

THE ASSOCIATION OF GLOBAL CUSTODIANS

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11 September 2020

LETTER DELIVERED BY E-MAIL TO:

Senior Director of Operations Addulla Jaffar Abdin
Abdulla.Abdin@bahrainclear.com

Re: Concerns relating to the progress of the delivery-versus-payment
enhancement initiative

The Association of Global Custodians¹ (AGC) is an informal group of 12 financial institutions that provide securities safekeeping services and asset-servicing functions to primarily institutional cross-border investors worldwide. As a non-partisan advocacy organization, the Association represents members' common interests on regulatory and market structure matters through comment letters, white papers and interaction with legislative and regulatory authorities and financial industry organizations around the globe.

In July 2019, Bahrain Clear opened a market consultation on the proposal to enhance the delivery versus payment (DVP) mechanism in the securities settlement system in Bahrain.

¹ The members of the Association of Global Custodians are BNP Paribas; BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; Northern Trust; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company. For more information visit www.theagc.com.

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The AGC Middle East and Africa Committee acknowledges and supports these efforts to mitigate counterparty risk by introducing a DVP mechanism for settlement of transactions. We appreciate the engagement on the enhanced DVP model to highlight the risks inherent in the current settlement mechanism. As you plan for the implementation of this initiative, we request your consideration in providing the final details of the DVP model as a result of the 2019 consultation feedback and communication of the project time line to allow reasonable time for market participants to support and notify their underlying client base including foreign investors. We request the announcement of an implementation date for the project. It is our view that 2 months' notice of the implementation date would be sufficient time for the industry to complete the necessary change management activities, provided that the enhanced DVP does not involve extensive or complex changes, in which case more time would be required to implement the changes. We would also like to reiterate the importance of this development on the foreign investor community and to highlight the following additional key areas of concern with the existing trading and settlement model for your consideration:

1. The dual account structure: Current market practice requires investors to open segregated broker trading accounts with each broker that they intend to trade with. While a dual account model exists in other markets, in Bahrain, the structure does not include a systemic linkage between the investor's trading accounts (operated by their brokers) and the custody account (operated by the local custodian). All activity has to be transacted through the trading accounts which necessitates the manual transfer of shares from the custody account to the trading account prior to the execution of sale transactions. For purchase transactions, once securities are settled through the trading account, there is a manual process to transfer of securities to the investor's custody account and this generally occurs 1-2 days after settlement. During the period of time where securities are held in the trading account, the securities are deemed not to be held in custody by the local custodian because it is the broker and not custodian that has control, visibility and instruction authority over the trading accounts. The current dual account structure presents regulatory compliance challenges for global custodians in

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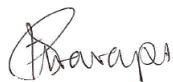
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relation to the safekeeping conditions for assets under custody. We request that the dual account structure be reviewed and reformed to address the stated concerns.

2. Trade rejection procedures: In the current model, executed trades are irrevocable and must settle as executed. There are no failed trade procedures. In addition, there is no process to reject transactions that are not valid, nor is there a procedure to allow for matching of transactions between the investor and broker at the point of order execution. We request that order matching; affirmation or rejection processes; and exception handling procedures be enhanced to ensure the effective functioning of the market. We request further that the penalty regime associated with these processing procedures be reviewed to ensure that it strikes a good balance between the objectives of market supervision and the objective to keep market costs at competitive levels.

We appreciate your consideration of our requests. We look forward to your responses and view on the matters detailed in this letter. Please contact catherine.tinavapi@sc.com if you would like to arrange further discussion or clarification of any matters set out in this letter.

Yours sincerely,



Catherine Tinavapi
Committee Chairperson
Association of Global Custodians Middle East and
Africa Committee