

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

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### Section 1. Definitions

When used in this regulation, the term

- A. “Agent” means a national bank, state bank, trust company or broker/dealer that maintains an account in its name in a clearing corporation or that is a member of the Federal Reserve System and through which a custodian participates in a clearing corporation, including the Treasury/Reserve Automated Debt Entry Securities System (TRADES) or Treasury Direct systems, except that with respect to securities issued by institutions organized or existing under the laws of a 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, “agent” may include a corporation that is organized or existing under the laws of a foreign country and that is legally qualified under those laws to accept custody of securities.
- B. “Clearing corporation” means a corporation as defined in [Section 8-102(a)(5) of the Uniform Commercial Code] that is organized for the purpose of effecting transactions in securities by computerized book-entry, except that with respect to securities issued by institutions organized or existing under the laws of a 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 that is organized or existing under the laws of a foreign country and which is legally qualified under those 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.
- C. “Custodian” means:
- (1) A national bank, state bank or trust company that shall at all times during which it acts as a custodian pursuant to this regulation be no less than adequately capitalized as determined by the standards adopted by United States banking regulators and that is regulated by either state banking laws or is a member of the Federal Reserve System and that is legally qualified to accept custody of securities in accordance with the standards set forth below, except that with respect to securities issued by institutions organized or existing under the laws of a 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, “custodian” may include a bank or trust company incorporated or organized under the laws of a country other than the United

States that is regulated as such by that country's government or an agency thereof that shall at all times during which it acts as a custodian pursuant to this regulation be no less than adequately capitalized as determined by the standards adopted by international banking authorities and that is legally qualified to accept custody of securities; or

- (2) A broker/dealer that shall be registered with and subject to jurisdiction of the Securities and Exchange Commission, maintains membership in the Securities Investor Protection Corporation, and has a tangible net worth equal to or greater than two hundred fifty million dollars (\$250,000,000).
- D. "Custodied securities" means securities held by the custodian or its agent or in a clearing corporation, including the Treasury/Reserve Automated Debt Equity Securities System (TRADES) or Treasury Direct systems.
- E. "Tangible net worth" means shareholders equity, less intangible assets, as reported in the broker/dealer's most recent Annual or Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (S.E.C. Form 10-K) filed with the Securities and Exchange Commission.
- F. "Treasury/Reserve Automated Debt Entry Securities System" ("TRADES") and "Treasury Direct" mean the 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. The operation of TRADES and Treasury Direct are subject to 31 C.F.R. pt. 357 *et seq*
- G. "Security" has the same meaning as that defined in [Section 8-102(a)(15) of the Uniform Commercial Code].
- H. "Securities' certificate" has the same meaning as that defined in [Section 8-102(a)(16) of the Uniform Commercial Code].

## **Section 2. Custody Agreement; Requirements**

- A. An insurance company may, by written agreement with a custodian, provide for the custody of its securities with that custodian. The securities that are the subject of the agreement may be held by the custodian or its agent or in a clearing corporation.
- B. The agreement shall be in writing and shall be authorized by a resolution of the board of directors of the insurance company or of an authorized committee of the board. The terms of the agreement shall comply with the following:
- (1) Securities' certificates held by the custodian shall be held separate from the securities' certificates of the custodian and of all of its other customers.
  - (2) Securities held indirectly by the custodian and securities in a clearing corporation shall be separately identified on the custodian's official records as being owned by the insurance company. The records shall identify which securities are held by the custodian or by its agent and which securities are in a clearing corporation. If the securities are in a clearing corporation, the records shall also identify where the securities are and if in a clearing corporation, the name of the clearing corporation and if through an agent, the name of the agent.

- (3) All custodied securities that are registered shall be registered in the name of the company or in the name of a nominee of the company or in the name of the custodian or its nominee or, if in a clearing corporation, in the name of the clearing corporation or its nominee.
- (4) Custodied securities shall be held subject to the instructions of the insurance company and shall be withdrawable upon the demand of the insurance company, except that custodied securities used to meet the deposit requirements set forth in Section [section of the state statute requiring deposit of securities as a condition of doing business] of this Insurance Law shall, to the extent required by that section, be under the control of the [appropriate insurance regulatory authority] and shall not be withdrawn by the insurance company without the approval of the [appropriate insurance regulatory authority].
- (5) The custodian shall be required to send or cause to be sent to the insurance company a confirmation of all transfers of custodied securities to or from the account of the insurance company. In addition, the custodian shall be required to furnish no less than monthly the insurance company with reports of holdings of custodied securities at times and containing information reasonably requested by the insurance company. The custodian's trust committee's annual reports of its review of the insurer's trust accounts shall also be provided to the insurer. Reports and verifications may be transmitted in electronic or paper form.

**Drafting Note:** The annual reports referred to in this subsection may be referred to also as single audits, directors' examinations, internal reports or audits or other similar terms. This is intended to refer to an audit of an insurer's assets only and not to the custodian's assets. (The drafters suggest that a reference to 12 C.F.R. 9.8 and 12 C.F.R. 9.9 may be useful here also; however, such a reference is not intended to limit the scope of this subsection to reports required only by the Comptroller of the Currency.)

- (6) During the course of the custodian's regular business hours, an officer or employee of the insurance company, an independent accountant selected by the insurance company and a representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, the custodian's records relating to custodied securities, but only upon furnishing the custodian with written instructions to that effect from an appropriate officer of the insurance company.
- (7) The custodian and its agents shall be required to send to the insurance company:
  - (a) All reports which they receive from a clearing corporation on their respective systems of internal accounting control, and
  - (b) Reports prepared by outside auditors on the custodians or its agent's internal accounting control of custodied securities that the insurance company may reasonably request.

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- (8) The custodian shall maintain records sufficient to determine and verify information relating to custodied securities that may be reported in the insurance company's annual statement and supporting schedules and information required in an audit of the financial statements of the insurance company.
- (9) The custodian shall provide, upon written request from an appropriate officer of the insurance company, the appropriate affidavits, substantially in the form attached to this regulation, with respect to custodied securities.
- (10) A national bank, state bank or trust company shall secure and maintain insurance protection in an adequate amount covering the bank's or trust company's duties and activities as custodian for the insurer's assets, and shall state in the custody agreement that protection is in compliance with the requirements of the custodian's banking regulator. A broker/dealer shall secure and maintain insurance protection for each insurance company's custodied securities in excess of that provided by the Securities Investor Protection Corporation in an amount equal to or greater than the market value of each respective insurance company's custodied securities. The commissioner may determine whether the type of insurance is appropriate and the amount of coverage is adequate.

**Drafting Note:** The following subsections provide alternate standards of custodial liability. The standard in the first alternative is equivalent to that of a bailee for hire under New York law. The second alternative is more strict.

- (11) The custodian shall be obligated to indemnify the insurance company for any loss of custodied securities, except that the custodian shall not be so obligated to the extent that the loss was caused by other than the negligence or dishonesty of the custodian.
- (12) The custodian shall be obligated to indemnify the insurance company for any loss of custodied securities occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft or mysterious disappearance, including loss by damage or destruction.]
- (13) In the event that there is a loss of custodied securities for which the custodian shall be obligated to indemnify the insurance company as provided in Paragraph (11) above, the custodian shall promptly replace the securities or the value thereof and the value of any loss of rights or privileges resulting from the loss of securities.
- (14) The agreement may provide that the custodian will not be liable for a failure to take an action required under the agreement in the event and to the extent that the taking of the action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosion, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control.

- (15) In the event that the custodian gains entry in a clearing corporation through an agent, there shall be an agreement between the custodian and the agent under which the agent shall be subject to the same liability for loss of custodied securities as the custodian. However, if the agent shall be subject to regulation under the laws of a jurisdiction that is different from the jurisdiction the laws of which regulate the custodian, the Commissioner of Insurance of the state of domicile of the insurance company may accept a standard of liability applicable to the agent that is different from the standard of liability applicable to the custodian.
- (16) The custodian shall provide written notification to the insurer's domiciliary commissioner if the custodial agreement with the insurer has been terminated or if 100% of the account assets in any one custody account have been withdrawn. This notification shall be remitted to the insurance commissioner within three (3) business days of the receipt by the custodian of the insurer's written notice of termination or within three (3) business days of the withdrawal of 100% of the account assets.

### **Section 3. Deposit with Affiliates; Requirements**

- A. Nothing in this regulation shall prevent an insurance company from depositing securities with another insurance company with which the depositing insurance company is affiliated, provided that the securities are deposited pursuant to a written agreement authorized by the board of directors of the depositing insurance company or an authorized committee thereof and that the receiving insurance company is organized under the laws of one of the states of the United States of America or of the District of Columbia. If the respective states of domicile of the depositing and receiving insurance companies are not the same, the depositing insurance company shall have given notice of the deposit to the insurance commissioner in the state of its domicile and the insurance commissioner shall not have objected to it within thirty (30) days of the receipt of the notice.
- B. The terms of the agreement shall comply with the following:
  - (1) The insurance company receiving the deposit shall maintain records adequate to identify and verify the securities belonging to the depositing insurance company.
  - (2) The receiving insurance company shall allow representatives of an appropriate regulatory body to examine records relating to securities held subject to the agreement.
  - (3) The depositing insurance company may authorize the receiving insurance company:
    - (a) To hold the securities of the depositing insurance company in bulk, in certificates issued in the name of the receiving insurance company or its nominee, and to commingle them with securities owned by other affiliates of the receiving insurance company, and
    - (b) To provide for the securities to be held by a custodian, including the custodian of securities of the receiving insurance company or in a clearing corporation.

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

*1981 Proc. II 27, 35, 309, 393, 395, 403-405 (adopted).*

*1995 Proc. 1<sup>st</sup> Quarter 7, 10, 223, 347, 361-365 (amended and reprinted).*

*2001 Proc. 2<sup>nd</sup> Quarter 12, 14, 322, 594, 614-617 (amended and model reprinted).*

*2004 Proc. 1<sup>st</sup> Quarter 926-927, 1049, 1051-1057 (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 3-365 to 3-377 (guideline amendments adopted).*







**FORM C**

**CUSTODIAN AFFIDAVIT**

(For use where ownership is evidenced by book entry at a Federal Reserve Bank.)

STATE OF \_\_\_\_\_ )  
 ) ss.  
COUNTY OF \_\_\_\_\_ )

\_\_\_\_\_, being duly sworn deposes and says that he or she is \_\_\_\_\_ of \_\_\_\_\_, a corporation organized under and pursuant to the laws of the \_\_\_\_\_ with the principal place of business at \_\_\_\_\_ (hereinafter called the “corporation”):

That his or her duties involve supervision of activities of the corporation as custodian and records relating thereto;

That the corporation is custodian for certain securities of \_\_\_\_\_ with a place of business at \_\_\_\_\_ (hereinafter called the “insurance company”) pursuant to an agreement between the corporation and the insurance company;

That it has caused certain securities to be credited to its book entry account with the Federal Reserve Bank of \_\_\_\_\_ under the TRADES or Treasury Direct systems; and that the schedule attached hereto is a true and complete statement of the securities of the insurance company of which the corporation was custodian as of the close of business on \_\_\_\_\_, which were in a “general” book entry account maintained in the name of the corporation on the books and records of the Federal Reserve Bank of \_\_\_\_\_ at such date;

That the corporation has the responsibility for the safekeeping of such securities both in the possession of the corporation or in the “general” book entry account as is specifically set forth in the agreement between the corporation as custodian and the insurance company; and

That, to the best of his or her knowledge and belief, unless otherwise shown on the schedule, the securities were the property of the insurance company and were free of all liens, claims or encumbrances whatsoever.

Subscribed and sworn to  
before me this \_\_\_\_ day  
of \_\_\_\_\_, 20\_\_\_\_

\_\_\_\_\_  
Vice President [or other authorized officer]

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## MODEL REGULATION 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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### Section 1. Definitions

When used in this regulation, the term

- A. "Agent" means a national bank, state bank, trust company or broker/dealer that maintains an account in its name in a clearing corporation or that is a member of the Federal Reserve System and through which a custodian participates in a clearing corporation, including the Treasury/Reserve Automated Debt Entry Securities System (TRADES) or Treasury Direct systems, except that with respect to securities issued by institutions organized or existing under the laws of a 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, "agent" may include a corporation that is organized or existing under the laws of a foreign country and that is legally qualified under those laws to accept custody of securities.
- B. "Clearing corporation" means a corporation as defined in [Section 8-102(a)(5) of the Uniform Commercial Code] that is organized for the purpose of effecting transactions in securities by computerized book-entry, except that with respect to securities issued by institutions organized or existing under the laws of a 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 that is organized or existing under the laws of a foreign country and which is legally qualified under those 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.
- C. "Custodian" means:
- (1) A national bank, state bank, federal home loan bank or trust company that shall at all times during which it acts as a custodian pursuant to this regulation be no less than adequately capitalized as determined by the standards adopted by the regulator charged with establishing standards for, and assessing, the institution's solvency and that is regulated by either federal or state banking laws or the Federal Home Loan Bank Act, as amended, or is a member of the Federal Reserve System and that is legally qualified to accept custody of securities in accordance with the standards set

forth below, except that with respect to securities issued by institutions organized or existing under the laws of a 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, “custodian” may include a bank or trust company incorporated or organized under the laws of a country other than the United States that is regulated as such by that country’s government or an agency thereof that shall at all times during which it acts as a custodian pursuant to this regulation be no less than adequately capitalized as determined by the standards adopted by international banking authorities and that is legally qualified to accept custody of securities; or

- (2) A broker/dealer that shall be registered with and subject to jurisdiction of the Securities and Exchange Commission, maintains membership in the Securities Investor Protection Corporation, and has a tangible net worth equal to or greater than two hundred fifty million dollars (\$250,000,000).
- D. “Custodied securities” means securities held by the custodian or its agent or in a clearing corporation, including the Treasury/Reserve Automated Debt Equity Securities System (TRADES) or Treasury Direct systems.
- E. “Tangible net worth” means shareholders equity, less intangible assets, as reported in the broker/dealer’s most recent Annual or Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (S.E.C. Form 10-K) filed with the Securities and Exchange Commission.
- F. “Treasury/Reserve Automated Debt Entry Securities System” (“TRADES”) and “Treasury Direct” mean the 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. The operation of TRADES and Treasury Direct are subject to 31 C.F.R. pt. 357 *et seq*
- G. “Security” has the same meaning as that defined in [Section 8-102(a)(15) of the Uniform Commercial Code].
- H. “Securities’ certificate” has the same meaning as that defined in [Section 8-102(a)(16) of the Uniform Commercial Code].

## **Section 2. Custody Agreement; Requirements**

- A. An insurance company may, by written agreement with a custodian, provide for the custody of its securities with that custodian. The securities that are the subject of the agreement may be held by the custodian or its agent or in a clearing corporation.
- B. The agreement shall be in writing and shall be authorized by a resolution of the board of directors of the insurance company or of an authorized committee of the board. The terms of the agreement shall comply with the following:
- (1) Securities’ certificates held by the custodian shall be held separate from the securities’ certificates of the custodian and of all of its other customers.
  - (2) Securities held indirectly by the custodian and securities in a clearing corporation shall be separately identified on the custodian’s official records as being owned by the insurance company. The records shall identify which

securities are held by the custodian or by its agent and which securities are in a clearing corporation. If the securities are in a clearing corporation, the records shall also identify where the securities are and if in a clearing corporation, the name of the clearing corporation and if through an agent, the name of the agent.

- (3) All custodied securities that are registered shall be registered in the name of the company or in the name of a nominee of the company or in the name of the custodian or its nominee or, if in a clearing corporation, in the name of the clearing corporation or its nominee.
- (4) Custodied securities shall be held subject to the instructions of the insurance company and shall be withdrawable upon the demand of the insurance company, except that custodied securities used to meet the deposit requirements set forth in Section [section of the state statute requiring deposit of securities as a condition of doing business] of this Insurance Law shall, to the extent required by that section, be under the control of the [appropriate insurance regulatory authority] and shall not be withdrawn by the insurance company without the approval of the [appropriate insurance regulatory authority].
- (5) The custodian shall be required to send or cause to be sent to the insurance company a confirmation of all transfers of custodied securities to or from the account of the insurance company. In addition, the custodian shall be required to furnish no less than monthly the insurance company with reports of holdings of custodied securities at times and containing information reasonably requested by the insurance company. The custodian's trust committee's annual reports of its review of the insurer's trust accounts shall also be provided to the insurer. Reports and verifications may be transmitted in electronic or paper form.

**Drafting Note:** The annual reports referred to in this subsection may be referred to also as single audits, directors' examinations, internal reports or audits or other similar terms. This is intended to refer to an audit of an insurer's assets only and not to the custodian's assets. (The drafters suggest that a reference to 12 C.F.R. 9.8 and 12 C.F.R. 9.9 may be useful here also; however, such a reference is not intended to limit the scope of this subsection to reports required only by the Comptroller of the Currency.)

- (6) During the course of the custodian's regular business hours, an officer or employee of the insurance company, an independent accountant selected by the insurance company and a representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, the custodian's records relating to custodied securities, but only upon furnishing the custodian with written instructions to that effect from an appropriate officer of the insurance company.
- (7) The custodian and its agents shall be required to send to the insurance company:
  - (a) All reports which they receive from a clearing corporation on their respective systems of internal accounting control, and
  - (b) Reports prepared by outside auditors on the custodians or its agent's internal accounting control of custodied securities that the insurance company may reasonably request.

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- (8) The custodian shall maintain records sufficient to determine and verify information relating to custodied securities that may be reported in the insurance company's annual statement and supporting schedules and information required in an audit of the financial statements of the insurance company.
- (9) The custodian shall provide, upon written request from an appropriate officer of the insurance company, the appropriate affidavits, substantially in the form attached to this regulation, with respect to custodied securities.
- (10) A national bank, state bank, federal home loan bank or trust company shall secure and maintain insurance protection in an adequate amount covering the bank's or trust company's duties and activities as custodian for the insurer's assets, and shall state in the custody agreement that protection is in compliance with the requirements of the custodian's banking regulator. A broker/dealer shall secure and maintain insurance protection for each insurance company's custodied securities in excess of that provided by the Securities Investor Protection Corporation in an amount equal to or greater than the market value of each respective insurance company's custodied securities. The commissioner may determine whether the type of insurance is appropriate and the amount of coverage is adequate.

**Drafting Note:** The following subsections provide alternate standards of custodial liability. The standard in the first alternative is equivalent to that of a bailee for hire under New York law. The second alternative is more strict.

- (11) The custodian shall be obligated to indemnify the insurance company for any loss of custodied securities, except that the custodian shall not be so obligated to the extent that the loss was caused by other than the negligence or dishonesty of the custodian.
- (12) The custodian shall be obligated to indemnify the insurance company for any loss of custodied securities occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft or mysterious disappearance, including loss by damage or destruction.]
- (13) In the event that there is a loss of custodied securities for which the custodian shall be obligated to indemnify the insurance company as provided in Paragraph (11) above, the custodian shall promptly replace the securities or the value thereof and the value of any loss of rights or privileges resulting from the loss of securities.
- (14) The agreement may provide that the custodian will not be liable for a failure to take an action required under the agreement in the event and to the extent that the taking of the action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosion, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control.
- (15) In the event that the custodian gains entry in a clearing corporation through an agent, there shall be an agreement between the custodian and the agent under which the agent shall be subject to the same liability for loss of

custodied securities as the custodian. However, if the agent shall be subject to regulation under the laws of a jurisdiction that is different from the jurisdiction the laws of which regulate the custodian, the Commissioner of Insurance of the state of domicile of the insurance company may accept a standard of liability applicable to the agent that is different from the standard of liability applicable to the custodian.

- (16) The custodian shall provide written notification to the insurer's domiciliary commissioner if the custodial agreement with the insurer has been terminated or if 100% of the account assets in any one custody account have been withdrawn. This notification shall be remitted to the insurance commissioner within three (3) business days of the receipt by the custodian of the insurer's written notice of termination or within three (3) business days of the withdrawal of 100% of the account assets.

### **Section 3. Deposit with Affiliates; Requirements**

- A. Nothing in this regulation shall prevent an insurance company from depositing securities with another insurance company with which the depositing insurance company is affiliated, provided that the securities are deposited pursuant to a written agreement authorized by the board of directors of the depositing insurance company or an authorized committee thereof and that the receiving insurance company is organized under the laws of one of the states of the United States of America or of the District of Columbia. If the respective states of domicile of the depositing and receiving insurance companies are not the same, the depositing insurance company shall have given notice of the deposit to the insurance commissioner in the state of its domicile and the insurance commissioner shall not have objected to it within thirty (30) days of the receipt of the notice.
- B. The terms of the agreement shall comply with the following:
  - (1) The insurance company receiving the deposit shall maintain records adequate to identify and verify the securities belonging to the depositing insurance company.
  - (2) The receiving insurance company shall allow representatives of an appropriate regulatory body to examine records relating to securities held subject to the agreement.
  - (3) The depositing insurance company may authorize the receiving insurance company:
    - (a) To hold the securities of the depositing insurance company in bulk, in certificates issued in the name of the receiving insurance company or its nominee, and to commingle them with securities owned by other affiliates of the receiving insurance company, and
    - (b) To provide for the securities to be held by a custodian, including the custodian of securities of the receiving insurance company or in a clearing corporation.

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

*1981 Proc. II 27, 35, 309, 393, 395, 403-405 (adopted).*

*1995 Proc. 1<sup>st</sup> Quarter 7, 10, 223, 347, 361-365 (amended and reprinted).*

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*2004 Proc. 1<sup>st</sup> Quarter 926-927, 1049, 1051-1057 (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 3-365 to 3-377 (guideline amendments adopted).*



**FORM A**

**CUSTODIAN AFFIDAVIT**

[For use by a custodian where securities entrusted to its care have not been redeposited elsewhere.]

STATE OF \_\_\_\_\_ )  
 ) ss.  
COUNTY OF \_\_\_\_\_ )

\_\_\_\_\_, being duly sworn deposes and says that he or she is \_\_\_\_\_ of \_\_\_\_\_, a corporation organized under and pursuant to the laws of the \_\_\_\_\_ with the principal place of business at \_\_\_\_\_ (hereinafter called the “corporation”):

That his or her duties involve supervision of activities as custodian and records relating thereto;

That the corporation is custodian for certain securities of \_\_\_\_\_ having a place of business at \_\_\_\_\_ (hereinafter called the “insurance company”) pursuant to an agreement between the corporation and the insurance company;

That the schedule attached hereto is a true and complete statement of securities (other than those caused to be deposited with The Depository Trust Company or like entity or a Federal Reserve Bank under the TRADES or Treasury Direct systems) which were in the custody of the corporation for the account of the insurance company as of the close of business on \_\_\_\_\_; that, unless otherwise indicated on the schedule, the next maturing and all subsequent coupons were then either attached to coupon bonds or in the process of collection; and that, unless otherwise shown on the schedule, all such securities were in bearer form or in registered form in the name of the insurance company or its nominee or of the corporation or its nominee, or were in the process of being registered in such form;

That the corporation as custodian has the responsibility for the safekeeping of such securities as that responsibility is specifically set forth in the agreement between the corporation as custodian and the insurance company; and

That, to the best of his or her knowledge and belief, unless otherwise shown on the schedule, the securities were the property of the insurance company and were free of all liens, claims or encumbrances whatsoever.

Subscribed and sworn to  
before me this \_\_\_\_ day  
of \_\_\_\_\_, 20\_\_\_\_

\_\_\_\_\_  
(L.S.)  
Vice President [or other authorized officer]



**FORM C**

**CUSTODIAN AFFIDAVIT**

(For use where ownership is evidenced by book entry at a Federal Reserve Bank.)

STATE OF \_\_\_\_\_ )  
 ) ss.  
COUNTY OF \_\_\_\_\_ )

\_\_\_\_\_, being duly sworn deposes and says that he or she is \_\_\_\_\_ of \_\_\_\_\_, a corporation organized under and pursuant to the laws of the \_\_\_\_\_ with the principal place of business at \_\_\_\_\_ (hereinafter called the “corporation”):

That his or her duties involve supervision of activities of the corporation as custodian and records relating thereto;

That the corporation is custodian for certain securities of \_\_\_\_\_ with a place of business at \_\_\_\_\_ (hereinafter called the “insurance company”) pursuant to an agreement between the corporation and the insurance company;

That it has caused certain securities to be credited to its book entry account with the Federal Reserve Bank of \_\_\_\_\_ under the TRADES or Treasury Direct systems; and that the schedule attached hereto is a true and complete statement of the securities of the insurance company of which the corporation was custodian as of the close of business on \_\_\_\_\_, which were in a “general” book entry account maintained in the name of the corporation on the books and records of the Federal Reserve Bank of \_\_\_\_\_ at such date;

That the corporation has the responsibility for the safekeeping of such securities both in the possession of the corporation or in the “general” book entry account as is specifically set forth in the agreement between the corporation as custodian and the insurance company; and

That, to the best of his or her knowledge and belief, unless otherwise shown on the schedule, the securities were the property of the insurance company and were free of all liens, claims or encumbrances whatsoever.

Subscribed and sworn to  
before me this \_\_\_\_ day  
of \_\_\_\_\_, 20\_\_\_\_

\_\_\_\_\_  
Vice President [or other authorized officer]

Model Regulation on Custodial Agreements  
and the Use of Clearing Corporations

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**MODEL REGULATION ON CUSTODIAL AGREEMENTS  
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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.**

**MODEL REGULATION ON CUSTODIAL AGREEMENTS  
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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. ADMIN. CODE r. 482-1-077 (1996/2003).	
Alaska	NO CURRENT ACTIVITY	
American Samoa	NO CURRENT ACTIVITY	
Arizona	NO CURRENT ACTIVITY	
Arkansas	ARK. CODE R. 26 (Revised) (1987/2002).	
California		CAL. CODE REGS. tit. 10, § 2509.14 (1983) (Workers' Comp. deposits).
Colorado	NO CURRENT ACTIVITY	
Connecticut		BULLETIN FS-2 (2002) (Includes some of model).
Delaware	NO CURRENT ACTIVITY	
District of Columbia	NO CURRENT ACTIVITY	
Florida	FLA. ADMIN. CODE ANN. r. 69O-143.041 to 69O.143.042 (1986).	

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<b>NAIC MEMBER</b>	<b>MODEL ADOPTION</b>	<b>RELATED STATE ACTIVITY</b>
Georgia	GA. COMP. R. & REGS. 120-2-69 (1996).	GA. COMP. R. & REGS. 120-2-35 (1996) (Department deposits).
Guam	NO CURRENT ACTIVITY	
Hawaii	NO CURRENT ACTIVITY	
Idaho	NO CURRENT ACTIVITY	
Illinois	NO CURRENT ACTIVITY	
Indiana	NO CURRENT ACTIVITY	
Iowa	NO CURRENT ACTIVITY	
Kansas		KAN. ADMIN. REGS. § 40-1-47 (2002) (Department deposits).
Kentucky	806 KY. ADMIN. REGS. 7:090 (1982).	
Louisiana	LA. ADMIN. CODE tit. 37, §§ XIII.10501 to XIII.10511 (2005).	LA. REV. STAT. ANN. § 22:39 (1979/2004) (Includes authority to adopt regulations).
Maine	NO CURRENT ACTIVITY	
Maryland		MD. CODE REGS. §§ 31.04.09.01 to 31.04.09.04 (1968/2004).
Massachusetts	NO CURRENT ACTIVITY	
Michigan	NO CURRENT ACTIVITY	
Minnesota	NO CURRENT ACTIVITY	
Mississippi	NO CURRENT ACTIVITY	
Missouri		MO. CODE REGS. ANN. tit. 20, § 200-7.200 (1980/1990) (Uses affidavit forms from model).
Montana	NO CURRENT ACTIVITY	



**MODEL REGULATION ON CUSTODIAL AGREEMENTS  
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<b>NAIC MEMBER</b>	<b>MODEL ADOPTION</b>	<b>RELATED STATE ACTIVITY</b>
Nebraska		NEB. REV. STAT. § 44-5109 (1991/2005) (Includes definitions from model regulation); § 44-5154 (1991/2005) (Includes authority to adopt regulation); 210 NEV. ADMIN. CODE §§ 81-001 to 81-004 (2005).
Nevada	NO CURRENT ACTIVITY	
New Hampshire	NO CURRENT ACTIVITY	
New Jersey		N.J. CODE R. INS. §§ 11:2-32.1 to 11:2-32.5 (1991/2001) (Department deposits).
New Mexico	NO CURRENT ACTIVITY	
New York		N.Y. Circular Letter No. 1975-1 (1975); 1976-13 (1976); 1977-2 (1977) (Includes affidavits).
North Carolina		11 N.C. ADMIN. CODE §§ 11B.0124 to 11B.0151
North Dakota	N.D. ADMIN. CODE §§ 45-03-23-01 to 45-03-23-03 (1987/2012).	
Notthern Marianas	NO CURRENT ACTIVITY	
Ohio	NO CURRENT ACTIVITY	
Oklahoma	OKLA. STAT. tit. 36, § 1628 (1983).	
Oregon		OR. ADMIN. R. § 836-027-0200 (1998/2006).
Pennsylvania		148 PA. CODE §§ 1 to 4 (1981) (Uses affidavit forms from model).
Puerto Rico	NO CURRENT ACTIVITY	

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<b>NAIC MEMBER</b>	<b>MODEL ADOPTION</b>	<b>RELATED STATE ACTIVITY</b>
Rhode Island	NO CURRENT ACTIVITY	
South Carolina	NO CURRENT ACTIVITY	
South Dakota	NO CURRENT ACTIVITY	
Tennessee	TENN. COMP. R. & REGS. 0780-01-46 (1980/2013).	
Texas		TEX. ADMIN. CODE § 7.86 (1996/2002).
Utah	UTAH ADMIN. CODE r. 590-178 (1996/2006).	BULLETIN 2008-6 (2008).
Vermont	NO CURRENT ACTIVITY	
Virgin Islands	NO CURRENT ACTIVITY	
Virginia	NO CURRENT ACTIVITY	
Washington	NO CURRENT ACTIVITY	
West Virginia	W. VA. CODE §§ 33-8A-1 to 33-8A-8 (2002) (Combines model act and regulation).	
Wisconsin	NO CURRENT ACTIVITY	
Wyoming	57 WYO. CODE R. §§ 1 to 8 (2006).	

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

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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 Regulation on the Use of Clearing Corporations and Federal Reserve Book-Entry System By Insurance Companies to the Model Regulation on Custodial Agreements and the Use of Clearing Corporations. **2004 Proc. 1<sup>st</sup> Quarter 1065.**

### Section 1. Definitions

B. 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 referenced in federal law. **2004 Proc. 1<sup>st</sup> Quarter 1070.**

C. A working group was appointed in the summer of 1993 to determine whether brokers should be allowed to serve as custodians for insures' investments. **1993 Proc. 2<sup>nd</sup> Quarter 597.**

A number of interested parties submitted position papers on the issue of whether broker/dealers should be permissible custodians. The working group wanted to determine the safeguards in place for both banks and broker/dealer firms acting as custodians for insurer assets. One of the issues raised was the legal status of insurers' claims to assets held by custodians in the event of the bankruptcy and liquidation of the custodian. A broker suggested that an insurer and its policyholders were afforded greater protection and safety when the insurer maintained its securities and funds with a broker/dealers instead of a bank or trust company. Another interested party suggested that allowing broker/dealers into the custodial arena might increase competition among custodians, resulting in product innovation and lower costs. A trust company provided an outline of the benefits provided by using a bank or trust company as custodian. **1993 Proc. 3<sup>rd</sup> Quarter 308-325.**

The position papers did not alleviate concerns of the working group as to the distribution of assets in the event of a bankruptcy of a broker/dealer firm, so research was requested on this topic. A review of the Securities Investor Protection Act did not answer all the members' questions. A broker/dealer suggested that the model include specific criteria that must be satisfied before any securities intermediary, whether bank or broker/dealer, could act as a custodian for an insurance company's assets. **1993 Proc. 4<sup>th</sup> Quarter 492-494.**

One member of the working group contracted several banks to gather information on the costs of custodial services. Her research indicated that bank fees were around \$10,000 higher than those of broker/dealer firms due to the requirement for banks to collateralize cash deposits. She indicated the cost differential would not be significant to most insurers. **1994 Proc. 2<sup>nd</sup> Quarter 382.**

NAIC staff compiled and summarized research into the issue of broker/dealers acting as custodians for insurance company assets. The memorandum provided a comprehensive examination of the legal issues concerning the distinctions between banks as custodians and broker/dealers as custodians. After a review of the issues, the working group voted not to recommend a change to the policy to allow broker/dealers to be custodians. **1994 Proc. 3<sup>rd</sup> Quarter 306-310.**

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#### Section 1C (cont.)

After making a decision not to allow broker/dealers to be custodians, the working group decided to make some changes to the model definition of custodian. The original model required the bank or trust company to have \$500,000 aggregate capital. That was deleted, and a reference inserted to require that custodian banks be adequately capitalized under U.S. banking regulations. **1995 Proc. 1<sup>st</sup> Quarter 361-362.**

In 2002 the committee in charge of financial issues received a white paper from an industry group with a proposal to allow broker/dealers to serve as asset custodians for insurers. **2002 Proc. 2<sup>nd</sup> Quarter 467, 567-571.**

The industry group suggested appointing a working group to consider this issue. One regulator said her state had certain conditions under which qualified broker/dealers could serve as asset custodians and offered her assistance on any group that might be formed. Another regulator expressed strong support for existing arrangements and raised the concern that the industry proposal could lower the standard of solvency regulation. Another regulator asked about the frequency at which broker/dealers are examined by their regulator. An industry representative responded that it depended on the regulator. **2002 Proc. 2<sup>nd</sup> Quarter 467.**

A regulator pointed out that the basis for disallowing broker/dealers to act as custodians of company assets in 1994, when the issue was last reviewed, may be disputed and agreed the proposal warranted further analysis. **2002 Proc. 2<sup>nd</sup> Quarter 467.**

A former commissioner explained that he chaired the working group that considered this issue in 1994. At that time the working group made a decision not to allow broker/dealers to act as custodians based on the structural differences in how broker/dealers and banks/trust departments hold securities and the related costs of their services. An interested party responded that both types of entities hold them in “street name,” and that his association was not suggesting any different treatment. **2002 Proc. 2<sup>nd</sup> Quarter 467.**

A trade association suggested that it was time to reconsider the 1994 decision because of the passage of the Gramm-Leach-Bliley Act (GLBA). The paper submitted by the association argued that the restriction in the model imposed a costly restriction on insurance companies that was reflective of economic and financial services industry conditions that have long since passed. With the passage of GLBA, the playing field for banks, insurance companies and securities houses was leveled, allowing each to offer customers a further range of financial services. The paper argued that broker/dealers were well capitalized and highly regulated entities, as financially stable as banks and trust companies. The likelihood of a major broker/dealer becoming insolvent was remote. **2002 Proc. 2<sup>nd</sup> Quarter 567.**

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#### Section 1C (cont.)

The comment from interested parties outlined protections to prevent broker/dealer liquidation and how consumer assets would be protected in the event of a broker/dealer liquidation. The Securities Investor Protection Act (SIPA) was enacted to provide protection for securities industry customers. SIPA clarified that the customer-owned securities were not to be considered part of the broker/dealer's estate in the case of a liquidation and, in contrast to a bankruptcy proceeding, emphasized the return of securities to customers rather than a conversion to and distribution of cash. **2002 Proc. 2<sup>nd</sup> Quarter 569.**

NAIC staff were asked to review the issue for the new working group appointed. Their research noted that a primary concern raised in 1994 was the difference between "customer name property" and "customer property." The requirements to meet the "customer name property" definition were very stringent. The industry paper stated that the vast majority of securities were held in "street name," which seemed to be the same as "customer property." **2002 Proc. 2<sup>nd</sup> Quarter 573.**

When the newly appointed working group met for the first time, the chair identified four main issues that would need to be addressed before the working group could make a determination: (1) find out if significant delays would occur in getting insurance company assets returned in the case of a liquidation; (2) determine the level of broker/dealer regulation in comparison to banks and trust companies; (3) evaluate any potential conflict of interest; and (4) assess whether insurers desire an additional allowable asset custodian. **2002 Proc. 3<sup>rd</sup> Quarter 485.**

Regulators added two more issues to this list: (1) would there be a conflict if the broker/dealer was in the same holding company structure as the insurer; and (2) should the group set specific qualifications that a broker/dealer would have to meet. **2002 Proc. 3<sup>rd</sup> Quarter 485.**

The industry association advocating the expansion of the model responded in writing to all of the issues raised by the working group and NAIC staff. The association said that the issue of "customer name property" and "customer property" was irrelevant because virtually all banks and securities firms hold assets in street name. This does not make them the property of the broker. **2002 Proc. 3<sup>rd</sup> Quarter 485.**

The industry association was asked to explain how the regulatory landscape was different now than in 1994. The group responded that the laws were not different, but there had been a significant increase in the registration of securities in street name and the use of centralized depositories by both banks and broker/dealers. **2002 Proc. 3<sup>rd</sup> Quarter 486.**

In response to questions from regulators, the trade association noted that more than 99 percent of investors involved in the liquidations of brokers/dealers get their money back. **2002 Proc. 3<sup>rd</sup> Quarter 486.**

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**Section 1C (cont.)**

The response noted that neither a bank or a securities firm has a fiduciary duty when providing custodial services. As custodians, both banks and broker/dealers are subject to the same duties concerning the safeguarding of securities. **2002 Proc. 3<sup>rd</sup> Quarter 486-487**. A question was raised about what happened to securities held by broker/dealers in situations in which the broker/dealers became insolvent. A securities industry representative said the Securities Investor Protection Corporation transferred the accounts to a solvent broker/dealer. The securities were not part of the estate of the insolvent broker/dealers and were not included on its balance sheet. The same would be true for a bank; the trustee would move securities in bulk to a solvent bank. **2002 Proc. 4<sup>th</sup> Quarter 876**.

When asked about examination of broker/dealers, an association responded that the large firms were the focus of most of the attention, and they were reviewed annually. The association suggested that the NAIC limit the standard to require broker/dealers seeking to custody insurance company securities to have a net worth of at least \$100 million. Such a requirement would limit the number of broker/dealers eligible to serve as custodians to the top 20 to 30 firms. As a consequence, only those firms subject to a comprehensive annual examination would be eligible to serve as custodians. **2002 Proc. 4<sup>th</sup> Quarter 874**.

As the working group neared a decision on whether to allow broker/dealers to serve as custodians, it received a number of comments from interested parties. One was from a bank, stating reasons why banks make better custodians and two were from broker/dealer representatives refuting the arguments in the bank's letter. **2003 Proc. 1<sup>st</sup> Quarter 377-386**.

A bank representative stated that banks normally had higher capitalization requirements and more secure holding company support than most broker/dealers. In case of an insolvency, the Federal Deposit Insurance Corporation (FDIC) had a good record of quickly obtaining the assets of the insolvent bank, which was not always the case with broker/dealer insolvencies. **2003 Proc. 1<sup>st</sup> Quarter 376**.

A representative of a securities trade association responded that the Securities Investor Protection Corporation (SIPC) much like the FDIC, is able to transfer assets seamlessly in the case of an insolvency. He noted that large broker/dealers are closely regulated and scrutinized and suggested that any change to the NAIC models be limited to the more highly capitalized broker/dealers. **2003 Proc. 1<sup>st</sup> Quarter 376**.

The working group prepared a paper for its parent committee summarizing the comments received and the issues raised as to allowing broker/dealer to serve as custodians of insurers' securities. **2003 Proc. 2<sup>nd</sup> Quarter 506-508**.

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

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#### Section 1C (cont.)

When the parent committee considered the issue, the chair of the working group stated that, based on various facts presented in the issues paper, the conclusions reached in the past regarding broker/dealers as custodians were no longer valid. In today's environment, broker/dealers were regulated, held securities in the same manner as banks, and had an excellent track record of returning assets in the case of broker/dealer insolvency. The parent committee voted to adopt the working group recommendation by a six to four vote. This recommendation would require the models relating to custodians and the *Financial Condition Examiners Handbook* to be revised. **2003 Proc. 3<sup>rd</sup> Quarter 531.**

A Paragraph (2) was added in 2004 in response to the decision to allow broker/dealers to serve as custodians of insurers' securities. **2004 Proc. 1<sup>st</sup> Quarter 1052.**

D. Paragraph D was added as part of the 2004 amendments. **2004 Proc. 1<sup>st</sup> Quarter 1052.**

E. A regulator suggested adding a definition of tangible net worth when the model was being revised to add broker/dealers as custodians. **2004 Proc. 1<sup>st</sup> Quarter 1067.**

The working group debated the issue of whether to define "net worth" or "tangible net worth." One regulator expressed concern that utilizing net worth as a minimum requirement for broker/dealers would allow intangible assets to be included in the calculation of the minimum required amount. **2004 Proc. 1<sup>st</sup> Quarter 1065.**

At a subsequent meeting of the drafting group, the decision was made to utilize the phrase "tangible net worth." **2004 Proc. 1<sup>st</sup> Quarter 1049.**

G. Subsections G and H were added as part of the 2004 amendments. **2004 Proc. 1<sup>st</sup> Quarter 1052-1053.**

#### Section 2. Custody Arrangements; Requirements

After review of the custody arrangements already in place, the task force concluded that the procedures were already in place and likely to be continued and expanded. In addition, other new approaches to the handling of recording of securities were likely to emerge. If done correctly, there are some advantages to the system. The securities need not be safeguarded from loss or theft. Such systems reduce costs and problems related to the storage of custody accounts, recording by certificate number, and counting and insuring of securities. Also the securities have no coupons to cut and need not be withdrawn from custody and physically presented for payment at maturity. **1976 Proc. I 273.**

The problems of concern to the regulators were: (1) the ability of the examiners in each department to conduct the necessary inspections and verifications of securities held in book entry, (2) the ability of a state regulatory official to assert jurisdiction over securities held in book entry, and (3) establishment of clear title to securities held in book entry form. **1976 Proc. II 343.**

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

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#### Section 2 (cont.)

The Securities Industry Association wrote a letter to a congressmen encouraging federal regulation of insurance company use of book entry accounting systems, but the Securities Exchange Commission took the position that there was currently no need for federal legislation in view of NAIC activity. The SEC did, however, emphasize the importance of integrating all institutional investors, including insurance companies, into the developing national clearing and settlement system. **1979 Proc. II 244-245.**

A draft of proposed revisions to the *Examiner's Handbook* contained many of the requirements which ultimately were included in the model regulation. **1979 Proc. I 296-298.**

When considering model amendments in 2003, one regulator asked whether further restrictions should be included within the regulation limiting the ability of a foreign custodian to hold securities in excess of the deposit requirements existing under the foreign country. The group decided to consider this issue later. **2003 Proc. 4<sup>th</sup> Quarter 1264.**

An advisory committee report stated the opinion that the general rule regarding accessibility of the insurer's assets was as follows: A custodial bank (whether or not deposited securities are redeposited with a depository) is a "bailee for hire." As such, the property it is holding continues to be owned by the depositing company is entitled to receive back all its own securities held by the bank as custodian, including the right to reclaim securities redeposited with a depository, free of any claim of creditors of the bank. This is in contrast to cash an insurer may have deposited with the bank. The relationship between the bank and the insurer as to cash is that of debtor and creditor. Upon insolvency of the bank, the insurance company has a claim merely as a general creditor. **1979 Proc. II 236.**

Members of the group considering amendments to the model in 1994 asked about differences between a custodian acting in the capacity of an agent of the insurer as opposed to a trustee of the assets of the insurer. One issue was the extent to which an insurer could gain access to assets held by a custodian as agent or as trustee in the event of an insolvency of the custodian. **1994 Proc. 1<sup>st</sup> Quarter 274.**

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

B. The last two sentences of Paragraph (5) and the drafting note below the paragraph were added in 1995 when amendments were adopted. **1995 Proc. 1<sup>st</sup> Quarter 362.**

Paragraph (10) was added when the model was amended in 1995. **1995 Proc. 1<sup>st</sup> Quarter 363.**



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**Section 2B** (cont.)

When reviewing comments to the model's 2004 revisions, one regulator expressed concern that the proposed revisions did not require broker/dealers to provide insurance coverage in excess of that provided by the Securities Investor Protection Corporation (SIPC). The chair noted that the model did require custodians to maintain insurance coverage in an amount deemed reasonable by the commissioner. The working group decided to include language in the model requiring broker/dealers acting as custodians for insurance company assets to hold insurance coverage in excess to that provided by the SIPC in an amount equal to or greater than the largest single insurance customer deposit. **2004 Proc. 1<sup>st</sup> Quarter 1066-1067.**

When the revisions to Paragraph (10) were adopted in early 2004, the working group decided to move the sentence about the commissioner's ability to determine the type of insurance that was appropriate to the end of the paragraph. This would make it clear that the provision applied to both banks and broker/dealers. **2004 Proc. 1<sup>st</sup> Quarter 1065.**

Discussion of a new Paragraph (15) began in late 2000. The draft required the custodian to provide independent notification to a state insurance department when a custodial agreement was terminated or when an insurer withdrew 25 percent of the total portfolio within any consecutive 30-day period. **2000 Proc. 4<sup>th</sup> Quarter 621.**

The charge to the working group was to revise the model regulation to include an independent monitoring provision for the termination of the arrangement or significant asset withdrawal from a custodian. **2001 Proc. 1<sup>st</sup> Quarter 553.**

The first draft required the custodian to verify the extent of withdrawal in any 30-day period. An interested party commented that complying with the rolling 30-day period would not be practical. Additional compensation from the insurer would be necessary in order to comply with this time-consuming requirement. **2001 Proc. 1<sup>st</sup> Quarter 555.**

Another interested party pointed out that the proposed regulation required daily valuation of securities. Custodians may not have access to pricing data for non-public assets, nor do custodians price portfolios daily. **2001 Proc. 1<sup>st</sup> Quarter 555.**

The working group received another comment that suggested the proposed regulation would not improve the likelihood of preventing fraudulent transfers. The proposed regulation attempted to improve a duty of oversight and reporting on the custodial bank while actual compliance and enforcement of the monitoring and reporting requirement effectively remained with the insurer. The after-the-fact notice to the state insurance department would not prevent or protect removed assets. **2001 Proc. 1<sup>st</sup> Quarter 556.**

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

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#### Section 2B (cont.)

In response to the comments, the working group revised the draft to delete the rolling 30-day period and to remove reference to the 25% of total assets. The chair said the intent of the revision was to require notification upon the withdrawal of securities from a custodian. **2001 Proc. 2<sup>nd</sup> Quarter 594.**

#### Section 3. Deposit With Affiliates; Requirements

The working group drafting amendments in 1995 discussed deleting Section 3, but it was the consensus of the group not to delete Section 3 because the draft model investment law contains a provision allowing pooling of investments by affiliated companies under certain circumstances. **1995 Proc. 1<sup>st</sup> Quarter 361.**

#### Forms A, B, C

The drafters saw their problem not so much as the drafting of a model law on book-entry procedures, but the determination of satisfactory means to obtain verification of the ownership of securities. One state had prepared affidavits which must be presented or the department would not recognize the securities as admitted assets. That department had determined that the affidavits must prescribe a clear obligation on behalf of the custodian to the insurance company if its securities are lost. The department adopted three affidavits, one to be used where securities are deposited directly with a clearing house or bank that does not redeposit securities, a second one where for a custodian bank that has redeposited the securities, and a third for instances where ownership is evidenced on the books and records of the Federal Reserve Banks. **1976 Proc. I 273.**

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

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### Chronological Summary of Actions

*June 1981: Model adopted.*

*June 1995: Amendment to Section 1 to require bank acting as a custodian to be adequately capitalized. Amendment to Section 2 to require reports to insurer, and insurance protection for custodian.*

*October 2001: Added Section 2B(15).*

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