal law. **2004 Proc. 1<sup>st</sup> Quarter 1070.**

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### Proceedings Citations

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#### Section 2A (cont.)

During 2002 and 2003 a working group discussed extensively whether to allow broker/dealers to serve as custodians of insurers' securities. (See definition of custodian in model #298 legislative history for a summary of that discussion). That working group concluded that broker/dealers should be allowed to serve as custodians. This recommendation would require a revision of the model law and regulation. **2003 Proc. 3<sup>rd</sup> Quarter 531.**

#### Section 3. Use of Book-Entry Systems

The task force appointed to consider the issue of book entry accounting agreed that problems of implementation revolved around: (1) verification by the examiners of the various state departments of the securities being held in the accounts of particular companies, (2) establishment of ownership and clear title to securities held in book entry form, and (3) restrictions in state insurance laws. **1976 Proc. I 271.**

A. After a review of the operational and procedural features of the clearing corporation and book-entry systems, it became clear that there were many safeguards for the securities involved. However, some states had laws which might not allow the use of these systems. For example, a New York law in place at the time required that the properties of the insurer be in the control of the Board of Directors at all times. The examination law also required that examiners have access to the securities so they could inspect and count them. After consideration New York decided neither of these provisions prohibited book-entry systems. **1976 Proc. I 272-273.**

The new task force reviewed the work previously done by the NAIC, and noted the growth of use of depositories by financial institutions and the problems presently being encountered by examiners resulting from the absence of guidelines in the *Examiner's Handbook* as to the manner of authenticating and otherwise dealing with securities ownership recorded in book-entry form or on deposit with depositories. It was the sense of the task force that these problems were immediate and should be dealt with expeditiously. **1979 Proc. I 290.**

A review of state laws indicated a possible statutory impediment to implementation of a book-entry system. A number of states had laws that required domestic insurers to maintain some or all of their assets within the domiciliary state. Permission to transmit funds outside the state "as reasonably and customarily required in the regular course of business" was by itself slim authority to participate in book-entry systems, considering violation is generally a felony. **1979 Proc. II 237-238.**

When drafting model revisions in late 2003, the working group considered deleting part of Subsection A that pertained to securities held in bulk within a clearing corporation. The chair noted that there was some regulatory guidance that indicated insurance company assets should be in the name of the insurer. This clarification as to how clearing corporations operated was useful to examiners looking at investments in book-entry form. **2003 Proc. 4<sup>th</sup> Quarter 1264.**

Numerous technical changes were made to delete reference to the Federal Reserve book entry system. **2004 Proc. 1<sup>st</sup> Quarter 1053.**

B. To clarify the provision, specific reference was made to banks, trust companies and broker/dealers. **2004 Proc. 1<sup>st</sup> Quarter 1062.**

#### Section 4. Deposit of Securities by Domestic Insurance Companies

The state laws requiring deposits as a condition for doing business were seen as an impediment to participation in book-entry systems. However, an advisory committee report pointed out that the use of book entry securities systems to comply with state deposit requirements would provide states with the same financial protection for their policyholders at substantially reduced costs with greater flexibility. **1979 Proc. II 239-240.**

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**Proceedings Citations**

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**Section 5.        Deposit of Securities by Foreign Insurance Companies**

**Section 6.        Effective Date**

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*Chronological Summary of Action*

*December 1980: Adopted model.*

*June 1981: Amended definitions.*

*June 2004: Model amended to allow broker/dealers to act as custodians for insurance company assets.*

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