09-54

Notice of Rulemaking Hearing
Department of Commerce and Insurance
Insurance Division

There will be a hearing before the Insurance Division of the Department of Commerce and Insurance ("Division") to consider the promulgation of amendments of rules in Chapter 0780-1-46. The hearing will be conducted in the manner prescribed by the Uniform Administrative Procedures Act, Tenn. Code Ann. § 4-5-204, and will take place in Conference Room A, on the Fifth Floor of the Davy Crockett Tower, 500 James Robertson Parkway, Nashville, Tennessee 37243 at 10:00 a.m. CST on the 18th day of November, 2002.

Any individuals with disabilities who wish to participate in these proceedings should contact the Division to discuss any auxiliary aids of services needed to facilitate such participation. Such initial contact may be made no less than ten (10) days prior to the scheduled meeting date to allow time for the Division to determine how it may reasonably provide such aid or service. Initial contact may be made with the Division's ADA Coordinator at Davy Crockett Tower, 500 James Robertson Parkway, Nashville, Tennessee 37243 at (615) 741-2176.

For a copy of this notice of rulemaking hearing, please contact John F. Morris, Staff Attorney, at (615) 741-2199.

Chapter 0780-1-46

Relating to Securities Held Under Custodial Agreements and
Participation by Insurance Companies in
Depository Trust Companies and Federal
Reserve Book Entry Systems

Amendments

Chapter 0780-1-46 Relating to Securities Held Under Custodial Agreements and Participation by Insurance Companies in Depository Trust Companies and Federal Reserve Book Entry Systems is amended by deleting the chapter in its entirety and substituting the following language so that, as amended, the chapter shall read:

Chapter 0780-1-46

Permissible Methods of Holding Securities and
Securities to Be Deposited with the Department of Commerce and Insurance

Table of Contents

0780-1-46-.01 Purpose
0780-1-46-.02 Definitions
0780-1-46-.03 Permissible Methods of Holding Securities
0780-1-46-.04 Securities Held on Deposit with the Commissioner
Appendix A Custodial Agreement
Appendix B Custodian Affidavit A
Appendix C Custodian Affidavit B
Appendix D Custodian Affidavit C

0780-1-46-.01 Purpose.

(1) The purpose of this Chapter is to expedite the verification of insurance company assets during examinations conducted by the Department; to reduce costs and simplify delivery and receipt procedures involved in security transactions by insurance companies; to reduce the exposure

of securities to loss, theft, misplacement, damage, and other destruction; and to better provide for the storage, inspection, transportation, counting, and insuring of securities.

(2) Further purposes are to establish procedures for the verification of securities which insurance companies deposit in banks under custodial agreements; to permit insurance companies to hold securities in other than definitive certificates; to better safeguard the actual securities; to facilitate checking assets of an insurance company; and to recognize that definitive securities no longer represent the only tangible evidence of security obligations held by an insurance company.

Authority: Tenn. Code Ann. § 56-3-112.

0780-1-46-.02 Definitions.

(1) The following words and terms, when used in this Chapter, shall have, unless the context clearly indicates otherwise, the following meanings:

(a) "Definitive Security" includes but is not limited to bonds, notes, debentures, stock certificates and other like securities.

(b) "Department" means the Tennessee Department of Commerce and Insurance.

(c) "Commissioner" means the Commissioner of the Tennessee Department of Commerce and Insurance.

(d) "Clearing Corporation" means a depository corporation which maintains a book entry accounting system which meets the requirements of the definition of the terms in Tenn. Code Ann. § 47-8-101(3), including the Depository Trust Company or any other like entity which meets similar standards of depository safeguards and regulatory control.

Authority: Tenn. Code Ann. § 56-3-112.

0780-1-46-.03 Permissible Methods of Holding Securities.

(1) An insurance company may hold its securities in the following authorized manners:

(a) An insurance company may hold its securities in definitive certificates.

(b) An insurance company may hold its securities pursuant to its participation in the book entry system of the Federal Reserve through a member bank of the Federal Reserve System which, as a custodian, can transact and maintain book entry securities for the insurance company.

(i) This subparagraph shall not be interpreted so as to preclude an insurance company from participation in the Federal Reserve book entry system under a custodial agreement with a state-chartered bank which has redeposited securities with a member bank for participation in the Federal Reserve book entry program.

(c) An insurance company may hold its securities pursuant to its participation in depository systems of clearing corporations through a custodian bank.

(2) All insurance companies choosing to hold its securities in the manner described in subparagraphs (1)(b) or (1)(c) of this Rule shall execute a proper custodial agreement and appropriate custodian affidavits for its securities held under custodial agreements.

(a) The custodial agreement required by this Rule shall contain the following:

(i) A provision stating that the standard of responsibility on the part of the custodian shall not be less than that of the responsibility of a bailee for hire or a fiduciary under statutory or case law of Tennessee;

(ii) A provision stating that the securities held by the custodian are subject to instructions of the insurance company;

(iii) A provision stating that the securities may be withdrawn immediately upon demand of the insurance company; and

(iv) A provision stating that the agreement is between the custodian and the insurance company, and not the parent or affiliate of the insurance company.

(b) Such executed affidavits as well as the underlying agreement between the insurance company and the custodian shall be available to the Commissioner upon request pursuant to examinations conducted under Tenn. Code Ann. §§ 56-1-408 through 56-1-413.

(c) Examples of an acceptable custodial agreement as well as acceptable custodial affidavits are included in this Rule as appendices hereto.

(3) Each insurance company which enters into a custodial agreement must determine that the custodian maintains sufficient records to verify information which the insurance company reports on the Schedule D of the insurance company's Annual Statement blank(s).

(4) Failure to execute a proper custodial agreement or custodian affidavit may result in the Commissioner's non-admission of the insurance company's assets which are not held in a manner authorized by this Rule.

Authority: Tenn. Code Ann. § 56-3-112.

0780-1-46-.04 Securities Held on Deposit with the Commissioner.

(1) Securities to be placed on deposit with the Commissioner, pursuant to the provisions of Tenn. Code Ann. §§ 56-2-104, 56-21-102, 56-35-116 and 56-13-117 must be maintained under a separate depository agreement between the depository institution (commercial bank or clearing corporation), the insurance company and the Commissioner.

(a) This depository agreement required by this Rule must contain the following:

(i) Provisions to require the depository institution to provide verification of securities on deposit to the Commissioner;

(ii) Provisions that allow the Commissioner to require such verification from the custodian at any time the Commissioner deems that verification is appropriate. Examples of appropriate verification documents are Appendices B, C and D.

(iii) Provisions that require an authorized signature of the insurance company and the Commissioner, and/or his deputy, to concurrently appear on any withdrawal notices to the depository institution.

Authority: Tenn. Code Ann. § 56-2-117.

APPENDIX A

CUSTODIAL AGREEMENT

(For use by an insurance company which deposits its securities with a custodial depository institution.)

1. The Principal is the owner of certain securities, held on book-entry with <BANK>, in the name of <BANK> and evidenced by trade orders from the <INSURANCE COMPANY> to <BANK>, delivered for the settlement of securities trades by brokers and evidenced by trade orders from <INSURANCE COMPANY> to <BANK> or received as income from assets held by <BANK> for <INSURANCE COMPANY>, some of which are subject to a separate Depository Agreement among <INSURANCE COMPANY> and the Commissioner of the Commerce and Insurance for the State of Tennessee, the terms and conditions of which take precedence over any conflicting terms and conditions in this agreement.

2. Custody of Assets

   <BANK> shall hold and manage these assets for the benefit of, and at the direction of,<INSURANCE COMPANY>.

   a. <BANK>, a member of the Federal Reserve System, may utilize the Federal Reserve book-entry program. <BANK> shall hold such securities on deposit in an account with the name <INSURANCE COMPANY>. <BANK>, on its accounting system, will designate any securities so deposited as belonging to <INSURANCE COMPANY>.

   b. <BANK> may hold any securities not eligible for book-entry at <BANK> in the following manner:

      (1) items eligible for book-entry at the Depository Trust Company ("DTC") – an account directly with DTC or in an account with another bank or trust company who has an account at DTC, and

      (2) items not eligible for book-entry at DTC – in an account with another bank, trust company, or registered open-end management investment company or in the <BANK>'s own vault in either registered or bearer form.

      Securities so deposited will at all times be kept separate and apart from other such deposits with <BANK> so that they may be identified as belonging to <INSURANCE COMPANY>. The records of any other bank, trust company or registered open-end management investment company, with which <BANK> may hold the securities (either at DTC or otherwise), shall designate the account name for which it is being held.

   c. Upon request from the Department of Commerce and Insurance, <BANK> shall provide verification of securities on deposit. Examples of appropriate verification documents are Custodian Affidavits Forms A, B, and C.

   d. The collection of principal cash shall be made by <BANK> in accordance with its usual and customary business practice and in accordance with the usual and customary business practices for the banking and securities industries.

3. Income Collection and Investment

Income from the securities in this account shall be deposited into the demand deposit account of <INSURANCE COMPANY> as directed from time to time by an authorized agent of <INSURANCE COMPANY>. The collection of income shall be made by <BANK> in accordance with its usual and customary business practice and in accordance with the usual and customary business practices for the banking and securities industries. <BANK> will collect all income from investments held by it for <INSURANCE COMPANY> except any securities that are registered in the name of <INSURANCE COMPANY>.

4. Record-keeping and Reporting

<BANK> will keep records of all income and principal entries and will review statements of assets to <INSURANCE COMPANY> at least quarterly. All records of <BANK> concerning this account with <INSURANCE COMPANY> shall be available for inspection, during regular banking hours, by any duly authorized representative of <INSURANCE COMPANY>. Any errors or corrections on statements or in the account will be reported to <BANK> by <INSURANCE COMPANY> within a reasonable time of the receipt of the statement, but not to exceed ninety (90) days. Otherwise, all actions of <BANK> as reported shall be deemed to have been approved by <INSURANCE COMPANY>. <BANK>, when it becomes aware of the following events, shall notify <INSURANCE COMPANY> of matured but uncollected principal and interest, of securities called for redemption, of the expiration of the conversion privileged, of subscription or conversion rights and of similar proceedings relating to the assets in the account.

5. Indemnification

a. <BANK> is obligated to indemnify <INSURANCE COMPANY> for any loss of securities of <INSURANCE COMPANY> in <BANK>'s care, whether in <BANK>'s vault or in an account of <BANK> identified as belonging to <INSURANCE COMPANY> with another bank, trust company or registered open-end management investment company, except that, unless domiciliary state law, regulation or administrative action otherwise require a stricter standard, <BANK> shall not be so obligated to the extent that such loss was caused by other than burglary, robbery, holdup, theft or mysterious disappearance, including loss by damage or destruction, or the negligence or dishonesty of <BANK>, of its agents or of any other bank, trust company or registered open-end management investment company with which <BANK> is holding securities for <INSURANCE COMPANY>.

b. If the domiciliary state law, regulation or administrative action requires a stricter standard of liability for custodians of insurance company securities than that set forth in Section 5.a., then such stricter standard shall apply.

c. In the event there is a loss of the securities for which <BANK> is obligated to indemnify <INSURANCE COMPANY>, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

d. <BANK> shall not be liable for any failure to take action required to be taken hereunder in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing wars), revolution insurrection, riot, civil commotion, act of God, laws, regulations, orders or other acts of any governmental or judicial authority, or any other cause beyond <BANK>'s reasonable control.

e. In addition to the preceding requirements of this Section 5, <BANK>'s standard of responsibility hereunder shall be that of a bailee for hire under statutory and case law of the State of Tennessee. Without limiting the generality of the foregoing, it is agreed and

understood that <BANK> is not acting as a trustee and further that <BANK> is in no way responsible or liable for any decline in value of any securities.

6. Investment Responsibility

<BANK> will have no investment responsibility or authority and will make investments only on the direction of <INSURANCE COMPANY>.

7. Fees

<BANK> may be paid an annual fee by <INSURANCE COMPANY> for the services rendered under this agreement.

8. Termination

This agreement may be terminated by either party upon thirty (30) days' written notice given to the other party. Since the transfer of assets may take more than thirty (30) days from the date of the termination notice, <BANK> shall have a reasonable time after receipt of the written notice to deliver the assets to <INSURANCE COMPANY> or the new custodian and <INSURANCE COMPANY> shall have a reasonable time after receipt of the written notice to prepare to receive the assets or appoint a new custodian to receive the assets of <INSURANCE COMPANY>'s behalf. If a new custodian is appointed to hold the assets for <INSURANCE COMPANY>, <INSURANCE COMPANY> shall give <BANK> the delivery instructions to the new custodian.

9. Governing Law

This agreement shall be construed and interpreted according to the laws of the State of Tennessee.

_____

<BANK>

_____

<INSURANCE COMPANY>

APPENDIX B

CUSTODIAN AFFIDAVIT A

(For use by a custodian bank for securities entrusted to its care which have not been redeposited elsewhere.)

STATE OF)
) SS:
COUNTY OF)

<AUTHORIZED BANK OFFICER>, being duly sworn deposes and says that he is the <POSITION> of <BANK>, a banking corporation organized under and pursuant to the laws of the <STATE> with the principal place of business at <ADDRESS> (hereinafter called the "Bank");

That my duties involve supervision of activities of the Bank as custodian and records relating thereto;

That the Bank is custodian for certain securities of <INSURANCE COMPANY>, having a place of business at <ADDRESS> (hereinafter called the "Insurance Company") pursuant to an agreement between the Bank 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 Federal Reserve book entry procedure) which were in the custody of the Bank for the account of the Insurance Company as of the close of business on <DATE>; 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 a nominee of the Bank, or were in the process of being registered in such form;

That the Bank as custodian has the responsibility for the safekeeping of such securities as that responsibility is specifically set forth in the agreement between the Bank as custodian and the Insurance Company; and

That, to the best of my knowledge and belief, unless otherwise shown on the schedule, said securities were the property of said Insurance Company and were free of all liens, claims or encumbrances whatsoever.

Subscribed and sworn to before me this _____ day of _____, _____.

_____

<AUTHORIZED BANK OFFICER>

APPENDIX C

CUSTODIAN AFFIDAVIT B

(For use in instances where a custodian bank maintains securities on deposit with The Depository Trust Company or like entity.)

STATE OF)
) SS:
COUNTY OF)

<AUTHORIZED BANK OFFICER>, being duly sworn deposes and says that he is the <POSITION> of <BANK>, a banking corporation organized under and pursuant to the laws of the <STATE> with the principal place of business at <ADDRESS> (hereinafter called the "Bank");

That my duties involve supervision of activities of the Bank as custodian and records relating thereto;

That the Bank is custodian for certain securities of <INSURANCE COMPANY> with a place of business at <ADDRESS> (hereinafter called the "Insurance Company") pursuant to an agreement between the Bank and the Insurance Company;

That the Bank has caused certain of such securities to be deposited with the Depository Trust Company, and that the schedule attached hereto is a true and complete statement of the securities of the Insurance Company of which the Bank was custodian as of the close of business on <DATE>,
and which were so deposited on such date;

That the Bank as custodian has the same responsibility for the safekeeping of such securities whether in the possession of the Bank or deposited as that responsibility is specifically set forth in the agreement between the Bank as custodian and the Insurance Company; and

That, to the best of my knowledge and belief, unless otherwise shown on the schedule, said securities were the property of said Insurance Company and were free of all liens, claims or encumbrances whatsoever.

Subscribed and sworn to before me this _____ day of _____, _____.

_____
<AUTHORIZED BANK OFFICER>

APPENDIX D

CUSTODIAN AFFIDAVIT C

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

STATE OF)
) SS:
COUNTY OF)

<AUTHORIZED BANK OFFICER>, being duly sworn deposes and says that he is the <POSITION> of <BANK>, a banking corporation organized under and pursuant to the laws of the <STATE> with the principal place of business at <ADDRESS> (hereinafter called the "Bank");

That my duties involve the supervision of activities of the Bank as custodian and records relating thereto;

That the Bank is custodian for certain securities of <INSURANCE COMPANY> with a place of business at <ADDRESS> (hereinafter called the "Insurance Company") pursuant to an agreement between the Bank and the Insurance Company;

That <BANK> has caused certain of such securities to be credited to its book entry account with a Federal Reserve Bank under the Federal Reserve book entry procedure; and that the schedule attached hereto is a true and complete statement of the securities of the Insurance Company of which the Bank was custodian as of the close of business on _____ which were in a "general" book entry account maintained in the name of the Bank on the books and records of a Federal Reserve Bank at such date;

That the Bank has the same responsibility for the safekeeping of such securities whether in the possession of the Bank or in said "general" book entry account as that responsibility is specifically set forth in the agreement between the Bank as custodian and the Insurance Company; and

That, to the best of my knowledge and belief, unless otherwise shown on the schedule, said securities were the property of said Insurance Company and were free of all liens, claims or encumbrances whatsoever.

Subscribed and sworn to before me this _____ day of _____, _____.

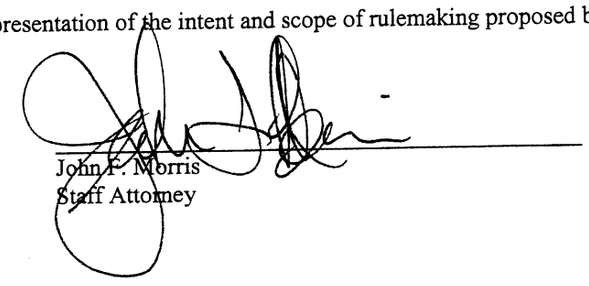
_____
<AUTHORIZED BANK OFFICER>

Authority: Tenn. Code Ann. § 56-3-112.

Legal Contact and/ or party who will approve final copy for publication:
John F. Morris
Staff Attorney
Office of Legal Counsel
25th Floor Tennessee Tower
312 Eighth Avenue, North
Nashville, Tennessee 37243
615-741-2199

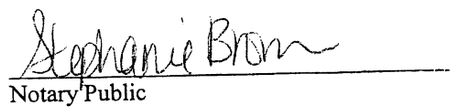
Contact for disk acquisition:
John F. Morris
Staff Attorney
Office of Legal Counsel
25th Floor Tennessee Tower
312 Eighth Avenue, North
Nashville, Tennessee 37243
615-741-2199

I certify that this is an accurate and complete representation of the intent and scope of rulemaking proposed by the Commissioner of Commerce and Insurance.



John F. Morris
Staff Attorney

Subscribed and sworn to before me this the 30 day of September, 2002.



Notary Public

My commission expires on the 28 day of January, 2006.

The notice of rulemaking set out herein was properly filed in the Department of State on the 30th day of September, 2002.

Riley C. Darnell
Secretary of State

BY: Shawna Grau