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Opinion No. 09-163

Deposits of Securities by Insurance Companies in Clearing Corporations

QUESTIONS

Tenn. Code Ann. § 56-3-112(a)(1) authorizes an insurance company to deposit or arrange for the deposit of securities that it may own in a "clearing corporation as defined in § 47-8-102, in Euroclear or in a federal reserve bank under book-entry system." Pursuant to the authority granted to the Commissioner of Commerce and Insurance in Tenn. Code Ann. § 56-3-112(b) to promulgate rules and regulations governing the deposit of securities by insurance companies, Tenn. R. 0780-1-46-.03(1) sets forth the permissible methods by which an insurance company may hold its securities. Pursuant to subsection (c), an insurance company may hold securities through participation in depository systems of clearing corporations through a custodian bank.

An insurance company that is domiciled and operating in Tennessee is a member of the Federal Home Loan Bank of Cincinnati ("FHLBCin"), and it deposits funds and non-certificated book-entry securities through FHLBCin as part of that institution's correspondent services. FHLBCin's book-entry securities are processed by the Federal Reserve Bank; its physical and DTC securities settlement services are provided by a safekeeping agent, BNY Mellon.

1. Does the arrangement described above comply with Tenn. Code Ann. § 56-3-112 and Tenn. R. 0780-1-46-.03(1)?

a. Are the Federal Reserve Bank and BNY Mellon "clearing corporations" under Tenn. Code Ann. §§ 47-8-102(a)(5)(ii) and (iii), respectively?

b. Is FHLBCin a "custodian bank" under Tenn. R. 0780-1-46-.03(1)(c)?

2. Alternatively, does the arrangement described above comply with Tenn. Code Ann. § 56-3-112 and Tenn. R. 0780-1-46-.03(1) if FHLBCin is a "clearing corporation" under Tenn. Code Ann. § 47-8-102(a)(5)(iii)?

3. Alternatively, does the arrangement described above comply with Tenn. Code Ann. § 56-3-112 and Tenn. R. 0780-1-46.-03(1) if the insurance company's deposit of securities through FHLBCin meets the standard of "any other like entity which meets similar standards of

depository safeguards and regulatory control" set forth in the definition of "clearing corporation" in Tenn. R. 0780-1-46-.02?

OPINIONS

1. and 2. Tenn. Code Ann. § 56-3-112 was enacted in 1980, and the sole amendment thereto occurred in 1995. Since the definition of "clearing corporation" in Tenn. Code Ann. §§ 47-8-102(a)(5)(ii) and (iii) did not exist until 1997, the insurance company cannot comply with Tenn. Code Ann. § 56-3-112 and Tenn. R. 0780-1-46-.03(1) by relying on Tenn. Code Ann. § 47-8-102(a)(5)(ii) and (iii) because there is no indication that the General Assembly intended to incorporate future amendments of Tenn. Code Ann. § 47-8-102 into the body of Tenn. Code Ann. § 56-3-112. The definition of "clearing corporation" in effect in 1995 would have to be met.

3. Our response to questions 1 and 2 moots question 3 since a corporation must meet "the requirements of the definition of the terms in T.C.A. § 47-8-102" in order to be a "clearing corporation" under Tenn. R. 0780-1-46-.02.

ANALYSIS

This opinion concerns Tenn. Code Ann. § 56-3-112 regarding the deposit of securities by insurance companies. This statute provides:

> (a)(1) Notwithstanding any other law, any insurance company, with respect to its general account or separate accounts, is authorized to deposit or arrange for the deposit of securities that it may own in a clearing corporation as defined in § 47-8-102, in Euroclear or in a federal reserve bank under book-entry system. When the securities are so deposited, 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 the clearing corporation with any other securities deposited in the clearing corporation by any person, regardless of the ownership of the securities, and securities of small denominations may be merged into one (1) or more certificates of larger denominations.
>
> (2) Title to the securities may be transferred by bookkeeping entry on the books of the clearing corporation or federal reserve bank without physical delivery of certificates representing the securities.
>
> (b) The commissioner is authorized to promulgate rules and regulations governing the deposit by insurance companies of securities in clearing corporations and in federal reserve banks.
>
> (c) This section applies to any insurance company holding securities with respect to its general account or separate accounts on or after March 4, 1980.

Tenn. Code Ann. § 56-3-112.

The statute sets forth the three permissible methods by which an insurance company may deposit or arrange for the deposit of securities that it owns: "in a clearing corporation as defined in § 47-8-102, in Euroclear or in a federal reserve bank under book-entry system." Tenn. Code Ann. § 56-3-112(a)(1).[1] The statute also provides that the Commissioner of Commerce and Insurance is authorized to promulgate rules and regulations governing the deposit by insurance companies of securities in clearing corporations and in federal reserve banks. Tenn. Code Ann. § 56-3-112(b). Pursuant to this authority, the Commissioner has promulgated rules and regulations governing the permissible methods of holding securities. Tenn. R. 0780-1-46-.03(1) provides:

> 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.
>
> 1. 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.

In your request, you state that an insurance company, domiciled and operating in Tennessee, is a member of the FHLBCin, and it deposits funds and non-certificated book-entry securities through FHLBCin as part of that institution's correspondent services. FHLBCin's book-entry securities are processed by the Federal Reserve Bank; its physical and DTC[2] securities settlement services are provided by a safekeeping agent, BNY Mellon. You initially seek affirmation that this arrangement complies with Tenn. Code Ann. § 56-3-112 and Tenn. R. 0780-1-46-.03(1) because FHLBCin is a "custodian bank" under Tenn. R. 0780-1-46-.03(1)(c)

[1] When Tenn. Code Ann. § 56-3-112 was originally enacted in 1980, subsection (a)(1) provided for the deposit of securities in "a clearing corporation as defined in § 47-8-102, or in a federal reserve bank under book-entry system." Subsection (a)(1) was amended in 1995 by inserting the phrase ", in Euroclear" after the reference to "§ 47-8-102." 1995 Tenn. Pub. Acts ch. 363, § 9. Tenn. Code Ann. § 56-3-112 has not been otherwise amended since its original enactment.

[2] By "DTC," we assume you mean Depository Trust Corporation, which Black's Law Dictionary (8th Ed. 2004) defines as: "The principal central clearing agency for securities transactions on the public markets."

and the Federal Reserve Bank and BNY Mellon are "clearing corporations" under Tenn. Code Ann. §§ 47-8-102(a)(5)(ii) and (iii), respectively.

We first consider whether FHLBCin is a "custodian bank" under Tenn. R. 0780-1-46-.03(1)(c). We initially note that certain words and terms are defined for the purposes of Chapter 0780-1-46. These terms and definitions appear in Tenn. R. 0780-1-46-.02; however, "custodian bank" does not appear among the words and terms that are defined.[3] Black's Law Dictionary (8th Ed. 2004) defines "custodian bank" as "a bank or trust company that acts as custodian for a clearing corporation and that is supervised and examined by a state or federal authority." In light of this definition, we think that a federal home loan bank, such as FHLBCin, may serve as a "custodian bank" for the purposes of Chapter 0780-1-46.

The second part of the inquiry is whether the Federal Reserve Bank and BNY Mellon are "clearing corporations." You indicate that the Federal Reserve Bank meets the definition of a "clearing corporation" under Tenn. Code Ann. § 47-8-102(a)(5)(ii) and that BNY Mellon meets the definition under Tenn. Code Ann. § 47-8-102(a)(5)(iii). The definition provides:

> "Clearing corporation" means:
> (i) A person that is registered as a "clearing agency" under the federal securities laws;
> (ii) A federal reserve bank; or
> (iii) 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.

Tenn. Code Ann. § 47-8-102(a)(5).

We initially note that the current definition of "clearing corporation" in Tenn. Code Ann. § 47-8-102(a)(5) was enacted in 1997. As explained below, we are of the opinion that the current definition of "clearing corporation" does not apply to your query.

When Tenn. Code Ann. § 56-3-112 was enacted in 1980, it adopted by reference the definition of "clearing corporation" under Tenn. Code Ann. § 47-8-102.[4] At that time, Tenn. Code Ann. § 47-8-102 defined a "clearing corporation" as follows:

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[3] We note that the Department of Commerce and Insurance has issued a policy statement that defines a "custodian bank" as "a bank that is a member of the Federal Reserve System or a state chartered bank that is covered by the Federal Depository Insurance Corporation (FDIC)." However, this policy statement has not been promulgated as a "rule" pursuant to the Uniform Administrative Procedures Act. Accordingly, the definition of "custodian bank" in the policy statement has no force of law. *See* Op. Tenn. Att'y Gen. 01-091 (June 4, 2001).

[4] Tenn. Code Ann. § 47-8-102 is the definitional section of Chapter 8 of Title 47 "Uniform Commercial Code – Investment Securities." *See* Tenn. Code Ann. §§ 47-8-101, -102.

> A clearing corporation is a corporation:
> (a) at least ninety percent (90%) of the capital stock of which is held by or for one or more persons (other than individuals) each of whom:
> (i) is subject to supervision or regulation pursuant to the provisions of federal or state banking laws or state insurance laws, or
> (ii) is a broker or dealer or investment company registered under the Securities Exchange Act of 1934 or the Investment Company Act of 1940, or
> (iii) is a national securities exchange or association registered under a statute of the United States such as the Securities Exchange Act of 1934, and none of whom, other than a national securities exchange or association, holds in excess of twenty percent (20%) of the capital stock of such corporation; and,
> (b) any remaining capital stock of which is held by individuals who have purchased such capital stock at or prior to the time of their taking office as directors of such corporation and who have purchased only so much of such capital stock as may be necessary to permit them to qualify as directors.

Tenn. Code Ann. § 47-8-102(3)(1979).

In *Roddy Mfg. Co. v. Olsen*, 661 S.W.2d 868 (Tenn. 1983), the Tennessee Supreme Court addressed the question of whether the amendment of a statute affects other statutes that have adopted the particular statute by reference. The Court adopted the following rule as stated in *Hassett v. Welch*, 303 U.S. 303, 58 S.Ct. 559, 82 L.Ed. 858 (1938):

> " 'Where one statute adopts the particular provisions of another by a specific and descriptive reference to the statute or provisions adopted, the effect is the same as though the statute or provisions adopted had been incorporated bodily into the adopting statute. * * * Such adoption takes the statute as it exists at the time of adoption and does not include subsequent additions or modifications of the statute so taken unless it does so by express intent.' " *Id*. at 314, 58 S.Ct. at 564.

Roddy Mfg. Co., 661 S.W.2d at 871. The Court said this rule applies where the intent of the General Assembly is not clear with respect to whether the adopting statute is to be amended by implication. *Id*.

Turning to Tenn. Code Ann. § 47-8-102, there is no indication that the General Assembly intended to amend or affect any statutes (other than those in Chapter 8 of Title 47), when it enacted the current version of § 47-8-102 in 1997. In fact, Tenn. Code Ann. § 47-8-102(d) expressly states: "The characterization of a person, business, or transaction for purposes of this chapter does not determine the characterization of the person, business, or transaction for purposes of any other law, regulation or rule." Moreover, there is no language within Tenn. Code Ann. § 56-3-112 that suggests that the General Assembly intended to include future amendments of Tenn. Code Ann. § 47-8-102 into the body of Tenn. Code Ann. § 56-3-112.

With that said, we note that Tenn. Code Ann. § 56-3-112 was amended in 1995.[5] The Tennessee Supreme Court has stated that "[a]n amended act is ordinarily to be construed as if the original statute had been repealed and a new and independent act in the amended form had been adopted in its stead." *Redmon v. LeFevre*, 503 S.W.2d 97, 99 (Tenn. 1973). We are unaware of any Tennessee case that has addressed the application of this principle and the principle set forth above in *Roddy Mfg. Co*. in the same case. Assuming that both of these principles apply, Tenn. Code Ann. § 56-3-112 is to be construed as if the 1980 version were repealed and the 1995 version were adopted in its stead. *See Redmon*, 503 S.W.2d at 99. Accordingly, under *Roddy Mfg. Co*., the definition of "clearing corporation" in Tenn. Code Ann. § 47-8-102 in effect in 1995 would be the one to apply. At that time, Tenn. Code Ann. § 47-8-102 defined a "clearing corporation" as follows:

> A "clearing corporation" is a corporation registered as a "clearing agency" under the federal securities law or a corporation:
> (a) at least ninety percent (90%) of the capital stock of which is held by or for one or more persons (other than individuals) each of whom:
> (i) is subject to supervision or regulation pursuant to the provisions of federal or state banking laws or state insurance laws, or
> (ii) is a broker or dealer or investment company registered under the Securities Exchange Act of 1934 or the Investment Company Act of 1940, or
> (iii) is a national securities exchange or association registered under a statute of the United States such as the Securities Exchange Act of 1934,
> and none of whom, other than a national securities exchange or association, holds in excess of twenty percent (20%) of the capital stock of such corporation; and,
> (b) any remaining capital stock of which is held by individuals who have purchased such capital stock at or prior to the time of their taking office as directors of such corporation and who have purchased only so much of such capital stock as may be necessary to permit them to qualify as directors.

Tenn. Code Ann. § 47-8-102(3)(1992). In short, this definition retains the definition of "clearing corporation" in effect in 1980, and it adds that a corporation registered as a "clearing agency" under the federal securities law is also a "clearing corporation." This addition is currently codified at Tenn. Code Ann. § 47-8-102(a)(5)(i).

In sum, the latest definition of "clearing corporation" that could be found to apply is the one in effect in 1995. While the definition of "clearing corporation" now codified in Tenn. Code Ann. § 47-8-102(a)(5)(i) existed in 1995, the definition of "clearing corporation" set forth in Tenn. Code Ann. §§ 47-8-102(a)(5)(ii) and (iii) did not exist until 1997. Thus, in response to your first query, the insurance company cannot comply with Tenn. Code Ann. § 56-3-112 by relying on these provisions because there is no indication that the General Assembly intended to include future amendments of Tenn. Code Ann. § 47-8-102 into the body of Tenn. Code Ann. § 56-3-112. *See Roddy Mfg. Co.*, 661 S.W.2d at 871. For this same reason, the insurance company also cannot rely on Tenn. Code Ann. §§ 47-8-102(a)(5)(ii) and (iii) to comply with

[5] *See* note 1, *supra*.

Tenn. R. 0780-1-46-.03(1)(c). While a federal home loan bank is a "custodian bank," the rule states that "an insurance company may hold its securities pursuant to its participation in depository systems of *clearing corporations* through a custodian bank." *See* Tenn. R. 0780-1-46-.03(1)(c) (emphasis added.) "Clearing corporation" is a defined term under the rules. Under the express terms of Tenn. R. 0780-1-46-.02(1)(d), a "clearing corporation" must meet "the requirements of the definition of the terms in T.C.A. § 47-8-102."

For the insurance company to comply with Tenn. Code Ann. § 56-3-112 and Tenn. R. 0780-1-46-.03(1), the Federal Reserve Bank and BNY Mellon would each have to meet the definition of a "clearing corporation" in effect in 1995. In examining whether the Federal Reserve Bank and BNY Mellon meet either of the definitions of a "clearing corporation" in effect at that time, it appears that neither of them meets the first definition: a corporation registered as a "clearing agency" under the federal securities law.

With respect to BNY Mellon, the insurance company says that it meets the current definition of "clearing corporation" under Tenn. Code Ann. § 47-8-102(a)(5)(iii). Subsection (a)(5)(iii) provides:

> 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.

Tenn. Code Ann. § 47-8-102(a)(5)(iii) (emphasis added). If, in fact, BNY Mellon is not registered as a clearing agency under federal securities law, then it cannot comply with the first definition of a "clearing corporation" in effect in 1995. Similarly, the Federal Reserve Bank cannot meet this first definition because federal securities law explicitly excludes "any Federal Reserve bank" from the term "clearing agency." *See* 15 U.S.C. § 78c(a)(23)(B)(i).

Since it appears that neither the Federal Reserve Bank nor BNY Mellon meets the first definition of a "clearing corporation" in effect in 1995, they would have to meet the other definition of a "clearing corporation" in effect at that time: a corporation

> (a) at least ninety percent (90%) of the capital stock of which is held by or for one or more persons (other than individuals) each of whom:
>
> (i) is subject to supervision or regulation pursuant to the provisions of federal or state banking laws or state insurance laws, or
>
> (ii) is a broker or dealer or investment company registered under the Securities Exchange Act of 1934 or the Investment Company Act of 1940, or
>
> (iii) is a national securities exchange or association registered under a statute of the United States such as the Securities Exchange Act of 1934,
>
> and none of whom, other than a national securities exchange or association, holds in excess of twenty percent (20%) of the capital stock of such corporation; and,

> (b) any remaining capital stock of which is held by individuals who have purchased such capital stock at or prior to the time of their taking office as directors of such corporation and who have purchased only so much of such capital stock as may be necessary to permit them to qualify as directors.

Because the facts and information necessary to determine whether the Federal Reserve Bank and BNY Mellon are "clearing corporations" under this definition are not readily available to us, we do not opine as to whether either of these entities meets this particular definition.

In your second question, you alternatively ask whether the insurance company complies with Tenn. Code Ann. § 56-3-112 and Tenn. R. 0780-1-46-.03(1) if FHLBCin is a "clearing corporation" under Tenn. Code Ann. § 47-8-102(a)(5)(iii). As explained earlier, the insurance company cannot avail itself of the definition of "clearing corporation" in Tenn. Code Ann. § 47-8-102(a)(5)(iii) because there is no indication that the General Assembly intended to include future amendments of Tenn. Code Ann. § 47-8-102 into the body of Tenn. Code Ann. § 56-3-112. *See Roddy Mfg. Co.*, 661 S.W.2d at 871. FHLBCin would have to meet the definition of a "clearing corporation" in effect in 1995. Like the Federal Reserve Bank, FHLBCin is not a "clearing agency" because 15 U.S.C. § 78c(a)(23)(B)(i) expressly states that a "clearing agency" does not include "any . . . Federal home loan bank." With respect to the other definition of "clearing corporation" in effect in 1995, we are unable to opine whether FHLBCin meets that definition because the facts and information necessary to make that determination are not readily available.

Finally, you ask whether the insurance company complies with Tenn. Code Ann. § 56-3-112 and Tenn. R. 0780-1-46.03(1) if the insurance company's deposit of securities through FHLBCin meets the standard of "any other like entity which meets similar standards of depository safeguards and regulatory control," which is set forth in the definition of "clearing corporation" in Tenn. R. 0780-1-46-.02. We initially note that this question does not consider the rule's definition in its entirety. Subsection (1)(d) of this rule provides:

> "Clearing Corporation" means a depository corporation which maintains a book entry accounting system which meets the requirements of the definition of the terms in T.C.A. § 47-8-102, including the Depository Trust Company or any other like entity which meets similar standards of depository safeguards and regulatory control.

Tenn. R. 0780-1-46-.02(1)(d).

Under the express terms of the rule, a "clearing corporation" must meet "the requirements of the definition of the terms in T.C.A. § 47-8-102." Accordingly, our responses to your first two questions moot the final question.

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