



**ARKANSAS INSURANCE DEPARTMENT
LEGAL DIVISION**

1200 West Third Street
Little Rock, AR 72201-1904
501-371-2820
FAX 501-371-2629

RULE AND REGULATION 26 (Revised)

**USE OF DEPOSITORY CORPORATIONS AND FEDERAL RESERVE BOOK-ENTRY
SYSTEM BY INSURANCE COMPANIES, HOSPITAL AND
MEDICAL SERVICE CORPORATIONS AND HEALTH
MAINTENANCE ORGANIZATIONS**

SECTION 1. Purpose.

The purpose of this regulation is to authorize and to set forth the conditions and procedures for participation by insurers in modern systems for holding and transferring securities without physical delivery of securities certificates, specifically through utilization of depository corporations and the Federal Reserve book-entry system.

SECTION 2. Authority.

This regulation is promulgated pursuant to the authority of Ark. Stat. Ann. §§ 5-701, 66-2111, 66-2501 et seq., 66-2601 et seq., 66-4237, and 66-5213.

SECTION 3. Scope.

This regulation applies to all domestic insurers, hospital and medical service corporations, and health maintenance organizations. Section 6 and 7 of this regulation shall also be applicable to all foreign insurers and health maintenance organizations.

SECTION 4. Definitions.

When used in this regulation, the term

A. "Agent" shall mean a national or state bank which maintains an account in its name in a depository corporation or which is a member of the Federal Reserve System and through which a custodian participates in a depository corporation or the Federal Reserve book-entry system, 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, "agent" may include a corporation which is organized or existing under the laws of any foreign country and which is legally qualified under such laws to accept custody of securities.

B. "Commissioner" shall mean the Insurance Commissioner for the State of Arkansas.

C. "Custodian" shall mean a national or state bank which has at all times aggregate capital, surplus and undivided profits of not less than \$10,000,000 and which is regulated by either state banking laws or is a

member of the Federal Reserve System and which 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 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, "custodian" may include a bank or similar institution which has at all times aggregate capital, surplus and undivided profits of not less than the equivalent of \$10,000,000 and which is legally qualified to accept custody of securities.

D. "Depository Corporation" shall mean a corporation as defined in Ark. Stat. Ann. §85-8-102(3) which 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 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, "depository corporations" may include a corporation which is organized or existing under the laws of any foreign country and which is legally qualified under such laws to effect transactions in securities by computerized book-entry.

E. "Direct Participant" means a bank or other institution which maintains an account in its name in a depository corporation and through which an insurance company participates in a depository corporation.

F. "Federal Reserve book-entry system" shall mean the computerized systems sponsored by the United States Department of the Treasury and certain agencies and instrumentalities of the United States for holding and transferring securities of the United States government and such agencies and instrumentalities, respectively, in Federal Reserve Banks through banks which are members of the Federal Reserve System or which otherwise have access to such computerized systems.

G. "Insurer" means an insurance company, hospital and medical service corporation or health maintenance organization.

H. "Member bank" means a national or state bank which is a member of the Federal Reserve System and through which an insurer participates in the Federal Reserve book-entry system.

I. "Securities" shall mean certificated securities and uncertificated securities as defined in Ark. Stat. Ann. §85-8-102(1)(A) and (B).

SECTION 5. Terms Not Mutually Exclusive

The terms defined in Section 4 herein shall not be interpreted to be mutually exclusive. For example, as regards depository corporations, an insurer may be a "direct participant" with a depository corporation. In all other instances the insurer must use a "custodian" in order to gain access to a depository corporation. If the insurer uses a bank as a "custodian", that bank might be a "direct participant" with a depository corporation; thus the bank meets two definitions, "custodian" and "direct participant". Similarly the "custodian" bank might not be a "direct participant" with a depository institution and therefore, to participate in a depository corporation, must use the services of an "agent" which "agent" maintains an account with a depository corporation and thus the "agent" also meets the definition of "direct participant".

As regards the use of the Federal Reserve book-entry system, an insurer in all cases will utilize a "custodian". The "custodian" bank might also be a "member bank" and no "agent" should be necessary. If the "custodian" bank is not a "member bank" then the "custodian" bank could use the services of another bank which is a "member bank" to utilize the Federal Reserve book-entry system. Such a "member bank" would also be an "agent" as defined in Section 4 herein.

SECTION 6. Use of Book-entry systems.

With the prior approval of the Commissioner, an insurer may deposit within or outside this state or arrange for the deposit within or outside this state of securities held in or purchased for its general account and its separate

accounts in a depository corporation which is registered with the U.S. Securities and Exchange Commission or in the Federal Reserve book-entry system. When securities are deposited with a depository 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 depository corporation with any other securities deposited with such depository 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 insurer holds securities in the Federal Reserve book-entry system, or in a depository corporation, shall at all times show that such securities are held for such insurer and for which accounts thereof. Ownership of, and other interests in, such securities may be transferred by bookkeeping entry on the books of such depository corporation or in the Federal Reserve book-entry system without, in either case, physical delivery of certificates representing such securities.

SECTION 7. Deposits of Securities.

Securities held in book-entry systems may be used for purposes of deposits required by statute or arising from voluntary agreement with the Commissioner; provided that, all such deposits must be placed through an approved custodian located in Pulaski County, Arkansas.

Securities deposited with a depository corporation or held in the Federal Reserve book-entry system and used to meet the deposit requirements contemplated in this Section shall be under the control of the Commissioner and shall not be withdrawn by the insurer without the approval of the Commissioner. Any insurer holding securities in such manner shall provide to the Commissioner evidence issued by its custodian through which such insurer has deposited such securities in a depository corporation or through which such securities are held in the Federal Reserve book-entry system 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.

The custodian may make use of an agent in placing assets into the Federal Reserve book-entry system or a depository institution.

SECTION 8. Custody Agreement: Requirements.

An insurer may, by written agreement with a custodian authorized by a resolution of the insurer's board of directors or an authorized committee thereof, provide for the custody of its securities with a custodian, which securities may be held by the custodian or its agent or in a depository corporation or in the Federal Reserve book-entry system. Securities so held, whether held by the custodian or its agent or in a depository corporation or in the Federal Reserve book-entry system, are referred to herein as "custodied securities." The terms of the custody agreement shall comply with the following:

(1) Certificated securities held by the custodian shall be held either separate from the securities of the custodian and of all of its other customers or in a fungible bulk of securities as part of a Filing of Securities by Issue (FOSBI) arrangement.

(2) Securities held in a fungible bulk by the custodian and securities in a depository corporation or in the Federal Reserve book-entry system shall be separately identified on the custodian's official records as being owned by the insurer. Said records shall identify which custodied securities are held by the custodian or by its agent and which securities are in a depository corporation or in the Federal Reserve book-entry system. If the securities are in a depository corporation or in the Federal Reserve book-entry system, said records shall also identify where the securities are and if in a of the depository corporation and if through depository corporation, the name an agent, the name of the agent.

(3) All custodied securities that are registered shall be registered in the name of the insurer or in the name of a nominee of the insurer or in the name of the custodian or its nominee or, if in a depository corporation, in the name of the depository corporation or its nominee.

(4) Custodied securities shall be held subject to the instructions of the insurer and shall be withdrawable upon the demand of the insurer, except that custodied securities used to meet the deposit requirements set forth in Ark. Stat. Ann. §66-2209 shall, to the extent required by that statute, be under the control of the Commissioner and shall not be withdrawn by the insurer without the approval of the Commissioner.

(5) The custodian shall be required to send or cause to be sent to the insurer a confirmation of all transfers of custodied securities to or from the account of the insurer. In addition, the custodian shall be required to furnish the insurer with reports of holdings of custodied securities at such times and containing such information as may be reasonably requested by the insurer.

(6) During the course of the custodian's regular business hours the Commissioner shall be entitled to examine on demand, on the premises of the custodian, the custodian's records relating to custodied securities. Any officer or employee of the insurer shall be similarly entitled, but only upon furnishing the custodian with written instructions to that effect from an appropriate officer of the insurer.

(7) The custodian and its agents shall be required to send to the insurer (A) all reports which they receive from a depository corporation or the Federal Reserve book-entry system on their respective systems of internal accounting control and (B) any reports prepared by outside auditors on the custodians or its agent's internal accounting control of custodied securities that the insurer may reasonably request.

(8) The custodian shall maintain records sufficient to determine and verify information relating to custodied securities that may be reported in the insurer's Annual Statement and supporting Schedules and information required in any audit of the financial statements of the insurer.

(9) The custodian shall provide the appropriate affidavits, substantially in the form attached hereto as Exhibits A, B, C, and D to the insurer or the Commissioner.

(10) The custodian shall be obligated to indemnify the insurer 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.

(11) In the event that there is a loss of custodied securities for which the custodian shall be obligated to indemnify the insurer as provided in subsection (9) above, the custodian shall promptly replace the securities or the value thereof and the value of any loss of rights or privileges resulting from said loss of securities.

(12) The agreement may provide that the custodian will not be liable for any failure to take any action required to be taken under the agreement 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, accident, fire, explosion, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority.

(13) In the event that the custodian gains entry in a depository corporation or in the Federal Reserve book-entry system 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, provided however, that, if the agent shall be subject to regulation under the laws of a jurisdiction which is different from the jurisdiction the laws of which regulate the custodian, the Commissioner of Insurance of the state of domicile of the insurer may accept a standard of liability applicable to the agent which is different from the standard of liability applicable to the custodian.

SECTION 9. Effective Date.

This Regulation shall become effective on 8-1-87.

(Signed by Robert M. Eubanks III)

Insurance Commissioner

EXHIBIT A
CUSTODIAN AFFIDAVIT

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

STATE OF)
) SS.:
COUNTY OF)

_____, being duly sworn deposes and says that I am an officer of _____, a banking corporation organized under and pursuant to the laws of the _____, with its principal place of business at _____ (hereinafter called "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 _____, with a place of business at _____ (hereinafter called "insurance company"), pursuant to an agreement between the bank and the insurance company;

I
That the schedule attached hereto is a true and complete statement of securities (other than those caused to be deposited with a depository institution registered with the U.S. Securities and Exchange Commission 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 _____; 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 _____, 19____

_____(L.S.)

TYPED NAME

NOTARY PUBLIC

TITLE

EXHIBIT B

CUSTODIAN AFFIDAVIT

(For use in instances where a custodian bank maintains securities on deposit with a depository institution registered with the U.S. Securities and Exchange Commission.)

STATE OF)
)
COUNTY OF) SS.:

_____ , being duly sworn deposes and says that I am an officer of
_____, a banking corporation organized under and pursuant to the laws of the
_____, with its principal place of business at _____ (hereinafter called "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 _____, with a place of business at
_____ (hereinafter called "insurance company"), pursuant to an agreement between the bank and the
insurance company;

I
That the bank has caused certain of such securities to be deposited with (name and address)
_____ (hereinafter called
"_____"); 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 _____, and
which were so deposited with _____ at 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 with _____ 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 _____, 19____

_____ (L.S.)

TYPED NAME

NOTARY PUBLIC

TITLE

EXHIBIT 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 I am an officer of a banking corporation organized under and pursuant to the laws of the, with its principal place of business at (hereinafter called "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, with a place of business at (hereinafter called "insurance company"), pursuant to an agreement between the bank and the insurance company;

I That it has caused certain of such securities to be credited to its book-entry account with the Federal Reserve Bank of 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 book-entry account maintained in the name of the bank on which the books and records of the Federal Reserve Bank of as 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 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, 19 (L.S.)

TYPED NAME

NOTARY PUBLIC

TITLE

EXHIBIT D

CUSTODIAN AFFIDAVIT

(For use in instances where securities are deposited directly with a depository corporation registered with the U.S. Securities and Exchange Commission.)

STATE OF)
) SS.:
COUNTY OF)

_____, being duly sworn deposes and says that I am an officer of _____, a banking corporation organized under and pursuant to the laws of the _____, with its principal place of business at _____ (hereinafter called "bank");

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

That _____ is custodian for certain securities of _____, with a place of business at _____ (hereinafter called "insurance company"), pursuant to an agreement between _____ and the insurance company;

I
That the schedule attached hereto is a true and complete statement of securities which were in the custody of _____ for the account of the insurance company as of the close of business on _____;

That _____ as custodian has the responsibility for the safekeeping of such securities (whether in the possession of _____, deposited with a Federal Reserve Bank or deposited with another person acting as custodian for _____) as that responsibility is specifically set forth in the agreement between _____ 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 _____, 19____

_____ (L.S.)

TYPED NAME

NOTARY PUBLIC

TITLEt