

## THE ASSOCIATION OF GLOBAL CUSTODIANS

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COUNSEL AND SECRETARIAT TO THE ASSOCIATION:  
BAKER & MCKENZIE  
815 CONNECTICUT AVENUE, N.W.  
WASHINGTON, D.C. 20006  
  
TELEPHONE: 202/452-7000  
FACSIMILE: 202/452-7074  
  
WWW.THEAGC.COM

June 28, 2004

### VIA COURIER

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

Re: Commission File No. S7-13-04

Dear Mr. Katz:

The Association of Global Custodians ("Association") is an informal association of nine global banking institutions headquartered in North America that are major providers of securities custody services and related asset-servicing functions to institutional investors worldwide. We appreciate the opportunity to respond to the Securities and Exchange Commission's (the "Commission") recent Concept Release, *Securities Transaction Settlement, File No. S7-13-04*.

The role of the global custodian has traditionally been limited to the acceptance of customer instructions, the facilitation of delivery and receipt of securities (generally versus payment, through third parties such as foreign sub-custodians and depositories), and the provision of related functions associated with safekeeping of customer assets. Our clients have sufficient confidence in the custodians represented by the Association to allow us to hold assets of more than \$30 trillion, and settle billions of dollars in transactions each day. This confidence is also illustrated by the recent trend in the outsourcing of back office operations by investment managers to their custodians. Therefore, this response is informed by our roles as traditional custodians as well as operations arms of investment management firms.

## **Trade Confirmation and Affirmation**

In our traditional role, the global custodian is not a primary party in the confirmation and affirmation of trades between the broker-dealer and the institutional customer. Rather, the custodian receives the successful (as well as unsuccessful) results of this matching process. A frequent result of the current process is the unnecessary involvement of the custodian in resolving unsuccessful trade matches or soliciting trade information from the non-submitting party. *We favor the migration to a T+0 trade matching process, where each party contributes information and reacts to match results according to its normal role in the trade cycle.*

The Association believes that there are a variety of avenues for rulemaking that would effectively encourage trade matching on a T+0 basis. Requiring investment managers to participate in a trade matching process, or expanding SRO rules to require confirmation and affirmation to occur on T+0, would be reasonable approaches. It may be necessary to allow an additional day for matching for late day cross-border trading.

It has been noted that segments of the investment management community may be unprepared for the migration to early trade matching. We believe that common, well-accepted trade messaging standards are an essential and cost-effective element in encouraging all sizes of investment management firms to move toward early matching. It is also our view that global custodians maintain sufficient technological capability at reasonable cost to accommodate those firms that do not wish to make investments in trade matching.

The Association views the role of a trade matching service provider as central in obtaining a high level of early and successful matching. Regardless of whether the trade matching environment is characterized by a single "utility", or a fully competitive marketplace, provider standards of care should not result in higher operating risk for the global custodian community.<sup>1</sup>

## **Securities Settlement Cycles**

Concerning the implementation of a securities settlement cycle shorter than T+3, the Association believes that the current provisions and exemptions of Rule 15c6-1 should be re-examined in light of the emergence of new types of financial instruments. We should note that many exempted securities already settle on a less than T+3 basis. As

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<sup>1</sup>The Association previously conveyed its view to the Commission that negligence, rather than gross negligence, is the appropriate standard of care for exempt clearing agencies that provide trade matching services to intermediaries in the context of the National Clearance and Settlement System. See Comment Letter of March 24, 2003, submitted by Baker & McKenzie on behalf of the Association of Global Custodians, at note 9.

we have stated in response to other regulatory releases, cross-border trading presents particular challenges due to time zone differences and foreign exchange trading. Provisions will need to be in place to prevent market participants outside the U.S. from being disadvantaged by a shortened cycle.

The Association is of the view that reduction in the settlement cycle would significantly reduce liquidity and presettlement risk. It has been argued that presettlement risk has been significantly curtailed due to advances in bank credit risk management. This does not negate the fact that on any given day, billions of dollars in pending transactions exist on the ledgers of Association members. Though credit risk may be controlled, steadily increasing volumes and potential for severe disruption presents ongoing operational risk.

*However, strong evidence of success in presettlement matching is necessary before moving to a shortened cycle.* It is our view that most custodians have invested heavily in straight through processing and are generally well prepared for the transition to a less than T+3 environment. However, the custodian is dependent on the other parties in the trade cycle to effectively match trades early in the process. Until a strong record of effective matching can be demonstrated, a reduction in settlement cycle may result in short term increases in failing transactions.

### **Securities Certificates**

The use of physical securities is largely an anachronism given the significant technical capabilities of most participants in the clearing and settlement industry. Despite the advances brought about by immobilization through DRS, global custodians still pay millions of dollars each year in vaulting, insurance, and security costs to move and hold physical certificates. These costs are indirectly borne by our clients.

Moreover, the use of certificates offsets the straight through processing gains made through use of electronic standard messaging and prompt trade matching. Physical securities significantly complicate the determination of response and allocation of proceeds in regards to corporate actions. As corporate actions occur with more frequency and complexity, the reduction in risk in this area alone provides sufficient justification to immobilization and dematerialization.

We have reviewed the questions listed in the Release and can offer no operational or practical reason for continuing to provide physical securities certificates to investors. Therefore, the Association favors complete dematerialization of all issues. Recognizing the substantial change this represents to the industry, the Association concedes that immobilization of existing issues combined with dematerialization of all new issues would be an effective interim approach. However, we strongly believe that the

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technological capability of industry participants already constitutes a "widely available direct registration system" and that dematerialization is practical currently.

## Conclusion

The Commission has provided a useful summary and analysis of the major challenges regarding automation in securities settlement. Though advances in straight through processing have been significant over the past several years, the global custodian community favors further initiatives that will increase the quality and speed of service to our clients. We appreciate the opportunity to respond to this Release and look forward to further discussion on actions that will advance straight through processing in the industry.

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If you have any questions, please feel free to contact the undersigned or Michael D'Ambrisi, (617-946-1995) chair of the Response Committee.

Sincerely,

*Margaret R. Blake* by *JCB*

Margaret R. Blake  
Counsel to the Association  
(202) 452-7020

*Dan W. Schneider* by *JCB*

Dan W. Schneider  
Counsel to the Association  
(312) 861-2620