

THE ASSOCIATION OF GLOBAL CUSTODIANS

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August 19, 2004

Gary Palmer
Chief Executive
Dublin Funds Industry Association
1 Gandon House
Mayor Street
IFSC
Dublin 1
Ireland

**Re: Regulatory Issues in Connection with Custodian/Trustee
Supervision of Third Parties In Hedge Funds and Funds of
Hedge Funds Context**

Dear Mr. Palmer:

I write to you on behalf of the Association of Global Custodians (the "Association"), an informal association of nine global banking institutions that provide a variety of portfolio asset custody and related services to cross-border institutional investors in markets throughout the world. The Association participates on behalf of its members in public proceedings and consultative matters concerning regulatory and market structure matters affecting members' business. Members of the Association are listed on the letterhead above, and as you know some of these organizations are members of your association.

Among other activities, members of the Association, either directly or through their European branches and affiliates, act as custodians and/or trustees and administrators for various alternative investment funds organized in European jurisdictions, notably hedge funds and funds of hedge funds

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originated in the Republic of Ireland. In connection with carrying out these activities and appointing prime brokers under regulations adopted by the Irish Financial Services Regulatory Authority ("IFSRA") for these fund types, members have voiced particular concerns. Members are concerned, for example, about the scope and effect of obligations that are triggered through the required appointment of a prime broker as a sub-custodian. Also, members are concerned about the lack of clarity that exists regarding certain of the mandated duties pertaining to funds of funds and funds of hedge funds.

We are writing to you at this time -- in lieu of approaching IFSRA directly -- to express the Association's views in brief and to offer members' assistance in your organization's lobbying efforts to clarify the application of these regulations.

With respect to members' first concern, under the mandates set out in UCITS 4.0 and NU 7.7 issued by IFSRA, trustees (or custodians, as applicable) engaged in a custodial capacity by the applicable fund, are required to supervise relevant activities of prime brokers and collateral agents. That duty is put into effect via the requirement that such entities be appointed as sub-custodians to the trustee (or to the custodian.)

Accordingly, in the case of a prime broker, the trustee (or the custodian, as applicable) bears responsibility under the regulations to delegate direct custody functions relating to relevant assets to the prime broker. However, a trustee's ability to select and pre-qualify the prime broker in the best interest of the fund is typically limited as a practical matter, as is its ability to oversee other services that the prime broker (or the collateral agents) may provide directly to the applicable fund (facilitating short selling / collateral reporting, etc.). In view of those types of limitations and the encumbering obligations associated with sub-custodian appointments, the DFIA recently expressed the view to IFSRA that it is inappropriate for a trustee to be required to appoint collateral agents as sub-custodians, and our members strongly support this view. We believe that comparable considerations apply in the case of prime broker appointments as a sub-custodian, and we think regulatory clarifications, adjustments, or alternative approaches regarding aspects of this appointment requirement should be discussed with IFSRA.

With respect to members' second concern, additional points to clarify relate to pricing of shares for valuation purposes, as well as investment compliance, in the case of a fund of funds, including a fund of hedge funds. Such funds are complicated by their layered structure. Trustees and custodians are not positioned as a matter of contract or practice to audit or otherwise verify

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the pricing calculations and decisions made by the underlying hedge funds themselves, or to oversee investment compliance of the underlying hedge funds. Although it has become customary for trustees/custodians not to monitor or verify the calculation of the underlying funds' NAV by the underlying fund administrators, it would be valuable to have regulatory confirmation of that custom.

In practice, to address the above-noted limitations inherent in the actual scope of a trustee's or custodian's powers, some Association members attempt to obtain written assurances from the funds or fund managers and the respective service providers. They also attempt to see that special disclosures and disclaimers are inserted in the fund's offering documentation. These efforts are often not successful, and under the regulatory mandates the responsibility (and potential liability) nonetheless may rest on the trustee/custodian. We believe that these mandates impose liability risks that are not commensurate with the role and powers of trustees and custodians, and we think that the mandates should be clarified to more closely track the actual contractual relationships and functions and to focus duties on the appropriate parties in the chain of services.

In summary, we believe that the regulations do not fully take into account the actual business and operational circumstances and powers of custodians and trustees servicing hedge funds and funds of hedge funds and, accordingly, efforts should be directed toward obtaining suitable regulatory clarifications. We are interested in working with you to assist in any effort involving your organization which may be currently in process with IFSRA to mitigate any of the foregoing problems for custodians/trustees, and to provide support that would be useful to you in that effort. In addition, we would be pleased to discuss with you ways we could assist you on other issues or initiatives that may be of concern to your members, including efforts to harmonize the investment fund regulatory structures across the EU. We are keen to help avoid, where possible and appropriate, inconsistencies in the interpretation and application of European investment legislation and related regulations. In the event that no such effort is currently underway, we would like to discuss the possibility of beginning such an effort with your guidance and assistance.

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Please contact Susan Neel Morrison at 617.772.2198 or Anne King (Mellon Financial) at 353-1448-5011 for additional information and to initiate Association assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "Dan W. Schneider". The signature is fluid and cursive, with a long horizontal stroke at the end.

Dan W. Schneider
Baker & McKenzie
Counsel to the Association