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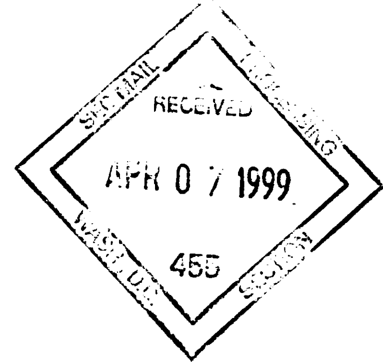
April 7, 1999



BY MESSENGER

Paul F. Roye
Director, Division of Investment Management
Securities and Exchange Commission
Mail Stop 5-6
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Mr. Roye:

On behalf of the Association of Global Custodians, I am writing to thank you for the opportunity to meet with you and your staff on Tuesday, March 30, 1999 concerning the treatment of securities depositories under Rule 17f-5. The Association's representatives found the discussion to be extremely positive. In particular, we support the staff's recognition that the decision to use a local depository is simply one component of an investment company's decision to invest in a particular country's securities markets and the staff's proposed elimination of the reasonable care finding with respect to depositories. Without re-canvassing all the matters addressed during the meeting, we would like to emphasize three additional points.

Depository Information Nondiscrimination

First, we strongly urge that the staff's proposed revisions to Rule 17f-5 not be based on a misconception concerning the practices of global custodians. All fund clients, regardless of size, have access to the same information. Global custodians do not furnish different levels or types of information concerning foreign securities depositories or other aspects of foreign securities markets to different investment company clients based on client size. The suggestion that large fund complexes receive more or better information than small complexes is unfounded.[1]

[1/] Particular funds (or fund directors) may, of course, occasionally request and obtain from the custodian specific information, in addition to that routinely supplied. This may, for example, occur in the context of questioning during board meetings. All fund clients, regardless of size, have the same

The principle of equal treatment is dictated by the practical realities of the highly competitive global custody business. Further, it would be prohibitively expensive for a custodian to develop different foreign market information packages for different fund clients. Doing so would not benefit the custodian in any way; on the contrary, it would be costly, inconsistent with the responsibility to act prudently, and could expose the custodian to potential liability and to serious injury to its reputation as an information source for its fund clients.

If this issue remains a concern, we would appreciate the opportunity to further discuss the matter with the staff.

Depository Information Flexibility

Second, we have great reservations about attempting to specify by rule the information concerning depositories that global custodians should furnish to fund clients. If the staff's consideration of such a requirement is predicated on a belief that custodians afford their fund clients unequal access to information based on fund size, that belief is, as discussed above, erroneous. Further, experience demonstrates the importance of flexibility in this field. The likelihood of changing circumstances over time and the differing objectives and perspectives of the many funds engaged in foreign investment militate against freezing a "one-size-fits-all" list of depository information into the rule. For these reasons, we urge the staff not to prescribe a specific set of information concerning depositories that must be delivered to funds or their advisers.

One alternative to such a regulatory requirement would be a general discussion in the text of the proposing or adopting release of the range of potential depository information that could be provided. Such a discussion should make clear that the Commission is not mandating that any particular type of information be provided. We would be pleased to work with the staff in framing an appropriate set of factors and specific examples for inclusion in such a discussion.

Another possibility would be to simply require that each fund and its global custodian address, by contract, the provision of foreign depository information, along with other relevant

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opportunity to pose such questions concerning their foreign custody arrangements.

infrastructure information. This approach would be consistent with the fact that custodians are the fund's primary source of information concerning foreign securities market infrastructure and would allow custodians and funds the flexibility to address changing foreign market conditions over time, consistent with industry standards and practices.

Indemnification or Insurance

Finally, while not discussed at the March 30 meeting, it is our understanding that the staff may intend to include in its rule proposal an exception to the requirement that the fund receive information concerning foreign depositories where the fund is adequately indemnified or insured against losses resulting from the use of the depository. We do not believe that such a provision is advisable for the following reasons:

- No comprehensive indemnification or insurance exists. The indemnification or insurance clause in Rule 17f-5(c)(2)(i) has uniformly been interpreted to require protection from losses stemming from the conduct of the custodian or bank subcustodian. It does not extend to depository losses. To the extent commercial insurance is available, it is narrowly drawn with respect to depository losses.

- No comprehensive indemnification or insurance is likely to be offered in the future. Advisers, custodians, and commercial insurers will not be prepared to assume the risks associated with governmental or quasi-governmental entities, such as foreign depositories, over which they have little or no influence.

- Such a provision would raise numerous questions and would therefore generate inquiries and no-action requests that would place demands on the staff's limited interpretive resources. For example, is insurance running to the depository to reimburse it for claims paid within the rule? How much coverage is "adequate"? In judging "adequacy", should the fund assume that only its assets would be lost or that the insurer or indemnifier would simultaneously face claims from other depository participants? How broad must an indemnity clause or insurance policy be in order to excuse a fund from obtaining any information concerning a depository?

In short, the practical likelihood that indemnification or insurance for depository risk will be offered is small, but the conceptual problems in fashioning a rule to address this theoretical possibility are great. Discussion of any indemnification or insurance that may exist in a particular case could be included as part of the information concerning the depository that the custodian supplies to the fund; indemnification or insurance are not, however, a substitute for such information.

* * *

We appreciated the opportunity to meet with you concerning this important matter and recognize that the staff has devoted extensive time and effort to considering how Rule 17f-5 can be amended to accommodate the use of foreign depositories. If you or other members of the staff have questions concerning our views, please let me know.

Best regards.

Sincerely,

Daniel L. Goelzer

cc: Robert E. Plaze, Associate Director
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C. Hunter Jones, Assistant Director
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INVESTMENT COMPANY INSTITUTE

CRAIG S. TYLE
GENERAL COUNSEL

April 7, 1999

Mr. Paul F. Roye
Director
Division of Investment Management
Securities and Exchange Commission
Room 5004
450 Fifth Street, NW
Washington, DC 20549

Dear Mr. Roye:

We appreciated the opportunity to meet with you and your staff on March 30, 1999 to discuss the treatment of foreign securities depositories under Rule 17f-5. We are writing to reiterate the views that the Institute and its members expressed at the meeting.

First, we continue to believe that the joint proposal to amend Rule 17f-5 submitted by the Institute and the Association of Global Custodians on February 26, 1999 represents a workable framework for the evaluation of foreign securities depositories under Rule 17f-5. We urge the staff to seriously consider that proposal, as it enjoys support by both investment advisers and global custodians.

Second, we have a number of comments on the alternative proposal that the staff is considering. We agree that the reasonable care finding should be eliminated with respect to depositories, and that depositories should be deemed "eligible foreign custodians" if they satisfy certain objective criteria. Indeed, we recommend that the staff consider expanding its list of objective criteria beyond those described at the meeting to include other criteria contained in our joint proposal.

We strongly disagree, however, that Rule 17f-5 should require delivery of a risk assessment report to the fund's board or adviser by the global custodian. The staff explained that this reporting requirement is intended to address concerns over the flow of information about depository risk to smaller funds. We believe that the FCM's monitoring and reporting obligations under the rule already adequately address the staff's concerns. Moreover, as stressed at the meeting, global custodians already provide the same information to all their clients, regardless of size. Thus, a risk assessment report requirement in the rule is not necessary to ensure an adequate or equitable flow of information.

More importantly, such a requirement would have very troubling implications, as it would seem to imply that a fund's board or adviser must separately consider the report in determining whether to invest in a particular country. We are concerned that this would give that risk undue prominence over all other relevant factors. Moreover, we believe that it is inappropriate for the Commission to mandate in a custody rule the information funds should

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consider in making an investment risk determination. In no other instances are similar reports required.

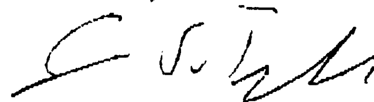
We are also concerned that a mandatory depository risk assessment report, particularly one that is required to include an analysis of specific enumerated factors, could be misinterpreted as requiring funds to make a separate custody risk determination. If this were the case, fund boards and advisers likely would continue to receive voluminous materials from their global custodians focusing on custody risk and continue to be required to make custody risk determinations based on that information. We do not believe that this is what the staff intends.

For all of these reasons, we strongly urge the staff not to include a requirement to deliver a risk assessment report in its proposed amendments to Rule 17f-5.

Finally, although not discussed at the meeting, we understand that the staff may be considering giving firms an option to use insurance or an indemnification in lieu of the risk analysis. We urge the staff to exercise caution in this area. It is not appropriate to use Rule 17f-5 to guarantee against all sources of possible loss once an institution has satisfied the relevant criteria for eligibility. As with other risks, it is the responsibility of the fund and its adviser to act prudently and fully inform shareholders about the risk, but not to insulate them from it. We therefore do not believe that it would be appropriate for the rule to include such an insurance or indemnification alternative.

We appreciate the opportunity to share our views with you on this matter. We share the Commission's interest in finding a workable solution for the treatment of depositories under Rule 17f-5. While we cannot support the approach outlined by the staff at the meeting, we remain ready to work together to develop an approach that would enjoy widespread support.

Sincerely,



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