THE ASSOCIATION OF GLOBAL CUSTODIANS

THE BANK OF NEW YORK MELLON
BROWN BROTHERS HARRIMAN
CITIBANK, N.A.
DEUTSCHE BANK
HSBC SECURITIES SERVICES
J.P. MORGAN
NORTHERN TRUST
RBC DEXIA INVESTOR SERVICES
SKANDINAVISKA ENSKILDA BANKEN
STANDARD CHARTERED BANK
STATE STREET BANK AND TRUST COMPANY

COUNSEL AND SECRETARIAT TO THE ASSOCIATION:

BAKER & MCKENZIE LLP

EUROPE
ATT: ARUN SRIVASTAVA
100 NEW BRIDGE STREET
LONDON EC4V 6JA, ENGLAND
INT'L TEL: 44 20 7919 1000

GLOBAL
ATT: ROBIN TRUESDALE
815 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20006
TEL: 202 452 7000
FAX: 202 452 7074

WWW.THEAGC.COM

7 April 2011

Mr Martin Foelsch
Permanent Representation of Germany to the European Union
Rue Jacques de Lalaing 8-14
1040 Bruxelles
Belgium

Via electronic submission: Martin.foelsch@diplo.de

Re: Commission Proposal for a Directive amending Directive 97/9/EC of the European Parliament and of the Council on investor compensation schemes

Dear Mr Foelsch

We write on behalf of the members of the Association of Global Custodians ("**Association**")[1] to set out members' views in brief concerning the European Commission's ("**Commission**") proposal to amend Directive 97/9/EC of the European Parliament and of the Council on investor compensation schemes ("**ICSD**").

The Association seeks to play a constructive, non-partisan role in ensuring the effectiveness of regulation across global financial markets, while avoiding any unintended consequences that may have negative implications for investors. In that spirit, the Association welcomes the Council's compromise text of 15 March 2011

[1] The Association is an informal group of 11 member banks, listed on the letterhead above, that conduct depositary and custodian services throughout Europe, collectively holding more than EUR 55 trillion of assets on behalf of their clients globally. Members' clients include European-based investment firms, funds and investors, and members play a substantial role in European markets.

("**Council Compromise**"), which it views as more proportionate than the Commission's initial legislative draft. Notwithstanding these improvements, members wish to highlight certain aspects of the Council Compromise, which the Association believes require further attention to ensure that changes to the ICSD are aligned with other EU policy initiatives and are effective in achieving the stated aim of improving investor protection.

1. Definition of "investment firm"

The Association acknowledges the Council's proposal to ensure that the cost of financing investor compensation schemes is borne by investment firms in relation to their investment business, rather than extending liability for scheme funding to other entities, such as third party custodians. Members note in this respect the low risk profile of third party custodians, resulting from strict requirements to segregate and safeguard client assets currently applicable under Directive 2004/39/EC ("**MiFID**") and under the anticipated Securities Law Directive ("**SLD**"), and the cost of risk-based capital that custodians already incur or will incur in respect of their obligations to hold investments in custody under the SLD, UCITS and the Alternative Investment Fund Managers Directive ("**AIFMD**"). Nonetheless, the Association would welcome further clarity regarding the intention to exclude third party custodians from the scope of such schemes in light of the proposed definition of "investment firm", which covers any firm performing core MiFID services, as defined in Section A of Annex I. This is because:

(i) many custodian entities also hold licences as MiFID "investment firms"; and

(ii) all custodians will fall within the proposed definition of "investment firm" when custody becomes a core MiFID service under proposed changes to both MiFID and the envisioned SLD.

The Association therefore supports further clarification regarding the entities that are intended to bear responsibility for scheme funding, including the full exclusion of third party custodians that have no direct contractual relationship with the underlying investor.

2. Funding principles

The Association welcomes the Council's efforts to modify the funding mechanism proposed by the Commission, in particular the effort to take into account scheme members' "business activity" when calculating contributions. This approach better

reflects the particular risk posed by a scheme member relative to investor assets held. Members believe, however, that greater clarity would be helpful as to how the funding mechanism would be applied in practice. Clarity should encompass the interplay between fixed and variable contributions, where it is important to ensure a suitable balance so that assets held in custody are not disproportionately represented. This is because:

(i) where securities are "held in custody", they are segregated from the investment firm's own assets and therefore do not fall within the investment firm's estate in the case of insolvency. As such, the risk that an investment firm will be unable to return such assets to investors due to its financial circumstances is small;

(ii) it would be inappropriate to create a framework in which assets held on an investment firm's own balance sheet via re-hypothecation would produce a lower scheme charge than assets "held in custody", since the latter are properly segregated from the investment firm's insolvent estate; and

(iii) a percentage-based pre-funding mechanism that is -- for the reasons explained in (i) and (ii) above -- disproportionate to the risk being covered, will have the undesired effect of locking away funds at significant cost to investors and the finance industry, without achieving equivalent improvements in investor protection.

3. Scope of protection

The Association acknowledges that both the current ICSD and the Commission's proposal give Member States the option to exclude professional investors from scheme coverage. Consistent with the underlying policy objective of the ICSD, however, we recommend that scheme coverage be explicitly limited to retail investors, thereby excluding scheme coverage for professional investors. Greater legal certainty and a level playing field are important components of an effective legislative framework, and we therefore support maximum legislative harmonization in the definition of eligible scheme participants.

4. Multiple liability and regulatory consistency

The Association agrees with the Council's view that the changes proposed under the ICSD must be aligned with other regulatory initiatives to avoid duplication of protections and unnecessary costs. In this respect, we welcome the removal of UCITS

activities from the scope of the ICSD. Similarly, we would urge the Council to avoid any unnecessary overlap with MiFID and the SLD, as well as any potential duplication of costs as between the ICSD and the Deposit Guarantee Schemes Directive ("**DGSD**"), in cases where an investment firm is also a credit institution. The current proposal ensures that investors cannot claim twice for the same loss of funds held; however, where such funds are covered by both the ICSD and the DGSD, there is no provision to ensure that credit institutions subject to both directives need not contribute twice in respect of the same funds - once under each directive. The Association believes that this and other similar potential inconsistencies need to be addressed.

* * * * *

The foregoing matters are of significant interest and concern to global custodians. Members of the Association would therefore welcome an opportunity to discuss these views with you further. For additional information or to initiate such a discussion, please contact the undersigned, or Nikita Aggarwal (nikita.aggarwal@cliffordchance.com or +44 (0)20 7006 1722) of Clifford Chance LLP, London, special counsel to the Association on European issues.

Sincerely yours,

Dan W. Schneider (pp. Nikita Aggarwal)

Dan W. Schneider
Baker & McKenzie LLP
Secretariat to the Association