

## THE ASSOCIATION OF GLOBAL CUSTODIANS

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

19 May 2008

Shri C.B. Bhave,  
Chairman, SEBI  
Plot No.C4-A,'G' Block,  
Bandra Kurla Complex, Bandra(East),  
Mumbai 400051

### Re: Potential T+0 Settlement Pre-payment Requirements for Foreign Institutional Investors

Dear Sir:

We write again on behalf of the members of the Association of Global Custodians (the "Association")<sup>1</sup> with regard to the potential that the Securities and Exchange Board of India ("SEBI") may advance the timeframe for pre-settlement funding to the opening of business on T+0. This change in timeframe for the recently-adopted requirements is scheduled to occur on 16 June and, as with the current funding requirements, apparently would apply to foreign institutional investors ("FII's") as well as other investors participating in the equity markets in India.

We understand that SEBI is beginning to review the issues and complications associated with such a timeframe change. Accordingly, for your consideration, we outline below the operational complications, burdens and risks that a T+0 pre-funding timeframe will impose on global custodians and global cross-border investors.<sup>2</sup> Based

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<sup>1</sup> As you know, the members of the Association provide securities safekeeping services and related asset-servicing functions to cross-border institutional investors, including pension funds, insurance companies and investment companies. Association members, listed on the letterhead above, act as the primary custodian to the vast majority of FIIs that participate in Indian markets.

<sup>2</sup> In our earlier comment letter, submitted on 14 April, we addressed the previously-captioned "margin" requirements as they would affect FII's. Since the date of that letter, the pay-in requirements have been recast as a form of settlement pre-funding.

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on our comments, we respectfully urge SEBI not to advance the pre-funding timeframe to T+0 for FII's.

### Comments.

Our comments are necessarily general in nature, given the absence of procedural detail at the exchange level regarding the precise way T+0 funding operations would work. In addition, the particular problems and risks we outline below are based on an assumption that T+0 pre-funding responsibilities would devolve directly on the custodian(s) for each FII, rather than on the FII's broker.

- Pre-funding in local currency by T+0 will require FII's and their global custodians to effect trades in foreign currency markets to generate the anticipated pre-funding aggregate amount as *early as T-1*. The currency amounts involved for any given day will necessarily be based on trade settlement estimates made on the day before trade execution and, as such, may be materially inaccurate. This risk will be most acute whenever there are significant overnight changes in relevant market prices or significant intra-day volatility on local markets. As a result of the need to provide funds based on estimates, FII's can never be certain whether they will have suitable "working" settlement funds on hand locally for each trading day or whether, on any day, they may fail to fulfill settlement. Dealing with this uncertainty, in turn, will inject inefficiencies and produce higher costs for FIIs and their brokers as well as increased systemic risk.
- Pre-funding of actual transaction settlements by local subcustodians on T+0 will have to be based on *pre-affirmed trade information* -- likely brokers' notes or other preliminary memoranda. This would seem to be the case even if the exchanges accelerate the confirm/affirm processes from the afternoon of T+1 to some time on T+0 (which we understand is being discussed but which may be difficult to achieve in fact given the multiple timezones involved in FII transactions). Brokers' notes or other preliminary, informal trade documents are prone to error, and reliance solely on unaffirmed settlement data generated by the executing broker is not consistent with market standards globally. Indeed, for some FII's, authorization to release settlement amounts prior to a completed confirm/affirm process -- as the T+0 timeframe would appear to require -- may not be permitted under applicable regulations.

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- The foregoing currency-conversion and pre-settlement-funding complications (and the accompanying financing risks) are amplified for the cross-border, global investment community, for which any atypical tightening of the trade-and-settlement timeframes in a particular market has disproportionate impact. By definition, FII's and their money managers are resident in numerous timezones distant from India and the local clearinghouses. Given that reality, providing currency/funding instructions to the FII's global custodian and, in turn, to the relevant local subcustodian in advance of trade execution (or receipt of affirmed settlement reports) presents custodians and FII's with substantial challenges and increased uncertainty and related risk.

These challenges and particular risks will be unique to the Indian markets. As we emphasized in prior comments, the introduction of such special costs and risks may make FII's hesitant to continue to invest actively in India.

- Neither SEBI nor the exchanges have issued clear procedural details and guidelines laying out how T+0 settlement pre-funding operations are to occur.<sup>3</sup> The lack of such detail creates uncertainty for FII's and all parties in the FII servicing chain. In turn, this limits the degree to which intermediaries can establish and test internal procedures or make system investment decisions to appropriately support FII's investment needs.

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<sup>3</sup> We understand that, as one possibility, discussions are underway among brokers to assume responsibility for any required T+0 pre-funding (until T+1) as an offshoot of their customer risk assessment activity; and to cover their financing costs, brokers may well charge higher transaction service fees to FII's. The actual operational details of such broker pre-funding – i.e., how it is structured and carried out -- will determine its relative practicality. In the end, it is possible that such operations will have little actual risk-management value and will simply increase transaction costs in India.

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We appreciate the opportunity to provide you again with the Association's views. If you have questions or would like additional information, please contact the undersigned.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Dan W. Schneider', with a long horizontal flourish extending to the right.

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

Cc: Dr. T. C. Nair,  
Whole-Time Member, SEBI

Susan Olson, ICI