THE ASSOCIATION OF GLOBAL CUSTODIANS

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BROWN BROTHERS HARRIMAN
THE CHASE MANHATTAN BANK
CITIBANK, N.A.
INVESTORS BANK & TRUST COMPANY
MELLON TRUST/BOSTON SAFE DEPOSIT & TRUST COMPANY
NORTHERN TRUST COMPANY
STATE STREET BANK AND TRUST COMPANY

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July 24, 2000

VIA AIR COURIER

Brenda Gibson
Investment Business Policy Department
The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Re: **Response To Consultation Paper No. 45 and 45a – COB 9.1**

Dear Ms. Gibson:

This letter is submitted on behalf of the Association of Global Custodians ("Association") in response to the request of the Financial Services Authority ("FSA") for comments on Consultation Papers No. 45 and 45a. The Association recognizes that comments on CP 45 were due by June 30, 2000, apologizes for its tardiness, and respectfully requests that the FSA nonetheless accept and consider the views set forth herein.

The Association is an informal group of nine U.S. banks that are major providers of global custody services to institutional investors throughout the world. Accordingly, Sections 9.1 (Custody) and 9.3 (Client Money) of Chapter 9 (Customer Assets) of the Conduct of Business Sourcebook ("COB") are of considerable interest and importance to the Association.

The Association has reviewed the June 30, 2000 comments concerning Chapter 9 submitted by certain signatory banks and the portions of "A Memorandum by the Law Society's Company Law Committee" that address Sections 9.1 and 9.3. The Association endorses these comments and associates itself with the views and recommendations of the ad hoc group of banks and of the Company Law Committee. We urge that the FSA modify its proposals as suggested in these two papers.

We would also like to highlight three points that are of particular concern to the Association. These points are summarized below.

Regulatory Complexity

At the outset, we note that Chapter 9 of the COB is extremely detailed and complex. We question whether requirements of this type materially contribute to asset safety and whether the compliance costs imposed by rules that are complicated and prescriptive regarding even relatively minor matters are justified. Authorities in several other jurisdictions, including the United States, Canada, and Australia, have recently adopted or revised their regulatory requirements governing foreign custody of securities.[1] In each case, these regulators have concluded that they can accomplish the objective of promoting asset safety without resorting to the length and intricacy of Chapter 9. We urge that the FSA reconsider its regulatory methodology and adopt a more simplified, plain-language approach.

Scope of Client Money Rules

The Association is concerned that the client money rules are unnecessarily broad and reach situations that do not merit regulation. In particular, we

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1/ See Investment Company Act Rules 17f-5 and 17f-7, 17 C.F.R. 270.17f-5 and 240.17f-7 (governing foreign custody of the assets of U.S. investment companies); Australia Prudential Regulatory Authority ("APRA") Custodian Requirements For APRA Supervised Entities (1999) (governing the custody of assets of Australian insurance companies and certain other entities); Section 6 of National Instrument NI 81-102 (governing foreign custody of the assets of Canadian mutual funds).

recommend that these rules recognize the common situation in which a custodian opens a deposit account with a subcustodian bank in the name of a custody client for the purpose of creating a local market source of funds for the client's securities transactions. Provided that the subcustodian is otherwise lawfully engaged in the business of receiving and holding deposits, and that the account is opened and maintained in the ordinary course of business, we do not believe that any additional regulatory requirements are necessary or appropriate in this situation.

Treatment of Central Securities Depositories

The COB deems central securities depositories to be "custodians."[2] As a result, the placement of custody assets with a depository would require compliance with the same suitability and custodian agreement provisions (Sections 9.1.42 and 9.1.66 respectively) that apply to the use of other types of custodians. The Association strongly recommends that the FSA reconsider this approach. We do not believe that treating depositories as if they can be evaluated and selected on the same basis as bank subcustodians is realistic or feasible.

The use of securities depositories should not be governed by custody regulations for several reasons --

- Unlike subcustodian banks, depositories cannot be "selected." On the contrary, the use of a particular securities depository is usually compulsory once a decision has been made to invest in securities that trade in the market served by that depository. Therefore, use of the depository follows automatically from the decision to invest in a security that is held at that depository, since it is rarely practical, and sometimes impossible, for an institutional investor to withdraw securities from a central securities depository and hold them in physical form.[3]

2/ For example, the definition of "custodian" includes an "approved depository."

3/ Even where it is otherwise possible to do so, holding physical certificates is often inconsistent with market trading and settlement practices and would therefore render the security in question illiquid. This is increasingly the case as settlement times are compressed in response to the G-30 recommendations.

- The decision to invest in a security that trades in a particular market is tantamount to a decision to use that market's depository, and conversely a decision to refrain from using the depository can only be implemented by selling the securities that are held through it. Therefore, the investor, not its custodian, must determine whether the use of the depository is appropriate as a part of the overall decision to invest in a given market, just as the client, not its custodian, decides what investments to purchase.

- It is not possible to negotiate with a securities depository concerning the terms under which assets are held. Therefore, the existence of contractual protections, such as those in Section 9.1.66, is not a workable requirement in the case of securities depositories. Most depositories do not enter into contracts with either participants or with the investors whose assets are held at the depository. Even if the rules and practices of a depository are viewed as the equivalent of a custody contract, individual participants have no ability to alter the depository's rules or to obtain modifications in order to conform to the custody regulatory requirements in the home country of particular investors whose assets are held at the depository.

We recommend that the FSA, like several other regulatory bodies, including the APRA and the Canadian securities regulators, exclude securities depositories from treatment as custodians or subcustodians.[4] Alternatively, like the U.S.

4/ APRA's rules expressly provide that securities depositories are not subcustodians: "Subcustodian includes an entity appointed by the Custodian to hold assets of the Custodian's client on its behalf but excludes securities depositories." See Custodian Requirements For APRA Supervised Entities, Section A (Definitions). This definition is also applicable in interpreting Policy Statements 130-133 of the Australian Securities and Investments Commission.

Similarly, the definition of an eligible foreign subcustodian adopted by the Canadian securities regulators does not include a securities depository. See Section 6.3 of National Instrument NI 81-102. Moreover, the Canadian rules expressly state: "A custodian or sub-custodian of a mutual fund may deposit portfolio assets of the mutual fund with a depository, or a clearing agency, that operates a book-based system." Id., Section 6.5(3).

Securities and Exchange Commission, the FSA could create a rule requiring that clients be informed by their global custodian of the facts relevant to assessing the risks associated with particular depositories.[5] Such disclosure permits the client to determine whether use of that depository is appropriate, given the client's overall investment objectives and risk tolerance.

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The Association appreciates the opportunity to comment on CP 45 and 45a. We would be pleased to submit specific proposals to accomplish the goals we have recommended or to meet with you and your colleagues to discuss our concerns. If you have questions or require further information, please contact the undersigned at Baker & McKenzie, 815 Connecticut Avenue, N.W., Washington, D.C. 20006 (telephone: 202/452-7013; fax: 202/452-7074; e-mail: daniel.l.goelzer@bakernet.com).

Sincerely,

Association of Global Custodians

The Association of Global Custodians
By: Daniel L. Goelzer
Counsel to the Association

5/ Rule 17f-7, adopted by the U.S. Securities and Exchange Commission on April 27, 2000, requires investment company global custodians to provide their mutual fund clients with a "risk analysis" concerning the depositories in which fund assets are held and to monitor these depositories on a continuing basis and report any material changes in their risk profile. The rule also contains eligibility standards for foreign securities depositories. Rule 17f-7 does not, however, subject the use of foreign securities depositories to the reasonable protection and contract requirements that apply to the use of bank subcustodians. Indeed, when it adopted Rule 17f-7, the U.S. SEC simultaneously excluded depositories from the definition of Eligible Foreign Custodians – recognizing that depositories are fundamentally different. See Investment Company Release No. 24424 (April 27, 2000), 65 FR 25630 (May 3, 2000).