

OPINION NO. 90-044**Syllabus:**

Securities owned by the Public Employees Retirement System may be deposited with the Depository Trust Company and registered in the name of the Depository Trust Company or the Company's nominee without violating the requirement of R.C. 145.09 that the securities be "held" in the name of the Public Employees Retirement Board or its nominee.

To: William S. McLaughlin, Executive Director, Public Employees Retirement System, Columbus, Ohio

By: Anthony J. Celebrezze, Jr., Attorney General, June 21, 1990

I have before me your request for my opinion on the question whether the Public Employees Retirement System of Ohio (PERS) "may hold any of its assets in the name of a member or a nominee of the Depository Trust [Company] for the purpose of facilitating the transfer of such assets."

The general administration and management of PERS are vested in the Public Employees Retirement Board. R.C. 145.04. Your question arises in light of R.C. 145.09, which states, in part:

The [public employees retirement] board may sue and be sued, plead and be impleaded, contract and be contracted with. *All of its business shall be transacted, all of its funds invested, all warrants for money drawn and payments made, and all of its cash and securities and other property shall be held in the name of the board, or in the name of its nominee*, provided that nominees are authorized by retirement board resolution for the purpose of facilitating the ownership and transfer of investments and restricted to members of the board, the executive director, and designated members of the staff, or a partnership composed of any of the foregoing persons. (Emphasis added.)

The Board is, thus, authorized to place property in the name of a nominee, for the purpose of facilitating the ownership and transfer of investments. Nominees are, however, restricted to "members of the board, the executive director, and designated members of the staff, or a partnership composed of any of [such] persons."

Your question is whether a violation of R.C. 145.09 would occur if securities of the Board were placed with the Depository Trust Company (DTC). You have described the operations of DTC as follows:

The Depository Trust [Company] ("DTC")...is a corporation owned by its participating members, i.e., banks and brokerage firms. The DTC has a fully automatic system which accounts for the securities on a book entry form for its members with the securities registered in DTC's nominee. Clearing of purchases and sales of securities occurs without the physical movement of the securities. The evidence of ownership is the book entry. The book entry form eliminates the extra costs and potential delays of physically transferring securities which requires the transfer and re-issue of securities in the new owner's name.

Under the arrangement that you have described, the securities in question are registered in the name of DTC's nominee, Cede & Co. DTC has physical possession of the certificates and uses a book-entry system to indicate ownership of the securities.¹ You have asked whether PERS may "permit its securities to be registered in the name of DTC or a nominee of a clearing agent."

As used in your question, the word "registered" refers to the name appearing as owner upon the books of the issuer and upon the stock certificates themselves. See, e.g., R.C. 1308.01; R.C. 1701.24-.28. Your question relates to certificated securities that may be issued in registered form. See, e.g., R.C. 1308.01²; R.C. 1701.24. Traditionally, such securities, when owned by PERS, have been registered

¹ Information from the Depository Trust Company indicates that, in addition to its depository services, DTC is able to provide other services, such as the pledging of securities by book-entries on DTC's accounting records. Depository Trust Company, *The Depository Trust Company Annual Report 1988*, 6 (1989). The situation you have described provides only for securities to be deposited with DTC and purchases and sales to be made by book-entry deliveries. I am not considering any other activities or services that might be performed by DTC.

² R.C. 1308.01 states, in part:

(A) As used in sections 1308.01 to 1308.44 of the Revised Code, unless the context otherwise requires:

(1) A "certificated security" is a share, participation, or other interest in property of or an enterprise of the issuer or an

in the name of PERS or its nominee.³ Under the book-entry depository system operated by DTC, the securities would be registered in the name of Cede & Co. – that is, the name of Cede & Co. would appear on the books of the issuer as the

obligation of the issuer which is:

(a) Represented by an instrument issued in bearer or registered form;

(b) Of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(c) Either one of a class or series or by its terms divisible into a class or series of shares, participations, interests, or obligations.

(2) An "uncertificated security" is a share, participation, or other interest in property or an enterprise of the issuer or an obligation of the issuer which is:

(a) Not represented by an instrument and the transfer of which is registered upon books maintained for that purpose by or on behalf of the issuer;

(b) Of a type commonly dealt in on securities exchanges or markets; and

(c) Either one of a class or series or by its terms divisible into a class or series of shares, participations, interests, or obligations.

(3) A "security" is either a certificated or an uncertificated security. If a security is certificated, the terms "security" and "certificated security" may mean either the intangible interest, the instrument representing that interest, or both, as the context requires. A writing that is a certificated security is governed by sections 1308.01 to 1308.44 of the Revised Code [dealing with investment securities], and not by sections 1303.01 to 1303.78 of the Revised Code [dealing with commercial paper], even though it also meets the requirements of such sections. Sections 1308.01 to 1308.44 of the Revised Code do not apply to money. If a certificated security has been retained by or surrendered to the issuer or its transfer agent for reasons other than registration of transfer, other temporary purpose, payment, exchange, or acquisition by the issuer, that security shall be treated as an uncertificated security for purposes of sections 1308.01 to 1308.44 of the Revised Code.

(4) A certificated security is in "registered form" if:

(a) It specifies a person entitled to the security or to the rights it represents; and

(b) Its transfer may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security so states.

(5) A certificated security is in "bearer form" if it runs to bearer according to its terms and not by reason of any indorsement.

See also N.Y. U.C.C. §8-102(1) (McKinney Supp. 1990); U.C.C. §8-102(1) (1987).

³ I am aware that the Public Employees Retirement Board has, by rule, designated as its nominee under R.C. 145.09 a partnership known as Ohio PERS. 1 Ohio Admin. Code 145-1-05. The partnership is authorized to hold in its name "the legal title or registered ownership of such stocks, bonds, notes, and other securities and property as the Board may from time to time instruct or direct." 1 Ohio Admin. Code 145-1-05(C)(2). The partnership holds such legal title or registered ownership as nominee of the Board, with beneficial ownership being held by the Board. 1 Ohio Admin. Code 145-1-05(C)(2), (C)(3), (D)(3), (D)(5). The property must "be deposited in the

registered owner.⁴

same manner and at the same location as is required for like property whose legal title or registered ownership is held directly by the board." 1 Ohio Admin. Code 145-1-05(C)(4). Rule 145-1-05 clearly contemplates that legal title or registered ownership of securities shall be held by either the Board or its nominee, Ohio PERS. I note, however, that while rules of an administrative agency in Ohio constitute part of the law governing that agency, the rules are subject to change by the agency. *See, e.g., State ex rel. Cuyahoga County Hospital v. Ohio Bureau of Workers' Compensation*, 27 Ohio St. 3d 25, 28, 500 N.E.2d 1370, 1372-73 (1986) ("[a]dministrative regulations issued pursuant to statutory authority have the force and effect of law; consequently, administrative agencies are bound by their own rules until those rules are duly changed"). Therefore, if the Board should determine that it is desirable and statutorily permissible for the Board or its nominee to take actions that are not authorized by existing rules, the Board may amend its rules accordingly. *See generally* R.C. 145.09 (authorizing the Public Employees Retirement Board to adopt rules for the proper administration and management of R.C. 145.01-.58).

⁴ The practical effect of registration of securities deposits in the name of Cede & Co. was described in the Depository Trust Company's annual report, as follows:

Registration of securities deposits in DTC's Cede & Co. nominee name enables the depository to:

- Promptly determine whether certificates are transferable or whether replacement securities should be required from the depositing Participant.
- Permit retransfer of certificates quickly and simply, when necessary.
- Allocate dividends, distributions, and voting rights to Participants properly and without delay.

While these reasons require it to be the owner of record, DTC's objective is to avoid being a barrier to communications between issuers and beneficial owners. Indeed, in some cases, the existence of DTC may assist a corporate issuer in keeping up with changes in ownership of its voting stock.

Several reports serve issuers: The *Security Position Listing Report* itemizes by Participant the number of shares of each issue on deposit. DTC sends this report to each issuer annually without charge, indicating Participant positions as of the record date for the issuer's annual meeting. Issuers may also obtain daily, weekly, monthly, or dividend-record-date listings for a modest fee.

DTC's *Participant Proxy Contact List* specifies each Participant's name and address, and the name and phone number of the person responsible for handling proxies there. The depository updates this list four times yearly, and sends it to issuers without charge.

The *Omnibus Proxy* enables issuers to communicate directly with Participants, and enables Participants to exercise voting rights of securities they hold. The *Omnibus Proxy* is, in effect, an assignment: Cede & Co., the shareholder of record, assigns each Participant the voting rights of shares in that Participant's DTC account as of record date. The depository forwards the *Omnibus Proxy*, with a list of Participant assignees, to the issuer, while simultaneously notifying each Participant listed there that it has sent the *Omnibus Proxy* and specifying the number of shares the Participant is entitled to vote.

After DTC completes these steps - soon after record date - communication between issuers and beneficial owners occurs as if the depository did not exist. A brochure on this subject,

A literal reading of R.C. 145.09 by itself suggests that the statute prohibits the arrangement that you have described. The Board is required to hold securities in its name, unless they are held in the name of a duly-authorized nominee. Only certain persons are eligible to serve as nominees, and neither DTC nor Cede & Co. is such a person. It might, therefore, be argued that an arrangement under which securities of the Board are registered in the name of Cede & Co. would be impermissible.

A more detailed review of the statutes governing the Board, the Treasurer of State, and the ownership and transfer of securities indicates, however, that the arrangement in question does not constitute a violation of R.C. 145.09.⁵ R.C. 145.09 provides that all business of the Board shall be transacted in the name of the Board or its nominee, that all funds of the Board shall be invested in the name of the Board or its nominee, and that all securities of the Board shall be held in the name of the Board or its nominee. The evident intent of such language is to preserve the integrity of property owned by the Board. There is no express requirement that securities be registered in the name of the Board or its nominee. R.C. 145.09 requires only that securities be "held" in the name of the Board or its nominee.

The word "held" is susceptible of a variety of meanings, depending upon the context in which it is used. *See, e.g.*, R.C. 1301.01(T) ("['holder' means a person who is in possession of a document of title or a certificated instrument or an investment security drawn, issued, or indorsed to him or to his order or to bearer or in blank"); *Gregory v. Gregory*, 343 Ill. 630, 643, 175 N.E. 804, 809 (1931) ("the word 'held' has no primary or legal technical meaning and...the meaning to be given to the word is determined largely by the connection in which it is used;...it has been held that the word 'having' or 'hold,' as to property, imports ownership and time of ownership..."); *Black's Law Dictionary* 657-58 (5th ed. 1979) (including the following definitions of the word "hold": "1. To possess in virtue of a lawful title;...9. To keep; to retain; to maintain possession of or authority over"); *Webster's New World Dictionary* 668 (2d college ed. 1978) (defining "hold" to mean "to have and keep as one's own; have the duties, privileges, etc. of; own; possess...[to hold shares of stock...]"). An examination of the usage of "held" in R.C. 145.09, together with related statutes, suggests that securities may be "held" in the name of the Board or its nominee even though they are registered in the name of Cede & Co.

R.C. 145.11 establishes the members of the Board as trustees of the various funds created under R.C. 145.01-.58. It sets forth the standard of care to which the Board is held and lists the types of investments that the Board is authorized to make. Among the authorized investments are various securities that may be held by DTC. *See, e.g.*, R.C. 145.11(Q). With respect to such investments, R.C. 145.11 states:

All investments shall be purchased at current market prices and the instruments of title of such investments shall be placed in the hands of the treasurer of state, who is hereby designated as custodian thereof, or in the hands of his authorized agent. Securities so purchased may be deposited by the treasurer of state for safekeeping

Shareholder Communications and The Depository Trust Company, is available upon request.

Depository Trust Company, *The Depository Trust Company Annual Report 1988*, 13 (1989).

⁵ I am examining your question in light of your concerns regarding R.C. 145.09. I am not considering any questions concerning the authority of the Treasurer of State or the Treasurer's authorized agent to undertake the actions in question except to determine whether depositing securities of PERS with the Depository Trust Company would violate the requirement of R.C. 145.09 that the securities be "held" in the name of the Public Employees Retirement Board or its nominee. *See generally* R.C. 145.11; 1989 Op. Att'y Gen. No. 89-077.

with an authorized agent, selected by the treasurer of state, who is a qualified trustee under section 135.18 of the Revised Code. He shall collect such principal, dividends, distributions, and interest thereon as they become due and payable and place them when so collected into the retirement funds.

The treasurer of state shall honor and pay all instruments drawn on the retirement funds for payment of such investments upon delivery to him or his authorized agent, of the documents of title of such investments when there is attached to such instruments a certified copy of such resolution of the retirement board authorizing the purchase of such investments. The retirement board may sell any of its investments upon like resolution, and the proceeds thereof shall be paid by the purchaser to the treasurer of state upon delivery to him of the documents of title of such investments by the treasurer of state or his authorized agent. For the purpose of facilitating the purchase of common stock, commercial paper, or such other investments as may require payment prior to delivery of final evidence of ownership, the treasurer of state may, for the purpose of making payment, accept a confirmation of purchase or trust receipt, pending delivery of certificates, notes, or other evidence of ownership, pursuant to receipt of a resolution authorizing such purchase adopted or approved by the retirement board. (Emphasis added.)

Pursuant to R.C. 145.11, the Treasurer has designated an Ohio bank as her authorized agent to serve as custodian of the investments of the Board. The bank is a member of DTC and the proposal is that the securities owned by the Board be placed in the bank's account with DTC. The bank would note in its records that the securities are owned by PERS. The question is whether this type of depository arrangement would conform with the requirement of R.C. 145.09 that securities be held in the name of the Board or its nominee. *See generally* note 5, *supra*.

R.C. 145.11 expressly provides for the instruments of title of the investments made by the Board to be placed in the hands of the Treasurer of State, who holds them as custodian, or in the hands of the Treasurer's authorized agent. It is, thus, clear that the requirement that securities be held in the name of the Board or its nominee does not mean that the securities must be in the physical possession of the Board or its nominee. Instead, the instruments of title of the investments must be placed in the hands of the Treasurer or the Treasurer's agent. Those instruments of title must, then, be held in the name of the Board or its nominee.

The Board may invest in a wide variety of assets. *See* R.C. 145.11. For some of them, such as cash and bearer bonds, there is no established means of indicating ownership on the face of the assets. The Treasurer or the Treasurer's authorized agent must, accordingly, hold that property in the name of the Board or the Board's nominee by clearly indicating such ownership in its records. Some securities are issued in uncertificated form and, thus, are not represented by instruments. *See, e.g.*, R.C. 1308.01; R.C. 1308.44; R.C. 1701.24. The fact that certain securities are represented by instruments that may be issued in registered form does not mean that such securities must be registered to the Board or its nominee in order to be held in the name of the Board or its nominee. Rather, an ownership arrangement satisfies R.C. 145.09 if, regardless of registration or physical possession of certificates, it clearly provides that the securities are owned by the Board or its nominee. It appears that this requirement is met in the arrangement you have described involving placement of securities with DTC.

Arrangements for the book-entry ownership of securities are of fairly recent origin. They were established to deal with problems of excess paperwork and have practical benefits with regard to security and convenience of transfer. Federal legislation relating to a national system for clearance and settlement of securities transactions states:

(1) The Congress finds that —

(A) The prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto, are necessary

for the protection of investors and persons facilitating transactions by and acting on behalf of investors.

(B) Inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors.

(C) New data processing and communications techniques create the opportunity for more efficient, effective, and safe procedures for clearance and settlement.

(D) The linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will reduce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors.

(2) The [Securities and Exchange] Commission is directed, therefore, having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents, to use its authority under this chapter to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities (other than exempted securities) in accordance with the findings and to carry out the objectives set forth in paragraph (1) of this subsection. The Commission shall use its authority under this chapter to assure equal regulation under this chapter of registered clearing agencies and registered transfer agents.

15 U.S.C. §78q-1(a) (1988) (enacted by Pub. L. 94-29, §15, 89 Stat. 141 (1975)).

DTC is registered as a "clearing agency" under the federal securities law, *see* 15 U.S.C. §§78c(a)(23), 78q-1(b) (1988), and is, therefore, a "clearing corporation" as that term is used in legislation relating to stock ownership and transfer, *see, e.g.*, R.C. 1308.01(C) (Ohio's version of the Uniform Commercial Code); N.Y. U.C.C. §8-102(3) (McKinney Supp. 1990) (New York's version of the Uniform Commercial Code); U.C.C. §8-102(3) (1987). A clearing corporation has been described as follows: "A clearing corporation is a special kind of financial intermediary. It holds securities on deposit from brokers, banks and other financial institutions, and clears trades among its depositors by making entries on its records." U.C.C. §8-320 Official Comment (1987). A clearing corporation holds no securities for its own account, thus eliminating the possibility that customers' securities might be intermingled with securities owned by the clearing corporation and making the chance of inconsistent claims small. U.C.C. §8-313 Official Comment (1987). DTC is a New York State limited purpose trust company and is regulated by the New York State Banking Department. *See* Depository Trust Company, *The Depository Trust Company Annual Report 1988*, 29 (1989).

The transferee of securities held in book-entry form is considered to be the owner of the securities, even though the securities are registered in the name of the clearing corporation or the clearing corporation's nominee. R.C. 1308.28(B), a portion of Ohio's version of the Uniform Commercial Code, states expressly: "The purchaser is the owner of a security held for him by a financial intermediary...." *See also* N.Y. U.C.C. §8-313(2) (McKinney Supp. 1990); U.C.C. §8-313(2) (1987). "Financial intermediary" is defined to mean "a bank, broker, clearing corporation, or other person, or the nominee of any of them, which in the ordinary course of its business maintains security accounts for its customers and is acting in that capacity." R.C. 1308.28(D); *see also* N.Y. U.C.C. §8-313(4) (McKinney Supp. 1990); U.C.C. §8-313(4) (1987). *See generally* R.C. 1308.17 (a person to whom a security is transferred on the books of a clearing corporation may be a bona fide purchaser); N.Y. U.C.C. §8-302 (McKinney Supp. 1990); U.C.C. §8-302 (1987). *But see generally* R.C. 1308.14(A) ("the issuer...may treat the registered owner [of a certificated security] as the person exclusively entitled to vote, to receive notifications, and otherwise to exercise all the rights and powers of an owner"); R.C. 1308.35(D) (a transfer of securities under R.C. 1308.35 does not constitute a transfer of registration by the issuer); N.Y. U.C.C. §§8-207(1) and 8-320(4) (McKinney Supp. 1990); U.C.C. §§8-207(1) and 8-320(4) (1987).

R.C. 1308.28(A) provides that the transfer of a security to a purchaser occurs, *inter alia*:

(1) At the time he or a person designated by him acquires possession of a certificated security;

(2) At the time the transfer, pledge, or release of an uncertificated security is registered to him or a person designated by him; [or]

...

(7) At the time appropriate entries to the account of the purchaser or a person designated by him on the books of a clearing corporation are made under section 1308.35 of the Revised Code....

See also N.Y. U.C.C. §8-313 (McKinney Supp. 1990); U.C.C. §8-313 (1987).⁶

R.C. 1308.35 states, in part:

(A) In addition to other methods, a transfer, pledge, or release of a security or any interest therein may be effected by the making of appropriate entries on the books of a clearing corporation reducing the account of the transferor, pledgor, or pledgee and increasing the account of the transferee, pledgee, or pledgor by the amount of the obligation, or the number of shares or rights transferred, pledged, or released, if the security is shown on the account of a transferor, pledgor, or pledgee on the books of the clearing corporation; is subject to the control of the clearing corporation; and

(1) If certificated,

(a) Is in the custody of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them; and

(b) Is in bearer form or indorsed in blank by an appropriate person or registered in the name of the clearing corporation, a custodian bank, or a nominee of any of them; or

(2) If uncertificated, is registered in the name of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them.

(B) Under this section entries may be made with respect to like securities or interests therein as a part of a fungible bulk and may refer merely to a quantity of a particular security without reference to the name of the registered owner, certificate or bond number, or the like and, in appropriate cases, may be on a net basis taking into account other transfers, pledges, or releases of the same security.

(C) A transfer under this section is effective, as provided in section 1308.28 of the Revised Code, and the purchaser acquires the rights of the transferor as provided in section 1308.16 of the Revised Code.

See also N.Y. U.C.C. §8-320 (McKinney Supp. 1990); U.C.C. §8-320 (1987). R.C. 1308.16 provides that, "[u]pon transfer of a security to a purchaser as provided in [R.C. 1308.28], the purchaser acquires the rights in the security which his transferor had or had actual authority to convey," unless the purchaser's rights are limited by

⁶ The Official Comment to U.C.C. §8-313 (1987) states, in part:

This section is intended to bring the law of securities transfers into line with modern security trading practices....It is recognized that most transfers are not effected through physical delivery of a certificate from seller to buyer, but rather through adjustments in balances of the parties' accounts with various intermediaries. Whether each intermediary has physical possession of a certificate to match every security it "holds" in its customer accounts is of no importance....

...The important factor is that the [financial] intermediary must "hold" securities in an account for the customer.

his fraudulent or illegal activity or his attempt to improve his position by taking from a bona fide purchaser. See R.C. 1308.17(D); see also N.Y. U.C.C. §§8-301 and 8-302 (McKinney Supp. 1990); U.C.C. §8-301 and 8-302 (1987).

Arrangements under which securities of a particular entity are held by that entity's custodian in the custodian's account at DTC are discussed in *GASB Technical Bulletin No. 87-1*, as follows:

[T]he fact that the...DTC book entry system is used is not central to determining *who* holds the securities....That is,...DTC generally should not be considered to be the party that holds the securities. [That system is] simply the "vault" in which the securities are held....

...Holding securities "in the name of the entity" means establishing the entity's rights to the securities. The entity's rights to and claims on securities it owns should be unconditional....In the...DTC book entry system, the conditions that indicate securities are held in the name of the entity include having the securities held in a custodial or fiduciary account and identified as owned by or pledged to the entity in the custodian's internal accounting records.

Governmental Accounting Standards Board, *GASB Technical Bulletin No. 87-1*, 4 (1987).

As discussed above, the word "hold" or "held" is used in a variety of senses. The requirement that all property of the Public Employees Retirement Board "be held in the name of the board" was added to R.C. 145.09 in 1969. See 133 Ohio Laws, Book I, 1146 (Am. S.B. 408, eff. Nov. 21, 1969). Similar language appeared in statutes governing the State Teachers Retirement System as early as 1919. See 108 Ohio Laws, Part I, 195 (1919) (H.B. 359, filed May 9, 1919) (enacting G.C. 7896-2, which established a "state teachers' retirement system" under the management of a "Retirement Board" and provided that "by such name [the Retirement Board] all of its business shall be transacted, all of its funds invested, all warrants for money drawn and payments made, and all of its cash and securities and other property shall be held"). There is no indication in the statutes or their application over the years that "held" is to be construed as being synonymous with "registered." It appears, instead, that securities owned by PERS may be deposited with DTC and registered in the name of DTC or DTC's nominee without violating the requirement of R.C. 145.09 that the securities be "held" in the name of the Public Employees Retirement Board or its nominee. See note 3, *supra*. See generally *FDIC v. European American Bank & Trust Co.*, 576 F.Supp. 950, 954 (S.D. N.Y. 1983) ("recognizing that the relevant statute was passed before the advent of computerized banking, the Court should respect the agency's efforts to adapt statutory language to new developments").

It is, therefore, my opinion, and you are hereby advised, that securities owned by the Public Employees Retirement System may be deposited with the Depository Trust Company and registered in the name of the Depository Trust Company or the Company's nominee without violating the requirement of R.C. 145.09 that the securities be "held" in the name of the Public Employees Retirement Board or its nominee.