

The Florida Senate
PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Judiciary Committee

BILL: SB 562

INTRODUCER: Senator Fasano

SUBJECT: Ownership or Transfer of Securities

DATE: March 7, 2007

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Knudson</u>	<u>Deffenbaugh</u>	<u>BI</u>	Favorable
2.	<u>Daniell</u>	<u>Maclure</u>	<u>JU</u>	Favorable
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

This bill modernizes Florida law by expanding the scope of permissible custodians¹ to allow licensed securities brokers and dealers to also serve as custodians of securities bought and sold by domestic insurance companies. The bill also revises the definition of a “clearing corporation.” The amendments are in conformity with the National Association of Insurance Commissioners Model Act on Custodial Agreements and the Use of Clearing Corporations (#295).

This bill substantially amends section 628.511, Florida Statutes.

II. Present Situation:

Section 628.511, F.S., permits domestic insurers to hold and transfer securities in a clearing corporation or in the Federal Reserve book-entry system² without actual physical delivery of securities certificates. Florida defines a “clearing corporation” as:

1. A person that is registered as a “clearing agency” under the federal securities laws;
2. A federal reserve bank; or

¹ The terminology “custodian” has also been added by this bill and will replace the term “direct participant,” as used in s. 628.511(2)(c), F.S.

² The Federal Reserve book entry system is defined in Florida statute as “the computerized systems sponsored by the United States Department of the Treasury and 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.” See s. 628.511(2)(d), F.S.

3. Any other person that provides clearance or settlement services with respect to financial assets that would require it to register as a clearing agency under the federal securities laws but for an exclusion or exemption from the registration requirement, if its activities as a clearing corporation, including promulgation of rules, are subject to regulation by a federal or state governmental authority.³

Securities may be deposited with a clearing corporation that holds the securities. The records of the custodian through which the insurer holds the securities in a clearing corporation must show at all times that the securities are held for the insurer and the accounts where the securities are kept. The purpose of the section is to allow domestic insurers to use modern systems for holding and transferring securities, without having to physically deliver the securities certificates.

Florida based s. 628.511, F.S., on the National Association of Insurance Commissioners (NAIC) Model Act on Custodial Agreements and the Use of Clearing Corporations (#295). The NAIC amended the Model Act in 2004, primarily by updating language referring to the definition of a clearing corporation and allowing broker/dealers to serve as a custodian – an entity that is legally qualified to accept custody of a security. Currently, Florida does not use the term “custodian,” but rather the term “direct participant,” and only permits a national bank, state bank, or trust company to serve as a “direct participant.”⁴

III. Effect of Proposed Changes:

This bill amends s. 628.511, F.S., relating to the ownership or transfer of securities by domestic insurers without actual physical delivery of the security certificate. The bill in essence amends the statute to more fully conform with the National Association of Insurance Commissioners Model Act 295, as amended in 2004.

First, the bill eliminates the terminology “direct participant” and uses the word “custodian,” which is the term used in the Model Act. Second, the bill would permit a securities broker or dealer to also act as the custodian for securities that are held in a clearing corporation. The bill itself does not contain a definition of “broker or dealer.” However, the term is defined elsewhere in Chapter 678, F.S.,⁵ as well as in the NAIC Model Regulation on Custodial Agreements and the Use of Clearing Corporations (#298). Model rule 298 requires a “broker/dealer” to be “registered with and subject to jurisdiction of the Securities and Exchange Commission,” maintain “membership in the Securities Investor Protection Corporation” and have “a tangible net worth equal to or greater than two hundred fifty million dollars (\$250,000,000).”⁶ This standard for a broker/dealer seeks to safeguard the insurer’s securities investments by minimizing the risk of loss in the event of bankruptcy or liquidation of the custodian. The federal Securities Investor Protection Act (SIPA) has clarified that in the case of liquidation of a broker/dealer, securities are not considered part of the broker/dealer’s estate and the securities

³ Section 678.1021(1)(e), F.S.

⁴ Currently, the term “direct participant” is defined in s. 628.511(2)(c), F.S.; however, the term is not used in the section.

⁵ Section 678.1021(1)(c), F.S., defines a broker as “a person defined as a broker or dealer under the federal securities laws, but without excluding a bank acting in that capacity.”

⁶ National Association of Insurance Commissioners, Model Regulation on Custodial Agreements and the Use of Clearing Corporations, 298-2 (January 2006).

would be transferred to a solvent broker/dealer.⁷ This creates a seamless transfer of assets in the case of broker/dealer insolvency. Additionally, the model rule established a net worth requirement, which would help limit the number of broker/dealers eligible to serve as custodians.⁸ The Office of Insurance Regulation has indicated that it intends to conform the Florida Administrative Code to the NAIC Model Regulation, which would incorporate the model rule's safeguards on brokers/dealers.

The bill redefines a "clearing corporation" that may hold such securities to include "the Treasury/Reserve Automated Debt Entry System or Treasury Direct book-entry securities systems as established pursuant to 31 U.S.C. chapter 31, 12 U.S.C. s. 391, and 5 U.S.C. s. 301." Model Act 295 included the Treasury/Reserve Automated Debt Entry Securities System (TRADES) in the definition of a "clearing corporation" upon adding broker/dealers to the list of permissible custodians. This bill updates Florida law to conform to the Model Act. Although the Model Act uses the conjunction "and" rather than "or," as seen in this bill, Florida courts have uniformly found that the word "or" also means "and" for purposes of statutory construction. The bill simplifies the Florida Statutes to include the various book-entry systems in which a Treasury security may be maintained in the definition of a clearing corporation.

This act shall take effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

⁷ National Association of Insurance Commissioners, Model Regulation on Custodial Agreements and the Use of Clearing Corporations, Legislative History, 298-15 (January 2006).

⁸ *Id.* at 298-16.

C. Government Sector Impact:

Representatives from the Office of Insurance Regulation (OIR) indicate that rulemaking will be necessary to amend Rule 69O-143.041, F.A.C, and Rule 69O-143.042, F.A.C., in order to conform the rules to the National Association of Insurance Commissioners Model Regulation on Custodial Agreements and the Use of Clearing Corporations (#298). The bill is not anticipated to have a fiscal impact on the OIR.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.

This Senate Professional Staff Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.
