

## THE ASSOCIATION OF GLOBAL CUSTODIANS

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14 December 2006

Mr. Mario Nava  
DG Internal Market  
European Commission  
B – 1049 Brussels  
Belgium

### **Re: Comments Concerning the Code of Conduct for Clearing and Settlement**

Dear Mr. Nava:

This letter is sent on behalf of the Association of Global Custodians ("Association"),<sup>1</sup> in response to your invitation to comment on the role of European infrastructure users in the process of monitoring the implementation of the European Code of Conduct for Clearing and Settlement, dated 7 November 2006 (the "Code"). We also submit brief comments on aspects of the Code that we believe merit some clarification.

The Association commends the European Commission ("Commission") for its determination and leadership in bringing about the Code and for basing the process and principles on a self-regulatory paradigm. We believe that the Code constitutes an important new approach to promoting efficiency in European securities markets. As described further below, we think that the success of the Code – including as a self-regulatory mechanism -- will depend in key respects on continued user input to the Commission and the infrastructure organizations ("Organizations") that created and

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<sup>1</sup>

The Association members are listed on the letterhead above.

## THE ASSOCIATION OF GLOBAL CUSTODIANS

Mr. Mario Nava  
14 December 2006  
Page 2

signed the document. We therefore look forward to providing our views and assistance as the implementation process and related consultations evolve.

At this early stage, we offer the following brief comments.

1. Formalized user involvement in Code implementation and evolution will promote sound decisions and fair self-regulatory principles. Typically, infrastructure organizations engaged in self-regulation consult with users about matters such as infrastructure services, prices, and the content of regulation. At the present stage, however, there is no clear mandate that there be a user group to provide input to the Commission and the organizations and individuals who are implementing and embellishing the Code. We believe that gap should be closed, and we fully support the Commission's expressed intention to engage users to assist in monitoring the implementation of the Code. Monitoring the Code's implementation will be a complex undertaking, and inclusion of an expert-users'-group approach would provide the Commission and the signing Organizations with relevant – and necessary – insight. Given the favorable experience with the discussion sessions in Brussels, we suggest a group comparable in composition to the mix of users that participated in those meetings.

2. The Code should include definitions that are addressed to infrastructure functions and activities. Use of such definitions would affirm the Code's narrow scope of application, would provide support for the Code's substantive elements, and would reduce ambiguities in the text. We believe it is critical, particularly at the CSD level, to identify which infrastructure services are "core" services -- i.e., those essential central-facility services delivered by infrastructures operating in a monopoly position. Identification of "core" services will necessarily distinguish those services from value-added services, for which a competitive market may exist; and such distinctions are essential to make the principles of price transparency and unbundling meaningful. That is, infrastructure users and the Commission can only identify and assess the existence of cross-subsidies if such definitions and distinctions are supplied (and, of course, if suitable pricing information is made available). As a corollary, the need for public price transparency and unbundling of services exists only where an entity provides both "core" utility services and value-added services.

3. The Commission should make it explicit that the scope of the Code applies to infrastructure Organizations, and not to intermediaries. The use of the terms "provider" and "service provider" in the Code are ambiguous and suggest an overbroad scope for which no case has been made. Section II of the Code states, "[i]nsofar as

## THE ASSOCIATION OF GLOBAL CUSTODIANS

Mr. Mario Nava  
14 December 2006  
Page 3

elements of this Code apply to trading and post-trading activities, all providers carrying out similar activities, irrespective of whether or not these are operated by the undersigned Organizations, should in principle adhere to the Code in order to ensure a level playing field across all market providers.” The Code should provide clarity concerning which specific “providers” are intended to be included. It is not at all clear -- and the Code does not explain -- how any providers other than the signing Organizations could carry out activities “similar” to those of the centralized market infrastructures. Similarly, the Code does not explain why service providers that are not infrastructure entities should adhere to a Code that has been crafted for infrastructure entities and activities. Finally, it is not clear how third parties’ adherence could “ensure a level playing field” in any meaningful competitive or commercial sense. We firmly believe the undefined term “providers” should be replaced by the term “infrastructure entities” or should be defined to mean infrastructure organizations.

Such a clarification would ensure that the Code applies to infrastructure entities only and not to commercial intermediaries. To extend the Code beyond infrastructure entities would require a new foundation -- one that has not been produced to date.

As the Association’s past comments to the Commission have confirmed, custodian banks provide economically and distinctly different services primarily to different categories of customers than do central infrastructure depositories (“CSDs”). These differences make the two distinct service levels neither comparable nor fungible. Custodians, either directly or indirectly, provide institutional investors, including pension funds, insurance companies, and mutual funds, with securities safekeeping services and related asset-servicing functions. They deliver these services as commercial intermediaries, and as part of an array of banking services for bank customers. Typically, these investor-customers -- unlike CSD users -- are not professional securities processors, and they therefore require the professional safekeeping and asset servicing capabilities of professional intermediaries in order to access and participate in multiple markets. Most of these customers demand flexibly-structured servicing arrangements that are commonly heavily negotiated.

In contrast, CSDs occupy an exclusive, central-utility position in their respective markets, providing non-negotiated, one-size-fits-all settlement services to the full community of professional intermediaries, including custodians. In that role, utility depositories bear responsibility for measuring, controlling and managing aggregate settlements and the related systemic risks for the entire community of intermediaries and other organizations that must use the utilities’ central facilities. As the Commission

THE ASSOCIATION OF GLOBAL CUSTODIANS

Mr. Mario Nava  
14 December 2006  
Page 4

knows, many CSDs also perform registrar functions for all the outstanding securities of various issuers, thereby providing definitive asset ownership recordation and transfer services to all intermediaries, and indirectly to all investors. Thus, CSDs perform fundamentally different -- and also specialized -- market functions. Although both depositories and custodians hold securities for others, the similarities in function, market position and scope of responsibility end there. The Code should not blur those critical functional distinctions, nor should its text suggest that Code principles have any application beyond the focus on infrastructures.

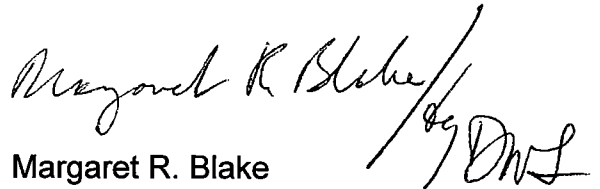
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We appreciate the opportunity to provide the Association's views, and we hope the foregoing is useful. If you have questions or would like additional information, please contact either of the undersigned.

Sincerely yours,



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



Margaret R. Blake  
Baker & McKenzie LLP  
Counsel to the Association

Cc: Commissioner Charles McCreedy