

Senate Bill No. 1815

CHAPTER 179

An act to amend Section 1104.9 of the Insurance Code, relating to insurance.

[Approved by Governor July 15, 1996. Filed with Secretary of State July 17, 1996.]

LEGISLATIVE COUNSEL'S DIGEST

SB 1815, Lewis. Insurers: investments.

Under existing law, a domestic admitted insurer, other than a domestic life insurer, may maintain its securities and moneys outside California with a qualified custodian, as specified. A qualified custodian may place the securities or moneys in a qualified subcustodian, as defined. A qualified subcustodian must meet requirements of net worth and shareholders' equity, among others. Qualified subcustodians may be located in this state, a reciprocal state, or outside the United States.

This bill would change certain net worth requirements in provisions relating to qualified subcustodians to shareholder equity requirements and would make related changes. The bill would also allow the Insurance Commissioner to consider other specified factors to determine if a qualified foreign subcustodian is financially secure.

The bill would also revise certain restrictions on placement of assets in qualified depositories.

The people of the State of California do enact as follows:

SECTION 1. Section 1104.9 of the Insurance Code is amended to read:

1104.9. (a) (1) As used in this section, "qualified custodian" means: (A) commercial banks (as defined in Section 105 of the Financial Code), savings and loan associations (as defined in Section 5102 of the Financial Code), and trust companies (other than trust departments of title insurance companies), or any entity approved by the commissioner as a qualified custodian; (B) that is domiciled and has a principal place of business in this state; and (C) that either has a net worth of at least one hundred million dollars (\$100,000,000) or is able to demonstrate to the satisfaction of the commissioner that it is financially secure. The commissioner may consider, among other factors, evidence of the following in order to determine whether a custodian is financially secure for the purpose of this subdivision: (i) its obligations under an agreement approved by the commissioner pursuant to subdivision (c) are guaranteed by its parent holding



company, (ii) its parent holding company has a net worth of at least one hundred million dollars (\$100,000,000), or (iii) it is a member of a holding company system with a net worth of at least one hundred million dollars (\$100,000,000).

(2) As used in this section, “qualified depository” means an entity that is located in this state or a reciprocal state and is (A) a depository that provides for the long-term immobilization of securities or a clearing corporation that is also a depository, and that in either case has been approved by or registered with the Securities and Exchange Commission, (B) a Federal Reserve bank, or (C) an entity approved by the commissioner as a qualified depository.

A “qualified depository” may also include an entity that is located outside the United States, if it is a securities depository and clearing agency, incorporated or organized under the laws of a country other than the United States, (i) that operates a transnational system for securities or equivalent book entries (specifically Euroclear and Cedel, or successors to all or substantially all of their operations), or (ii) that operates a central system for securities or equivalent book entries, but solely for securities issued by, or by entities within, the country in which the securities depository and clearing agency is incorporated or organized. The depository shall meet all qualifying requirements imposed by this section upon Euroclear or Cedel.

(3) As used in this section, “qualified subcustodian” means an entity located in this state or a reciprocal state (A) that holds securities of the domestic insurer, and maintains an account through which the securities are held, in this state or a reciprocal state and (B) that has shareholder equity of at least one hundred million dollars (\$100,000,000) or is able to demonstrate to the satisfaction of the commissioner that it is financially secure. The qualified subcustodian shall be: (A) a commercial bank, a savings and loan association, or a trust company (other than trust departments of title insurance companies); (B) a subsidiary of a qualified custodian; or (C) any entity approved by the commissioner as a qualified subcustodian. The commissioner may consider, among other factors, evidence of the following in order to determine whether a subcustodian is financially secure for the purpose of this subdivision: (i) its obligations are guaranteed by its parent company, (ii) its parent holding company has shareholder equity of at least one hundred million dollars (\$100,000,000), or (iii) it is a member of a holding company system with shareholder equity of at least one hundred million dollars (\$100,000,000). A “qualified subcustodian” may also include an entity that is located outside the United States, that is used by the domestic insurer for the purpose of obtaining access to a qualified depository located outside the United States. The qualified foreign subcustodian shall be a banking institution or trust company, incorporated or organized under the laws of a country other than the United States, that is regulated by that country’s government or an agency thereof,



and that has shareholders' equity in excess of two hundred million dollars (\$200,000,000), whether in United States dollars or the equivalent of United States dollars, as of the close of its most recently completed fiscal year; or a majority-owned direct or indirect subsidiary of a qualified United States bank or bank holding company, if the subsidiary is incorporated or organized under the laws of a country other than the United States and has shareholders' equity in excess of one hundred million dollars (\$100,000,000), whether in United States dollars or the equivalent of United States dollars, as of the close of its most recently completed fiscal year; or is able to demonstrate to the satisfaction of the commissioner that it is financially secure. The commissioner may consider, among other factors, evidence of the following in order to determine whether a qualified foreign subcustodian is financially secure for purposes of this subdivision: (i) its obligations are guaranteed by its parent company, (ii) its parent holding company has shareholder equity of at least two hundred million dollars (\$200,000,000), or (iii) it is a member of a holding company system with shareholder equity of at least two hundred million dollars (\$200,000,000).

(4) As used in this section, "subsidiary" means: (A) an entity all of whose voting securities (other than director qualifying shares, if any) are owned, directly or indirectly, by a qualified custodian; or (B) any affiliated entity approved by the commissioner as a subsidiary of a qualified custodian. For the purpose of this section, an affiliated entity means an entity that (A) controls or is controlled, either directly or indirectly or through one or more intermediaries by a qualified custodian or (B) is under the common control, directly or indirectly, as or with a qualified custodian.

(5) As used in this section, "entity approved by the commissioner as a qualified custodian," "entity approved by the commissioner as a qualified depository," "entity approved by the commissioner as a qualified subcustodian," and "entity approved by the commissioner as a subsidiary of a qualified custodian" mean those entities that meet the conditions or standards established by the commissioner. The commissioner shall charge and collect in advance a one-time fee of one thousand five hundred dollars (\$1,500) to review an application for approval of any entity pursuant to this section.

(6) As used in this section, "reciprocal state" has the same meaning as in subdivision (f) of Section 1064.1.

(7) As used in this section, "moneys" means cash held incidental to securities transactions occurring in the ordinary course of business with respect to securities held pursuant to the custodial agreements under this section.

(8) (A) Except as provided in subparagraph (B), as used in this section, "insurer," "domestic insurer," and "domestic admitted insurer" mean any insurer, other than a domestic life insurer that is incorporated or which has its principal place of business in this state.



Except as provided in subparagraph (B), no portion of this section applies to domestic life insurers nor shall this section affect the interpretation of any other portion of this code with respect to domestic life insurers nor is it intended to create a precedent for the application of its provisions to those insurers. However, the exclusion of domestic life insurers from this section shall not be construed to diminish the commissioner's existing authority over those insurers under any other provision of this code.

(B) Domestic life insurers that are wholly owned by any insurer other than a domestic life insurer or are part of an insurance holding company system whose other insurer affiliates are not domestic life insurers may elect to be subject to this section by affirmatively stating that election in the statement otherwise required to be filed by that system pursuant to Section 1215.4.

(b) Notwithstanding Section 1104.1, a domestic admitted insurer may maintain its securities and moneys in a reciprocal state, subject to the requirements of this section, through a custodian account located in California in or with a qualified custodian, and that qualified custodian may maintain those securities or moneys in a qualified depository or qualified subcustodian, either or both of which may be located in a reciprocal state. In addition, a domestic insurer that has foreign investments or any other investments that require delivery outside of the United States upon sale or maturity that qualify under Section 1240, 1241, or 10506, or any other provision of this code may maintain those securities or moneys in or with a qualified depository located in a jurisdiction outside the United States. However, the aggregate amount of general account investments so deposited shall not exceed the lesser of 5 percent of the total admitted assets of the insurer or 25 percent of the excess of admitted assets over the sum of paid up capital, liabilities, and surplus required by Section 700.02. However, unless exempted by the commissioner, not more than 50 percent of that amount of assets that an insurer is authorized to invest pursuant to Section 1241 or 1241.1 may be maintained in any single country in a qualified depository as defined in clause (ii) of paragraph (2) of subdivision (a) and as to life companies not more than 12.5 percent of that amount of assets that an insurer is authorized to invest pursuant to Section 1241 or 1241.1 may be maintained in any single country in a qualified depository as defined in clause (ii) of paragraph (2) of subdivision (a). The percentage or dollar value of admitted assets and paid up capital and liabilities shall be determined by the insurer's last preceding annual statement of conditions and affairs made as of the preceding December 31 that has been filed with the commissioner pursuant to law. No broker or agent, as defined in the Federal Securities Exchange Act of 1934 (15 U.S.C.A. Sec. 78c et seq.), may serve as a qualified custodian, qualified subcustodian, or qualified depository under this section. However, no otherwise qualified custodian or



subcustodian shall be disqualified on account of its activities as a broker or dealer, as so defined, when the activities are incidental to its custodial or other business.

(c) No securities shall be deposited in or with a qualified custodian, qualified depository, or qualified subcustodian except as authorized by an agreement between the insurer and the qualified custodian, if the agreement is satisfactory to and has been approved by the commissioner. The agreement shall require that the securities be held by the qualified custodian for the benefit of the insurer and that the books and records of the qualified custodian shall so designate. The agreement shall further require that beneficial title to the securities remain in the insurer and shall require that the qualified subcustodian and qualified depository be the agents of the qualified custodian. The agreement shall also specifically require that the qualified custodian shall exercise the standard of care of a professional custodian engaged in the banking or trust company industry and having professional expertise in financial and securities processing transactions and custody would observe in these affairs. This section does not affect the burden of proof under applicable law with respect to the assertion of liability in any claim, action, or dispute alleging any breach of, or failure to observe, that standard of care.

(d) No agreement between the qualified custodian and the insurer shall be approved by the commissioner unless the qualified custodian agrees therein to comply with this section. Except when the agreement is submitted in conjunction with an application for an original certificate of authority or variable contract qualification, a fee of five hundred dollars (\$500) shall be paid to the commissioner at the time of filing the agreement for approval. However, no fee shall be required if the form of the agreement has been previously submitted for approval and approved by the commissioner as certified by the insurer and qualified custodian submitting the agreement to the commissioner. The agreement shall be deemed approved unless, within 60 days after receipt by the commissioner of that agreement and any required filing fee, the commissioner has disapproved the agreement in writing citing specific reasons for disapproval.

(e) Notwithstanding the maintenance of securities with an out-of-state qualified depository or qualified subcustodian pursuant to agreement, if the commissioner has reasonable cause to believe that the domestic insurer (1) is conducting its business and affairs in such a manner as to threaten to render it insolvent, or (2) is in a hazardous condition or is conducting its business and affairs in a manner that is hazardous to its policyholders, creditors, or the public, or (3) has committed or is committing or has engaged or is engaging in any act that would constitute grounds for rendering it subject to conservation or liquidation proceedings, or if the commissioner determines that irreparable loss and injury to the property and



business of the domestic insurer has occurred or may occur unless the commissioner acts immediately, then the commissioner may, without hearing, order the insurer and the qualified custodian promptly to effect the transfer of the securities back to a qualified custodian, qualified subcustodian, or qualified depository located in this state from any qualified depository or qualified subcustodian located outside of this state (the transfer order). Upon receipt of the transfer order, the qualified custodian shall promptly effect the return of the securities. Notwithstanding the pendency of any hearing or action provided for in subdivision (f), the transfer order shall be complied with by those persons subject to that order. Any challenge to the validity of the transfer order shall be made in accordance with subdivision (f). It is the responsibility of both the insurer and the qualified custodian to oversee that compliance with the transfer order is completed as expeditiously as possible. Upon receipt of a transfer order, there shall be no trading of the securities without specific instructions from the commissioner until the securities are received in this state, except to the extent trading transactions are in process on the day the transfer order is received by the insurer and the failure to complete the trade may result in loss to the insurer's account. Issuance of a transfer order does not affect the qualified custodian's liabilities with regard to the securities that are the subject of the order.

(f) At the same time the transfer order is served, the commissioner shall issue and also serve upon the insurer a notice of hearing to be held at a time and place fixed therein which shall not be less than 20 nor more than 45 days after the service thereof. Upon request of the insurer and agreement of the department, the hearing may be held within a shorter time but in no event less than 10 days after the service of the notice of hearing. The transfer order and notice of hearing may be served by certified mail, express mail, messenger, telegram, or any other means calculated to give prompt actual notice to (1) the California office of the insurer designated in the agreement, its home office as shown on its most recently filed annual or quarterly statement, or its California agent for service of process; and (2) the California office of the qualified custodian designated in the agreement. If, as a result of the hearing, any of the statements as to conduct, conditions, or grounds for the transfer order are found to be true, or if other conditions or grounds are discovered or become known at the hearing and are found to be true, the commissioner shall affirm the transfer order and may make additional order or orders, pertaining to the transfer order, as may be reasonably necessary.

The insurer subject to the transfer order is entitled to judicial review in the state of the commissioner's order issued as a result of the hearing.



Alternatively, at any time prior to the commencement of the hearing on the transfer order, the insurer may waive the hearing and have judicial review in this state of the transfer order by petition for writ of mandate and declaratory relief without first exhausting administrative remedies or procedures. In that event the insurer is not entitled to any extraordinary remedies prior to trial.

No person other than the insurer has standing at the hearing by the commissioner or for any judicial review of the transfer order.

