

MEMO# 10828

March 23, 1999

ICI AND ASSOCIATION OF GLOBAL CUSTODIANS SUBMIT PROPOSED AMENDMENTS TO RULE 17F-5 RELATING TO SECURITIES DEPOSITORIES

[10828] March 23, 1999 TO: ACCOUNTING/TREASURERS COMMITTEE No. 8-99 RE: ICI AND ASSOCIATION OF GLOBAL CUSTODIANS SUBMIT PROPOSED AMENDMENTS TO RULE 17f-5 RELATING TO SECURITIES DEPOSITORIES

The ICI and the Association of Global Custodians ("Association") submitted to the Securities and Exchange Commission staff proposed amendments to Rule 17f-5 under the Investment Company Act of 1940 (the "Joint Proposal"). The amendments focus on the treatment of securities depositories under the rule. The amendments revise the Institute's and Association's earlier proposal, which was submitted to the SEC staff last June. A copy of the Joint Proposal is attached. The ICI's and Association's June submission recommended that Rule 17f-5 be modified to provide that the Foreign Custody Manager's ("FCM") duty to make a reasonable care determination with respect to a securities depository would be deemed to be satisfied if the FCM determines that the depository in question meets a set of eight objective criteria. In meetings with the ICI and the Association, the SEC staff raised several concerns about this approach. In particular, the staff expressed concern that an FCM might be deemed to provide reasonable care under the eight factors, notwithstanding that the FCM had actual knowledge that a depository was materially unsafe or out of compliance with local regulatory requirements. To address this concern, the Joint Proposal recommends that a proviso be added following the eight objective factors to make clear that a reasonable care determination could not be made if the FCM has "actual knowledge" of information that indicates that the depository is not in compliance with basic safe-keeping standards applicable in the relevant market. The staff also expressed concern that the rule was not clear that FCMs are required to obtain information concerning depositories, evaluate whether that information suggests that a change in custody conditions has occurred at the depository and provide such information to their investment company clients. In response, the Joint Proposal explains that, for both business and contractual reasons, global custodians (who are likely to be asked to assume FCM responsibilities in most cases) are already fulfilling that role. Nonetheless, to address the staff's concern, the Joint Proposal recommends that Rule 17f-5 be revised to make clear that the FCM must monitor both whether the initial reasonable care determination remains valid and whether there have been any material changes in the custody arrangements with the depository. This revision is intended to clarify that material changes in depository arrangements are within the rule's reporting obligations imposed by the fund's board on a delegate acting as

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