

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

22 December 2009

VIA ELECTRONIC TRANSMISSION

Mr. Mikhail Laufer, President
Depository Clearing Company
Moscow, Russia
E-mail: mikhail.laufer@dcc.ru

Mrs. Maria Ivanova
Director for Development
The National Depository Center
Moscow, Russia
E-mail: ivanovam@ndc.ru

RE: SEC Rule 17f-7 Eligibility

Dear Mr. Laufer and Mrs. Ivanova:

We write on behalf of the members of the Association of Global Custodians ("Association")¹ in response to your communication of October 2009, concerning eligibility issues presented by the status of The National Depository Center ("NDC") and Depository Clearing Company ("DCC") and the services each provides in the Russian markets. Association members appreciate the informational detail and commentary you supplied as well as the substantial effort you expended to provide Association members with your views.

¹ The Association is an informal group of eight global custodian banks that provide securities safekeeping services and related asset servicing functions to institutional investors worldwide, including U.S.-registered investment companies subject to SEC Rule 17f-7 under the Investment Company Act of 1940. Members provide such services to institutions that invest in securities of Russian issuers. Members of the Association are listed on the letterhead above.

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As a general principle, the Russian markets are important to institutional investors, and Association members are very interested in seeing NDC's and DCC's facilities and services and underlying national market legislation evolve so that the Russian markets include full central securities depository entities, regulated as such. Members are also keenly interested in interacting further with you on these issues so as to advance the understanding and identify the needed actions regarding U.S. Securities and Exchange Commission ("SEC") Rule 17f-7 as it applies in respect of NDC and DCC.

The Association's Depository Information Gathering Project Committee ("DIGP" or "DIGP Committee") reviewed and discussed your communication with interest, and the DIGP Committee and the Association wish to convey the following points and views in reply, for your consideration. Once you have had a chance to review this letter and the points conveyed, DIGP Committee representatives would be pleased to confer with you by teleconference to advance the dialogue.

Below we set out members' comments and views in numbered order.

1. **DIGP Role.** The DIGP Plays an Information Gathering-and-Review Role in support of AGC members' Depository Eligibility Decisions and Risk Assessments; Depository Eligibility and Use Determinations as well as Risk Analyses Under SEC Rule 17f-7 are Made by Individual Custodians and their Mutual Fund Clients, not by the DIGP.

- As the DIGP documentation sets out, the DIGP provides a mechanism to gather information about depositories that enables AGC members "to jointly review questionnaire responses in order to determine whether the information provided *permits a determination concerning eligibility*" under the six Rule 17f-7 criteria. The DIGP does not itself make eligibility determinations or ineligibility decisions or publicize DIGP Committee views; members use the information gathered in response to the questionnaire and during the basic DIGP Committee joint review (as well as information collected during members' ancillary due diligence activity) to make their own eligibility determinations and risk assessments, as required under Rule 17f-7 ("the Rule").

2. **Individual Custodian Assessments/Resulting Points to Convey.** AGC members have noted the following issues or concerns about NDC and DCC's limited scope of activities and operations, most evident in relation to settlements and transfers of ownership interests in equity securities. These limitations present challenges to members in making determinations whether either NDC or DCC are "eligible" under the Rule – particularly in relation to

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being, as required, a “system for the central handling of securities or equivalent book-entries” as that phrase is used in the Rule.

- No Legislation-based CSD Mandate. The settlement depositories are not recognized/authorized by legislation as Central Securities Depositories (“CSD”) and thus do not operate within a statutory national system framework and are not subject to standard CSD oversight regulation. The draft Russian law to establish the legal framework for a CSD in the market is still pending. Amendments to the Law On the Securities Market to lift the restriction on entities performing both depository and registrar functions also remains pending.

Local statutory recognition and governmental regulation of NDC and DCC as CSDs would provide a foundation for a market-wide requirement (or a practical convention) that settlements, including OTC settlements, take place through central depository facilities, controls and services. That requirement in turn should enable the settlement depositories to extend their services into the full range of settlement/book-entry transfers that are characteristic of standard market models. Members believe that, absent such recognition, authorization and regulation, a number of market participants will continue not to use or rely on the settlement depositories for custodian-facilitated settlements and transfers of foreign institutional investors’ equity transactions.

- Non-CSD License. DCC’s statement on page 8/15 confirms the limited nature of the settlement depositories’ license (despite the existence of a few, relatively-more rigorous regulations imposed on DCC and NDC as specialized custodians). On that page DCC notes: “the settlement depositories are not legally recognized as CSDs and officially the license of a settlement depository does not differ from that of a custodian...” The limited scope of the license and the corresponding partial regulatory oversight, in members’ view, has not led to robust systemic evolution, and as a result the current configuration of services is materially less than a full central utility system.

- Partial Systemic Evolution. Although the information supplied by NDC and DCC is detailed, neither the spectrum of depository services/risk controls nor the scope of regulatory oversight appear to have evolved to the point where the Russian market reflects a central-system, regulated CSD model. NDC provides mandatory, central settlement and transfer facilities *for government bonds*, and DCC – as noted in the depositories’ comments -- is the “leader in re-registrations in share registers of Russian issuers.” BUT the two settlement depositories together hold shares representing a relatively low percentage of share market capitalization; AND a large number of settlements and transfers following trades in equities for foreign institutional investors

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take place *in fact* between market participants at numerous registrars, external to the services/controls of either DCC or NDC.

> The nature of institutional trade settlement/transfer processes following equity trades is particularly critical to U.S. mutual funds and their custodians given the SEC's Templeton Funds letter compliance requirements, which – in lieu of Rule 17f-7 -- lay out the basic regulatory/control regime funds and custodians must meet and which underscore the central book-entry/finality role played by registrars.

> It continues to be the case that brokers often do not use the depository or its facilities when settling foreign institutional investors' trades in equities. Securities-side settlement between brokers and custodians and re-registration of ownership interests on such trades occur in many cases at the registrars (money-side settlement occurs through banks outside Russia) without the oversight and control of the settlement depositories. In members' view, this set of settlement processes/conventions can only be characterized as "de-centralized".

> When settlement occurs at the registrar, results are reported via a physical "extract" to local custodians and the depositories. The extract is the only evidence that shares have been moved in or out of custodian accounts at the registrar. The extract is essentially a printscreen, which itself lacks legal character and which must be physically transported to the depository for supplemental settlement steps, thereby reducing efficiency and timeliness and increasing transactional risk. Investors have no legal recourse regarding the contents of the extract, and systemic dependence on these documents creates unique (non-standard) legal risk.

> Registrar Service Agreements (RSAs) do exist between the registrars and the local custodians as well as between the registrars and, e.g., DCC; but the wide array of RSAs increase market complexity and impair transparency. In addition, it is not clear whether DCC maintains an RSA with each registrar, nor are the protective provisions within each RSA known. Further, it is not clear what steps DCC takes to monitor registrars and enforce compliance with RSAs. Finally, the absence of an RSA relative to a given registrar can inhibit the custodian's ability to access the registrar's books and records in the event of an audit or a dispute over a shareholding, which can prevent custodians from obtaining disclosure on materially adverse events that affect the registrar's ability to perform its functions.

> Similarly, electronic linkages have been established between DCC and some registrars and between DCC and NDC for some purposes, and these are encouraging steps. However, members note that the links are not mandatory,

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communications protocols are not standard, and the links with registrars do not appear to operate efficiently. Members strongly encourage DCC and NDC to accelerate cooperation with each other and with regulators and registrars toward the establishment of a central-system solution for the handling of equities, including by exploring operational integration or full linkage configurations and by avoiding costly duplication of services for common securities.

- Open Questions Re Finality. Members remain uncertain when settlement of equity trades is treated as final in the following circumstances: (1) when a book-entry settlement occurs at DCC or NDC between two custodians (for example, Citi and ING); (2) when a settlement takes place between a local custodian (for example, Citi Moscow) at DCC or NDC and a foreign custodian (for example, JPMC) at the registry. In those circumstances, members believe the following are unclear:

- The provisions of law which dictate finality of settlement/change of ownership;
- The provisions of law/judicial decisions that control a dispute between DCC or NDC, as applicable, and the registry; and
- The recourse available in the event the registry makes a mistake.

Members invite NDC's and DCC's views and clarifying comments concerning those uncertainties.

3. **Suggested Interaction with Legislators/Regulators, Registrars and Regional CSDs.** The AGC and members fully encourage DCC and NDC to initiate and participate in lobbying initiatives in Russia to cause legislative change that would establish a national clearance and settlement system that includes regulation and oversight of specially-authorized CSDs and that mandates use of CSDs for settlement and book-entry transfers, including via linkages with registrars. Attached is a copy of the Association's 2007 comment letter to Russian regulators describing standard legislative objectives on this subject and preferred systemic elements.

Members also encourage dialog between the settlement depositories and regional CSDs concerning experiences and best practices in securities handling. That dialog seems likely to assist NDC and DCC in advancing their regional leadership positions.

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4. **Service-specific Points.**

- DCC -- ESSS Issues. Members have noted a new development at DCC for handling securities – the Enhanced Speedy Settlement Scheme (ESSS), also called the settlement bridge. The ESSS settlement procedure is based on the use of a DCC account on the books of the local custodian banks for internal settlements on those custodians' books, i.e., settlement between relevant investor accounts and the account of DCC, for further credit to the counterparty's account at DCC.

DCC's decision to maintain, via these ESSS conventions, shares purchased by its participants but registered in the nominee name of the custodian bank (rather than re-registering the shares into DCC's nominee name on the books of registrars), calls into question DCC's ability to maintain and control the integrity of its participants' records of ownership and ensure finality of settlements. Among other confusing outcomes under these ESSS conventions, at any one time the assets held at DCC by its participants may be registered at the company registrars not in DCC's name, but in the names of the local custodians who participate in the ESSS scheme. Such outcomes run counter to standard nominee ownership recordation/finality of settlement conventions.

- DCC Settlement is Not Truly DVP. Although DCC has taken steps to support DVP settlements, such as US dollar (USD) DVP settlement via DCC, these initiatives do not meet international best practices, which define DVP transactions as the simultaneous, linked transfer of securities and cash. DCC is the only depository where a participant's direct client must have a cash account under the control of the depository, which creates a unique and fundamental risk for custodians managing cash on behalf of clients.

* * * * *

We appreciate your interaction with the Association and members. DIGP Committee members stand ready to discuss with you the foregoing comments, the underlying issues, and any replies you wish to make, when convenient for you. To

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arrange a phone conference, please contact the undersigned at 312.861.2620 as an initial matter.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Dan W. Schneider". The signature is fluid and cursive, with a prominent initial "D" and "S".

Dan W. Schneider

Baker & McKenzie LLP

Counsel to the Association

ATTACHMENT

CC: Natasha Sidorova, ING Bank

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BAKER & MCKENZIE LLP
815 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20006

TELEPHONE: 202/452-7000
FACSIMILE: 202/452-7074

WWW.THEAGC.COM

March 29, 2007

Mr. Oleg Vyugin
Head of the Federal Financial Markets Service
9, Leninsky Prospect
119991 Moscow,
Russia

Re: Draft Russian Legislation to Enhance the Central Role of Securities
Depositories in Settling Transactions in Russian Equity
Securities

Dear Mr. Vyugin:

We write to you on behalf of the Association of Global Custodians (the "Association"), an informal group of ten global banks that provide securities custody and related services to cross-border institutional investors.¹ Association members provide such services to a significant portion of the foreign institutions that actively invest in the equity securities of Russian issuers.

The Association wishes to convey members' appreciation and support for the positive legislative steps now being taken in Russia to enhance the role of central securities depositories in providing safe and efficient settlement services and facilities for all transactions in Russian equity securities. Currently, Association members, working with their Russian sub-custodians, facilitate settlements of client transactions in equity securities through the existing decentralized registry facilities; and based on that experience, members have great interest in the efforts of Russian authorities to strengthen the role, legal integrity, and operational reliability of centralized depository settlement for all such transactions.

¹ The member banks of the Association are listed on the letterhead above.

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We understand that legislation is being drafted for upcoming Parliamentary consideration that will promote final book-entry settlement and transfer through a unified, efficient central depository system for equity securities. We also understand that the legislation will envision an interim period of four years during which there may be more than one securities depository for equities in Russia. We further understand that such depositories will continue to operate separately while moving toward consolidation into one automated and efficient centralized facility.

Although Association members believe that a single central depository for equity securities per jurisdiction provides market participants and investors with the optimal basis for settlement efficiency and safety, we understand the need in Russia today to maintain multiple depositories for an interim period. However, because a multi-entity structure requires multiple points of access for market users and requires users to depend on different entities, it is important even during the multi-entity transition period to ensure that certain basic systemic features exist.

In this regard, we believe it particularly important that the central depositories for equity securities employ common standards that facilitate coordinated and efficient transaction settlement and ownership entitlement transfer. In this connection, we recommend:

- compatibility of depositories, including common settlement timeframes for both depositories;
- common settlement processes and suitable interfaces at each depository for market participants;
- common standards and methods for the distribution of corporate entitlements;
- common protective mechanisms, such as credit lines and debit caps, to manage participant default risk;
- common fee structures insofar as possible;
- effectively linked, automated facilities if the depositories service the same issues of securities; and

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- use of common clearing banks in the settlement process, and preferably settlement in central bank funds.

In addition, we strongly recommend that the legal power to effect changes in ownership by bookkeeping entry at the central depositories for equities be identical and that those powers, and the respective rights of entitlement holders, be legally certain and binding.

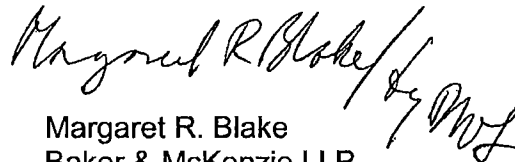
Finally, Association members wish to point out that under United States securities laws, US-registered investment companies investing in securities in non-US jurisdictions and holding their assets with a foreign depository must evaluate and monitor the depository to ensure it qualifies as an "eligible foreign depository" under the applicable US laws. A number of strict operational and legal elements affect those evaluations, and Association members customarily assist their investor-clients in understanding those requirements. Accordingly, consistency at all the depositories in operations and settlement practices will meaningfully assist custodians, acting on behalf of their investor-clients, in fulfilling those responsibilities.

We appreciate the opportunity to offer comments at this important stage in the evolution of Russian market infrastructure. If you would like further information, please contact either of the undersigned.

Sincerely yours,



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



Margaret R. Blake
Baker & McKenzie LLP
Counsel to the Association