The Association for Financial Markets in Europe
Association of Global Custodians – European Focus Committee
European Banking Federation

8th May 2023

Via Electronic Mail: rule-comments@sec.gov

Vanessa A. Countryman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Notice of Proposed Rulemaking on Safeguarding Advisory Client Assets (File No. S7-04-23)

Dear Ms. Countryman:

The Association for Financial Markets in Europe ("AFME")[1], the Association of Global Custodians – European Focus Committee ("AGC-EFC") and the European Banking Federation ("EBF") (AFME, AGC-EFC and EBF, collectively, the "Associations") welcome the opportunity to comment to the Securities and Exchange Commission (the "Commission") on its proposed rule "Safeguarding Advisory Client Assets," published 9th March 2022 (the "Proposed Rule").[2]

Collectively, members of the Associations play a crucial role in providing to U.S. investors access to investment opportunities **outside the United States**, through the provision of post trade services. Because of this, our comments are particularly related to the impact of the Proposed Rule on "**foreign financial institutions**" ("FFIs") who would fall within the Proposed Rule's definition of "qualified custodian". We are aware that other associations and stakeholders will have submitted more comprehensive comments covering all aspect of the Proposed Rule as it would apply to "Qualified Custodians": we share the concerns expressed in these other submissions – and support and endorse them[3] – but will not elaborate on concerns expressed therein to the same level of detail.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable financial markets that support economic growth and benefit society.

Established in 1996, the Association of Global Custodians (the "AGC") is a group of 12 global financial institutions[4] that each provides securities custody and asset-servicing functions

[1] AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the U.S., and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

[2] SEC Release No. IA-6240, 88 FR 14,672 (March 9, 2023) (the "Release").

[3] In particular, the signatory Associations support and endorse letters submitted jointly by the The American Bankers Association, ABA Securities Association, the Financial Services Forum, and the Bank Policy Institute as well as by the Association of Global Custodians (collectively, the "Other Associations' Submissions").

[4] The members of the Association are: BNP Paribas; BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; Northern Trust; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company. The AGC is registered on the EU Transparency Register, TR ID number 813994623570-13

primarily to institutional cross-border investors worldwide. As a non-partisan advocacy organization, the Association represents members' common interests on regulatory and market structure. The member banks are competitors, and the Association does not involve itself in member commercial activities or take positions concerning how members should conduct their custody and related businesses.

The European Banking Federation is the voice of the European banking sector, uniting 33 national banking associations in Europe that together represent some 3,500 banks – large and small, wholesale and retail, local and international – employing about 2,7 million people.

In our view the Proposed Rule risks significantly inhibiting access to capital markets and investments outside the United States to the detriment of U.S. investors and beyond the expectations that were articulated by the Commission in the Release. We therefore are compelled to call to the Commission's attention our concerns on behalf of our members as intermediaries and service providers who are needed by Registered Investment Advisers and U.S.-based custodians in order to gain access to rights and entitlements in securities and other investments outside the United States.

As we explain in more detail below, we have fundamental concerns about the significant negative impact that the Proposed Rule would have on cross-border investment: because of this we respectfully request that the Commission withdraw the Proposed Rule and further analyse and evaluate alternatives that would be less disruptive to markets and investors. Our members would welcome the opportunity to engage with the Commission in order to assist in this endeavour.

The Associations' members hope that the Commission's efforts to realise the goals expressed in the Release can benefit from their longstanding working knowledge and experience in the international post-trade environment. In the attached Annex, we provide background on global custody, explaining key attributes of and rationales for the indirect holding system which operates to provide investors cross-border access to rights and entitlements in securities throughout the world. In view of the market, legal, regulatory, and operational realities faced by intermediaries in providing this access, the Associations express the following concerns with the Proposed Rule, which justifies the Commission withdrawing it for further consideration, as requested above.

Concerns with the Proposed Rule

In particular, we call attention to the following concerns arising from our reading of the Proposed Rule and the Release:

1. Qualification conditions specific to FFIs

Of the seven proposed conditions for qualification as FFIs, two raise high concern.

The **first condition** ("Condition A") would require the adviser to determine that the adviser and the Commission are able to enforce judgments, including civil monetary penalties, against the FFI.[5] The Commission notes that the FFI could satisfy this condition by such means as appointing an agent for service of process in the United States or having offices in the United States, and the adviser can request the relevant documentation for verification purposes. The Commission acknowledges in the Release that this condition "would thus limit the types of foreign financial entities to those that are subject to or consent to U.S. jurisdiction."[6] We agree with this assessment of the likely outcome, however, we believe the outcome would be far more negative for investors than the Commission seems to anticipate.

FFIs are unlikely to consent to Commission enforcement: regulatory frameworks and market practices of other countries also provide for the safe custody of client assets, but approaches

[5] Proposed Rule, § 275.223-1(10)(iv)(A).
[6] Release, at 14,684.

vary. It is difficult to envision FFIs opening themselves up to direct enforcement by a regulatory authority other than their own and imposing requirements that may be inconsistent with those that apply to them directly (and which would be imposed by their own regulators). Indeed, a non-U.S. jurisdiction's particular approach may not accord with the specific requirements that the Commission would impose: an example of this is the way in which EU investment funds legislation defines and circumscribes "financial instruments that may be held in custody" as distinct from assets that can't be so "held" (so-called "Other Assets"): the EU's approach under investment funds legislation would clearly contradict the approach identified in the Proposed Rule.[7] Another example is that intermediaries in the United Kingdom who are regulated by the Financial Conduct Authority (the "FCA") are subject to their own extensive and detailed rules (the "CASS Rules"), which prescribe requirements regarding "client assets" and "client money".[8] It is because of examples such as these that – after the 2008 financial crisis - jurisdictions throughout the world pursued concepts of "equivalence" – as opposed to wholesale extraterritorial imposition of domestic requirements - as a means of gauging the adequacy of foreign legal, regulatory and supervisory approaches. As the European Commission has explained:

> *EU equivalence has become a significant tool in recent years, fostering integration of global financial markets and cooperation with third-country authorities. The EU assesses the overall policy context and to what extent the regulatory regimes of a given third country achieves the same outcomes as its own rules. A positive equivalence decision, which is a unilateral measure by the Commission, allows EU authorities to rely on third-country rules and supervision, allowing market participants from third countries who are active in the EU to comply with only one set of rules.*[9]

The Commission clearly should aspire to adopt a similar approach, as other regulatory authorities have done.

Unless this condition is corrected to align with international regulatory norms, investors and RIAs would be severely limited in accessing global markets, as FFIs would not be in a position to comply with these requirements.

The **fourth condition** ("Condition D") would require an FFI to hold financial assets for its clients in accounts designed to protect such assets from creditors of the FFI in the event of the insolvency or failure of the FFI in a manner that is "comparable to [the protections that the Commission is] proposing for assets held with U.S.-regulated bank or savings association qualified custodians". This indicates that requirements in the Proposed Rule regarding asset "protections" falling on domestic (U.S.) Qualified Custodians would also be extended to FFIs.

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[7] *See*, EU Parliament and Council Directive 2011/ 61/ EU of 8 June 2011 Alternative Investment Fund Managers [2011] OJ L 174, amending Directives 2003/ 41/ EC and 2009/ 65/ EC and Regulations (EC) No. 1060/ 2009 and (EU) No. 1095/ 2010. *See also*, EU Directive 2009/ 65/ EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast). More recently, this Directive has been recast by Directive 2014/ 91/ EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/ 65/ EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities.
(UCITS) as regards depositary functions, remuneration policies and sanctions, OJ L 257.

[8] Available at: https://www.handbook.fca.org.uk/handbook/CASS/

[9] European Commission, *Financial services: Commission sets out its equivalence policy with non-EU countries*, (29th July 2019). Available at:
https://ec.europa.eu/commission/presscorner/detail/en/IP_19_4309

Rather than restate in detail the concerns expressed by other associations[10] regarding the highly unworkable elements regarding scope and application of these requirements, as well as certain of the substantive requirements themselves, we instead hereby express our support for the submissions of these other associations in this respect. Without limiting this support, we emphasise the following points due to additional extreme complications created by imposing the Commission's expectations outside the United States:

a. Cash "segregation"

Under the proposed rule, a custodian bank would be required to segregate client cash in *"an account that is designed to protect such [cash] from creditors of the bank in the event of an insolvency or failure of the bank".*[11]

This cash segregation requirement gives rise to significant confusion and concern. On the assumption that all cash balances would need to be segregated so there is no liability on the balance sheet of a Qualified Custodian or an FFI, we believe this approach is not realistic and fundamentally alters the business model of bank custodians – including their ability to extend credit to clients to facilitate settlement of transactions. Indeed, the impact would be more fundamental due to interference with a bank's ability to manage liquidity on its own balance sheet, interfering with the way in which banks operate in foreign jurisdictions and undermining local prudential regulation: this would seem to interfere with the primacy of prudential law and regulation over deposits, including potentially impacting depositor preference schemes (which vary throughout the world) by creating a form of preferred status for this kind of depositor over other depositors. We note the Commission's reference to "special" deposits in the Release.[12] As the term is applied in U.S. banking law and regulation, such a deposit would remain a balance sheet liability of a bank and would not address the Commission's objective of making deposits bankruptcy remote. It is also not a structure that is specifically recognised outside of the United States.

As a general matter, a deposit account – including a special deposit - creates a debtor-creditor relationship between the bank and the depositor: this deposit liability is a general claim against all the assets of the bank, not a claim to particular cash held by the bank.

We emphasise the compounding disruption of imposing a "cash segregation" requirement which not only may be incompatible with U.S. banking law, regulation and market practice, but also with the frameworks and environments of non-U.S. jurisdictions. In addition, it might require complete segregation of cash throughout the custody chain, including where FFIs provide sub-custody services. Regardless of whether such a requirement would be possible or practicable in the United States, it would certainly be incompatible with law, regulation, market practice and the role of banks outside the United States: appointment of FFIs with such a requirement in place is difficult to envision.

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[10] As noted previously, we support and endorse in particular letters submitted jointly by the The American Bankers Association, ABA Securities Association, the Financial Services Forum, and the Bank Policy Institute as well as by the Association of Global Custodians.

[11] The Proposed Rule would require Qualified Custodian to "hold … client assets [including cash] in an account designed to protect such assets from creditors of the bank … in the event of the insolvency or failure of the bank". Proposed Rule, §275.223-1(d)10(i). As previously stated, we understand that this requirement may extend to FFIs due to Condition D. In any case, the concept of a special deposit as the term is employed in the United States does not apply to law, regulation or market practice outside the United States.

[12] Release, at 14,683.

b. Expansion to the scope of assets to be covered under the Proposed Rule

Problems arising due to the expansion of the scope of assets that Qualified Custodians (and, presumably, by extension, FFIs) would be expected to "possess or control" are well-addressed in the Other Associations' Submissions, which we fully agree with and endorse. We stress additional complexities and incompatibilities that inevitably would arise in jurisdictions outside the United States, where other laws, regulations and market practices apply.

c. Investment Compliance

The proposed rule seems to impose a pre-settlement investment compliance requirement, which would have obvious implications not just in the United States but also in foreign markets if the Qualified Custodian is expected to fail "non-compliant" trades.

The Proposed Rule would require a written agreement between an RIA and custodian bank that "specifies [the RIA's] agreed-upon level of authority to effect transactions in the account as well as any applicable terms or limitations, and permits [the RIA] and the client to reduce that authority."[13] The Release states that the reason for the new requirement is to reduce the "risk that a custodian may follow an instruction with respect to client assets presuming authority that the adviser does not have under its advisory contract with the client".[14]

We are very concerned that the Commission's intent may be to require a custodian to review each trade before settlement in order to determine whether that trade is outside the investment authority of the RIA.[15] As noted in the Other Associations' Submissions, review of trades by custodians, especially before settlement, cannot practically be achieved without a radical change to the process by which custodian banks currently handle client instructions and without a restriction on Straight-Through Processing of settlement instructions.

If a custodian were liable for the malfeasance of the RIA, it would likely – at a minimum - seek to delay settlement in order to perform the necessary oversight, making it more difficult to achieve timely settlement. It would seem almost certain that settlement fails would increase. These settlement fails would undermine the Commission's objective – as well as the objectives of public authorities outside the United States - to create safe and efficient securities markets. This in turn would undermine the goal of achieving settlement acceleration in the United States and elsewhere.

We emphasise the compounding disruption of imposing a particular view of investment compliance monitoring which not only may be incompatible with U.S. law, regulation and market practice, but also with the frameworks and environments of non-U.S. jurisdictions. If a U.S. custodian were to inject a pre-settlement investment compliance monitoring process – with the likely effect of inhibiting straight-through-processing and increasing the rate of settlement fails – the impact would be felt not only in U.S. capital markets but also in markets elsewhere. This would contravene policy goals of jurisdictions outside the United States as well as legal requirements such as EU requirements regarding settlement discipline under the Central Securities Depository Regulation ("CSDR"). Non-U.S. sub-

[13] Proposed Rule, § 275.223-1(a)(i)(D).

[14] *Id.*

[15] In its discussion of "a qualified custodian's participation in a change of beneficial ownership" related to determining that the custodian has "possession or control" of a given asset as required by the Proposed Rule, the Proposing Release states that "beneficial ownership may occur at different points in the transaction lifecycle based on the type of asset involved," pointing to both trade date and trade settlement. This suggests that the Commission may be seeking to hold a custodian bank responsible for the integrity of a transaction across its lifecycle. Proposing Release at 14,688 n.118.

custodians and central securities depositories ("CSDs") obviously would be loath to subject their processes to these kinds of disruptions and risks.

2. Liability provisions, including as they affect the appointment of FFIs

The Proposed Rule would require an RIA to obtain "reasonable assurances in writing" from the qualified custodian that "the existence of any sub-custodial, securities depository, or other similar arrangements with regard to the client's assets will not excuse any of the qualified custodian's obligations to the client."[16] The Release states that this requirement is designed to ensure that the custodian remains "responsible in circumstances where a loss or other failure to satisfy its obligations to the client, whether contractual or otherwise, can be attributed to a sub-custodian or other third party selected by the qualified custodian."

The Proposed Rule also requires the Qualified Custodian to "indemnify the client (and … have insurance arrangements in place that will adequately protect the client) against the risk of loss of the client's assets maintained with the custodian in the event of the qualified custodian's own negligence, recklessness, or willful misconduct."[17]

Since, as noted above, the Proposed Rule does not allow "sub-custodial, securities depository, or other similar arrangements" to excuse a custodian bank from its safeguarding obligations, it may force a custodian bank to be liable without limitation for the misconduct of other entities, even though a custodian bank may have no practical means of control over their operations and over market, political, and other similar risks.[18] There are overriding problems with this approach but, for reasons explained in more detail below, this proposed requirement is most problematic with respect to CSDs, which are highly regulated public market infrastructures servicing the entire market, and which custodians have no control over or ability to select.

More generally, this approach seems to characterise Qualified Custodians acting as global custodians as somehow motivated by a desire to evade their "safeguarding obligations": in truth, the reverse is true. The indirect holding system is used and structured in the way that it is as a necessity.[19] Instead of increasing risk, it reduces the risk that would otherwise arise if an investor – either directly or through an RIA – tried to access investments in foreign markets itself without the use of a central provider such as a global custodian.

The use of CSDs is not optional and is certainly not motivated by a desire to avoid responsibility. In virtually all markets, securities are immobilised in a CSD. The investor's decision to purchase securities in that market is also a decision to utilise the market's CSD, via a sub-custodian, if necessary. Further, in many markets, the investor's global custodian does not have the ability to participate directly in the CSD; participation is limited to local institutions that meet certain requirements. Therefore, the only way a global custodian can provide custody services to investment adviser clients that elect to invest in such a particular market is to establish a sub-custody relationship with an institution that is a member of the market's CSD.

By mischaracterising a custodian's "arrangements" with sub-custodians and CSDs as "outsourcings" or "delegations" (this is characterisation is incorrect since the appointment of

[16] Proposed Rule, §223-1(a)(1)(ii)(C).
[17] Proposed Rule, § 275.223-1(a)(1)(ii)(B).
[18] Proposed Rule, § 275.223-1(a)(1)(ii)(C).
[19] As more fully explained in the attached Annex, the use by investors of intermediaries such as custodians, sub-custodians, and central securities depositories to hold securities, is a fundamental building block of capital markets. It provides a way of managing a "many-to-many" problem, namely, the problem of how to connect multiple issuers (tens, if not hundreds, of thousands) to multiple investors (tens, if not hundreds, of millions). The custody chain benefits capital markets by minimising the number of individual connections that are necessary to connect issuers to investors. Custody networks thereby facilitate investment in securities, including cross-border investment in securities.

these other parties is a function of necessity in order to gain access to rights and entitlements in an investment on behalf of the client[20]), the Proposed Rule misapprehends the nature of the indirect holding system and the framework within which custodians, sub-custodians and CSDs operate.

The use of a CSD and one or more of its authorised participants is an aspect of the "country risk" of an investment – the risk that stems from the decision to invest in a country's securities markets. Imposing blanket liability on global custodians for losses that arise at the foreign sub-custodian or CSD level would shift part of the country risk of the investment from the investor to the custodian.

At a minimum, custodians should not be held responsible for actions that are beyond anyone's practical control; the Proposed Rule should make clear that custodians are not responsible for *force majeure* events and similar country risks that are inherent to the choice of investing in the relevant country. Additionally, the negligence standard that governs a custody arrangement should allow for the application of local law and market practice, which facilitates cross-border (non-U.S.) investment by recognising the existence of complementary but nevertheless non-U.S. standards. The concern for non-U.S. intermediaries is that the Proposed Rule would impede non-U.S. investment by mandating that RIAs only contract with custodians that follow the Commission's own specific viewpoints.

Without sensible limits on liability, custodians may refuse to contract with RIAs, eliminating significant network effects of the custody chain that are critical to well-functioning securities markets and upending current contractual relationships.

The Proposed Rule should not require custodians to indemnify clients by requiring that custodians be held responsible for (i) losses caused by a CSD, or (ii) losses caused by a sub-custodian or other third party when the Qualified Custodian has not been negligent in its selection or monitoring. Whilst these points may have been made in the Other Associations' Submissions in the context of U.S.-based would-be Qualified Custodians, we emphasise the compounding disruption on others in the custody chain who would be impacted by these requirements as well.

The Commission should support the freedom of all parties in the traditional custody model to agree to terms tailored to the risks of a particular situation. The Commission should allow custodian banks and their clients to negotiate a standard of care and liability standard that reflects the dynamics of the particular situation – including with respect to the particular RIA, end investor, trading strategy, assets, and jurisdictions involved – instead of imposing specific provisions by decree into all contracts regardless of appropriateness.

3. RIAs having U.S. and non-U.S. clients

Another overarching consideration is the confusion, operational risk and higher costs that would result in subjecting RIAs to requirements that differ so significantly from those that would apply in the case of non-U.S. clients. Outside the United States, rulesets that significantly differ as between U.S. and non-U.S. clients regarding the custody of client assets would be very

[20] The European Banking Authority ("EBA") in its Guidelines defined outsourcing as: "… an arrangement of any form between an institution, a payment institution or an electronic money institution and a service provider by which that service provider performs a process, a service or an activity that would otherwise be undertaken by the institution, the payment institution or the electronic money institution itself." EBA/GL/2019/02 (25th February 2019). In March 2021, the UK's Prudential Regulation Authority ("PRA") published its Supervisory Statement SS2/21 on "Outsourcing and Third-Party Risk Management" in which the PRA concluded that arrangements such as those for custody services provided among regulated financial institutions. See, para. 2.12.

difficult for a non-U.S. RIA to sustain: it may be difficult or impossible to find custodians willing to service clients with such different requirements.

While the same requirements might apply to U.S. and non-U.S. clients alike in the case of RIAs operating within United States, the inevitable increased cost and disruption visited upon such RIAs by the Proposed Rule would cause non-U.S. clients to balk at appointing them.

Conclusion

In conclusion, we believe the Proposed Rule would place significant and unreasonable burdens on foreign financial institutions intending to provide custodial services to U.S. clients operating through RIAs. This is likely to result in a significant reduction in the ability of U.S. clients to access non-U.S. markets in a safe and cost-efficient manner. Our respective members support the objective of ensuring investors' assets are appropriately protected. However, the Proposed Rule would significantly impact existing market practices which we believe currently provide effective protection of investor assets. We strongly urge the Commission to reconsider the impacts of the Proposed Rule and withdraw it for further consideration and consultation.

We would be grateful for the opportunity to discuss this matter further in order to achieve the Commission's objective of protecting investors whilst at the same time ensuring the continued safe and efficient facilitation of access to capital markets outside the United States and the operation of international post-trade services.

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ANNEX

Background on global custody

In order to invest in markets outside their home country, investors must have access to the financial system infrastructure of other jurisdictions. In the case of publicly offered securities, global custodians provide this access through their sub-custodian networks and participation via those networks in central securities depositories or securities settlement systems. When an investor elects to invest in securities that trade outside the United States, the investor necessarily also elects to assume the risks associated with that market's infrastructure and other local market conditions.

Generally, financial instruments that may be "held in custody" are treated as **intangible property** under most major legal regimes throughout the world.[21] This is a crucial distinction in most major markets – with consequences in the context of insolvencies of platforms or intermediaries.

In general, a custodian's role consists of three main functions:

1. **Holding physical securities** and / or records of ownership rights in dematerialised ("book-entry") securities on behalf of an investor - or another intermediary;
2. **Acting on instructions** to facilitate the settlement (change in ownership) of transactions in those securities on behalf of the relevant investor or another intermediary; and,
3. **Facilitating the exercise of other rights** associated with ownership of such securities (such as corporate actions; *eg,* voting on shareholder or unitholder resolutions) or the fulfilment of obligations (such as processing the payment of withholding taxes).

These functions are not confined to a "global custodian": they apply to any intermediary in the custody chain.

Asset administration and settlement activities (including delivery of assets in connection with purchases and sales) may have many layers of complexity which are more pronounced in the cross-border setting. These include country-specific law, regulation, and market practices. As a result, a custodian's duties are always affected and/or constrained by local conditions which may arise indirectly, i.e., at the layer of a sub-custodian and / or a CSD. Certain risks therefore are inherent in the investment decision and are not within the control of the custodian. This is an important factor when determining liability for the performance of services, particularly when prudential regulatory authorities have emphasised the importance of such risks not being absorbed into the banking system.[22]

The role of a custodian also may vary due to the broad array of different end investor types. These include regulated and partially regulated investment funds, pension schemes, financial institutions, brokerage firms, sovereigns, insurance companies, trusts, charitable foundations and

[21] There are variations on this, the most notable being the United States and Canada, which treat securities entitlements as a sui generis "bundle of rights" under Article 8 of the Uniform Commercial Code. *See*, Charles W. Mooney, Jr., Sandra M. Rocks and Robert S. Schwartz, *An Introduction to the Revised U.C.C. Article 8 and Review of Other Recent Developments with Investment Securities*, The Business Lawyer, Vol. 49, No. 4 (August 1994), pp. 1891-1906.

[22] *See*, U.S. Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Joint Statement on Crypto-Asset Risks to Banking Organizations, (3rd January 2023). Available at: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230103a1.pdf

endowments, retail investors, etc. The more these requirements vary, the more fragmented the custody model becomes, increasing operational risk and cost due to increased complexities and inconsistencies which weigh against scalability and efficiency.

Institutional investors (who may include investment managers acting with discretionary authority for underlying investors) will appoint custodian banks for a variety of reasons:

- They are mandated by law or regulation to engage the services of a qualified or licensed custodian in order to ensure the safety of the assets.
- They may be required by their underlying clients or by regulation to demonstrate segregation of duties between portfolio management and asset safekeeping.
- They may not have the ability to be a member of the financial market infrastructure (e.g., CCP or CSD).
- They need to have a more effective safekeeping and asset servicing solution than they can provide themselves.
- Operational efficiencies.
- They value the market knowledge and expertise of a custody provider, who may be able to provide access and servicing in multiple jurisdictions and across multiple asset classes.

Taking all of this into account, common principles and operational practices are essential for the efficiency and safety of the provision of post-trade services through the custody chain. These common principles and practices – outlined in the IOSCO's 2015 Standards for the Custody of Collective Investment Schemes' Assets[23] - include segregation of client assets and reconciliation of accounts between intermediaries.[24]

As briefly mentioned above, generally speaking, investor assets that a custodian "holds" as property are not – unlike deposits or personal / contract obligations – subject to claims by creditors of a custodian's insolvent estate. Investors' property interests (rights *in rem*) are therefore expected to be clearly demarcated ("segregated") in the records of the custodian in order to make it clear that no creditors of the custodian, or of any other party on whom the custodian relies to hold such interests on behalf of the investor, can assert claims against them.

A custodian's responsibility for the safe maintenance of financial instruments held-in-custody for its investors has always been addressed by the relevant national and state laws that apply to it. Despite differences in national approaches to custodianship[25], a common denominator is that a custodian is, at a minimum, expected to exercise reasonable skill and care in the **safe custody** of an investor's rights in their asset.

However, an unavoidable consequence of holding financial assets such as book-entry securities on a cross-border basis is that *'no intermediary [a custodian] can provide its account holder with a*

[23] The Board of the International Organization of Securities Commissions, *Standards for the Custody of Collective Investment Schemes' Assets*, Final Report FR25/2015 (November 2015) (the "IOSCO Standards"). Available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf

[24] Other standards include avoidance of conflicts of interest and ensuring the custodian's "independence", adequate disclosure to investors, ensuring adequate appointment criteria for and monitoring of sub-custodians, ensuring adequate enforceable contractual arrangements, etc. Id.

[25] There are five basic holding models for securities: the trust model, the entitlements model, the unshared property model, the pooled property model and the transparent model, each with its own peculiarities. See M. Haentjens, *Harmonisation of Securities Law, Custody and Transfer of Securities in European Private Law* ss 6.3.4–6.3.6 (Kluwer Law International 2007).

legal position that is better than the one it holds itself'[26] and yet *'each applicable law determines autonomously the legal position in respect of the relevant securities, without taking into account the parts of the holding chain which are outside its reach.'*[27] This describes the impact of the so-called *nemo dat* principle, which is unavoidable in the indirect holding system.

[26] P. Paech, *Cross-Border Issues of Securities Law: European Efforts to Support Securities Markets with a Coherent Legal Framework*, prepared for the Directorate General for Internal Policies, Economic and Monetary Affairs (May 2011).
[27] Id.