

BULLETIN 97-6

Date: December 4, 1997

To: All County and State Mutual Insurance Associations

From: Therese M. Vaughan, Commissioner of Insurance

Subject: Custodial Arrangements

The commissioner is aware that some county and state mutual associations have utilized the services of broker-dealers to custody assets in lieu of holding the securities themselves or with a banking institution. As a result, it is important to understand the ramifications, as to recovery of insurer assets, in the event of the liquidation of either a bank or broker-dealer that custodies assets. So long as both entities remain solvent, the differences may appear to be insignificant. However, in the event of a liquidation, the protections afforded to customers are dramatically different. In the event of a bank liquidation it is well established that trust assets held by the trust department of a bank do not become assets of the bank and will be returned to the owner. Upon the liquidation of a broker-dealer the same assurances are not present.

Chapters 518 and 518A, Code of Iowa (1997) provide that investment programs developed by companies take into account the safety of the company's principal, investment yield and growth, stability in the value of the investment, liquidity and investment diversification. In furtherance of these parameters, all domestic insurers have been requested to review their investment practices including custody arrangements. Your attention is directed to assets custodied with an outside party. If funds are held outside the trust department of a bank, potential peril for policyholder funds exists and therefore action is necessary to obviate this exposure.

In the event that assets are held by a third party outside the trust department of a bank, the association is directed to expediently move the assets to an appropriate custodian to insure that in the event of a liquidation, assets will be readily retrievable.

Attached and incorporated herein is a list of commonly asked questions and answers relating to custodial accounts and their implementation.

Any questions regarding this bulletin should be directed to Kimberlee L. Cross, Financial Regulation Counsel at 515-281-4163.

Custodial Arrangements

Commonly Asked Questions & Answers

What is a custodial account?

A type of agency account in which the custodian has the obligation to preserve and safekeep the property entrusted to it. A custodial agreement executed between the custodian and the association spells out the duties of the custodian relative to the association.

Can a mutual association retain physical custody of its own stocks, bonds, etc...?

Yes. The issue of custody only arises when securities are entrusted to a third party.

Is it acceptable to hold securities in a safety deposit box at an association's banking institution?

Yes. The safety deposit box is rented by and under the direct control of the association.

Is an association required to stop doing business with broker-dealers?

No. Broker-dealers play an important role in the securities industry. However, a broker-dealer is not an appropriate custodian for association assets.

What is an acceptable custodian bank?

An acceptable custodian is a bank or trust company that is supervised and examined by state or federal authorities which regulate the operation of banks or trust companies.

What is the deadline for compliance with Bulletin 97-6?

On or before December 31, 1998, associations shall no longer custody securities with broker-dealers.

What if an association continues to custody assets with a broker-dealer after December 31, 1998?

An association will be subject to administrative action which may result in the suspension of the associations' certificate of authority to do business.

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