THE ASSOCIATION OF GLOBAL CUSTODIANS

BNY MELLON
BROWN BROTHERS HARRIMAN
CITIBANK, N.A.
DEUTSCHE BANK
HSBC SECURITIES SERVICES
J.P. MORGAN
NORTHERN TRUST
RBC 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

12 October 2012

European Commission
Maria Teresa FABREGAS FERNANDEZ
Head of Unit G3: Securities Markets
Rue de Spa 2/pastraat 2
1000 Bruxelles/Brussels
Belgique

RE: European Commission's MiFID II / MiFIR proposals

Dear Ms. Fabregas Fernandez:

We write on behalf of the Association of Global Custodians (the "Association")[1] to provide you with members' views regarding provisions governing depositaries and custodial activities as proposed in the European Commission's ("Commission") drafts of MiFID II and MiFIR. Members welcome the drafts and concur with much of the text of both documents. However, members believe certain proposals raise issues or concerns that call for adjustments and further clarification along the lines described below.

In this letter, members focus on the key area of concern -- the proposal to include custody services as a core service in Section A of Annex 1 of MiFID II. The Association may have additional comments at a later date regarding these and various other matters, and will provide such comments as feasible.

As a general note, the Association welcomes the amendments adopted by the European Parliament's ECON Committee on 26 September 2012, which effectively retain safekeeping as an ancillary service under MiFID II. We fully endorse ECON's reasoning for these reinstating amendments, and we strongly encourage the preservation of these amendments in the ongoing legislative process.

* * * *

[1] Association members provide safekeeping and asset-servicing functions to institutional cross-border investors, and in so doing serve, among other things, as depositaries for EU-originated investment funds. Members of the Association are listed on the letterhead above.

Under the Commission's MiFID II proposal, however, custody services (i.e. safekeeping and administration of financial instruments) would be treated as a core service (i.e. included in Section A of Annex 1) rather than an ancillary service (i.e. included in Section B of Annex 1). Members understand that this proposal is driven by an interest in ensuring that custody services are adequately regulated; however, members strongly believe that this proposal, as drafted, is an inappropriate means to effectively achieve this goal. We set out below two reasons for that view.

1. Custody/Administrative services as "post-trade" activities are outside the scope of MiFID/MiFIR.

The first reason the proposal is inappropriate is because custody services are a post-trade activity having different characteristics than trading activities. MiFID and its related rules and requirements are intended to comprehensively regulate trading (pre-settlement) activities. A MiFID firm with responsibility for customer assets is required under the MiFID Implementing Directive (2006/73/EC) to ensure that the arrangements it makes in conducting its MiFID business, suitably protect customers' rights to such assets -- regardless whether the MiFID firm holds the assets in safekeeping itself (per Article 16 of the Implementing Directive) or places them with third party safekeeping agents (per Article 17 of the Implementing Directive). In the former case, if the MiFID firm retains the customer assets in safekeeping, it would need to apply requirements and bodies of law (including law and regulation relating to fiduciary duties and property rights concepts) that fall entirely outside of MiFID constructs. In the latter case, in contrast, even where a MiFID firm retains control as to *disposition* of client assets (for example, as discretionary asset manager), the MiFID firm is not considered to actually hold the assets in custody or safekeeping. Nevertheless, the Implementing Directive requires the MiFID firm in this latter case to undertake certain minimum due diligence and other measures to ensure that third parties with whom the assets are placed sufficiently protect customer interests, in recognition that these third parties (especially those outside the EU) will be subject to entirely separate regulatory and legal regimes comprehensively covering safekeeping duties.

MiFID did not seek to address all aspects of custody and safekeeping as a regulated "core" activity specifically because its various provisions are inappropriately suited to custody and safekeeping activities. Safekeeping activity differs significantly from activities which *are targeted* by MiFID, such as trading, investment management, and distribution of financial instruments. Rather, safekeeping is generally considered an asset-servicing consequence of investment decisions of customers or their appointed representatives (who themselves would be MiFID firms), and given that functionality it is unclear how suitability or assessment of appropriateness could be meaningfully applied.

Safekeeping agents who perform no other activities are not investment firms, nor are they trading venues. They provide no investment advice and they have no involvement in pricing, distribution, trading, portfolio management or marketing of financial instruments. They act purely as non-discretionary agents to facilitate settlement of transactions and to maintain resulting customer assets. As a matter of appropriate policy, it is crucial to continue to maintain the clear line between those who instruct custodial agents and those, such as custodians, who receive and implement these instructions as non-discretionary agent.

2. Other Directives and regulations will address custody/administrative services comprehensively and those authorities would conflict with MiFID/MiFIR.

The second reason why it is inappropriate to treat custodial and administrative services as "core" activities, is because the European Commission has publicly stated that it will introduce by the end of 2012 a legislative proposal on securities law. This proposal is specifically intended to regulate post-trade activity, including safekeeping and custody services. As noted on the European Commission's website, the third issue area the legislation will address is "the submission of any activity of safekeeping and administration of securities under an appropriate supervisory regime". Hence, it is not sensible for MiFID to cover safekeeping and administration of securities; the securities law legislation will comprehensively prescribe relevant requirements in these respects.

The Association believes that there are bodies of law and regulation affecting safekeeping services that would benefit from further clarification, in particular because of the differences in property and contract laws that deal with entitlements to intermediated securities. Association members therefore welcome the prospect of well-drawn securities law legislation. We note that there have been international efforts to try to provide greater certainty across markets, such as the Geneva Securities Convention, but the adoption of new rules on a global basis has been limited to date. It would accordingly be helpful for the European Union to address these issues comprehensively in the forthcoming SLD.

As a related matter, members note that CSDs will be regulated under the forthcoming CSD Regulation, and that authority will separately address both "core" and "ancillary" activities of CSDs.

* * * *

For the foregoing reasons, the Association believes that custodial services should continue to be treated as ancillary services under MiFID. Adverse impacts of treating safekeeping as a core activity are:

- The need under MiFID to classify customers based on considerations that were designed to address the relative sophistication and financial capacity of customers -- these considerations are not relevant to post-trade custodial and safekeeping duties;

- The possible extension of best execution and other "trading-like" requirements to services such as securities settlement – these requirements would be entirely inappropriate; and

- The application of the equivalency requirements for "third-country" firms in the context of global custody services would inappropriately inhibit access to markets outside the EU, as well as access to non-EU service providers – these requirements and affects would significantly impact global custodians' operating models.

The Association appreciates the opportunity to provide you with members' views on the foregoing topics. Members stand ready to provide supplemental comments as appropriate.

Sincerely yours,

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