



18 June 2010

Ric Wilding
Client Assets Policy
Prudential Banking and Investment Business Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Mr Wilding,

RE: CP10/9: Enhancing the Client Assets Sourcebook

The Depository and Trustee Association (DATA) represents all depositaries and trustees of UK based authorised unit trusts and open-ended investment companies. At the end of April 2010, the members of DATA were responsible for safeguarding £510.9 billion of funds under management.

DATA welcomes the opportunity to comment on the abovementioned FSA consultation paper.

Our comments focus on the issues we have identified with the proposal to create a rule that prohibits using general liens over client assets which are held under custodian agreements.

If you have any questions, please do not hesitate to contact me or our Company Secretary, Karen Bowie.

Yours sincerely

David Morrison
DATA Chairman

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Q13: Do you agree that we should introduce a rule prohibiting the use of general liens in custodian agreements and amending existing guidance to clarify our requirements?

Whilst we agree with the consultation proposal to permit the ability for a lien covering the custodian's charges that relate specifically to those client assets, we also feel that there are other circumstances where lien's should be permitted.

Traditional custody documentation often describes the interest of the custodian as a lien. A contractual lien confers a right to retain possession, but not a right of sale. The custodian may use the ability to create a lien for commercial reasons as described below, which in turn generates benefits which are in the unitholders best interests as they result in significantly reduced operating costs for the fund.

The ability to have a right of lien over custody assets is also a useful tool in mitigating credit risks which might arise from the client/custodian relationship in certain scenarios also discussed below.

Circumstances where a credit facility is offered:

Contractual settlement

One of the major services performed by a global custodian is the settlement of client transactions, including the delivery of assets out of the custody portfolio when the client or its agent instructs.

It is common practice for Custodians to offer contractual settlement against trades where clients can be assured of their proceeds on settlement date, regardless of whether the trade has actually settled in the market.

As part of this service offering, the Custodian retains the right to reverse those proceeds should the trade fail to settle within a reasonable period. It would be unfair, not to mention commercially unviable, to remove the Custodian's right of recourse over the return of cash (provided by means of a credit facility) in this type of scenario.

The benefit of contractual settlement is that it facilitates 'straight through processing' where client instructions are implemented automatically (subject to sufficient checks and control mechanisms). At a commercial level the client expects their transactions to be promptly settled.

The benefits to be derived from STP are well known. It minimises the need for human intervention, which slows down the settlement cycle and is the chief cause of delay in transaction processing due to erroneous data entry. STP avoids the need for the same instructions to be recorded again and again, sometimes incorrectly. Automated end to end processing is vital if the industry is to be able to meet the increased demand for cross-border investing and utilisation of complex investment strategies. STP is needed not only to accommodate rapidly growing trade volumes, but to deliver shorter settlement cycles, as well as helping to reduce operational risk.

Assured income payments

In the same way that Custodians offer contractual settlement for trades they can also offer contractual income/dividend payments to their clients for certain investments and markets. In circumstances where assured income payments are offered, Custody Agreements may reserve the right to reverse those payments from the client's accounts if the actual income payments are not received within a certain timeframe.

Overdraft arrangements

A global custodian's credit policy may require that uncollateralised exposures to the client above a certain limit should be assessed by senior staff before they are incurred. The right of a lien over custody assets in practice allows for a significantly reduced debit interest rate for the client along with other commercial benefits, which if removed, could significantly increase the cost of any such credit facilities. Again this could impact on the client's ability to manage their portfolio as part of an efficient cash management process, as well as restricting their ability to pass on cost savings to their own underlying clients.

Provision of credit lines in other circumstances

There may also be other instances where it is reasonable to have the right to a lien over assets such as a short term credit arrangement for the purchase of a property (immovable). Without the ability to protect itself in the event of a default, a custodian's fees would need to be much higher, meaning additional costs being passed onto underlying unitholders.

Whilst we have detailed various scenarios above which we believe provide benefits to unitholders we stress that any lien applied should only allow recourse to fund assets, rather than those more generally held within a global custody or omnibus account on behalf of someone else. The lien should also only be granted in circumstances that do not contravene local law or regulation.

Q14: Do you think that we should go further and prohibit all liens in custodian agreements?

No, please see comments above.

Q15: Do you foresee any unintended consequences in implementing this proposal?

Yes, please see our comments above.