

THE ASSOCIATION OF GLOBAL CUSTODIANS

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May 29, 2012

Elizabeth M. Murray
Secretary
Securities and Exchange Commission
101 F Street, NE
Washington, DC 20549-1090

RE: Release No. 34-66984; File No. SR-DTC-2012-03: Post-payable Adjustments and Payments Reversals; the Need for Payments Finality

Dear Ms. Murray:

We write on behalf of members of the Association of Global Custodians (the "Association") to express members'¹ concerns -- and likely those of intermediaries generally -- regarding specific elements of the proposed rule change captioned above (SR-DTC-2012-03), which takes a first step toward redressing the serious and growing problems of issuers' and paying agents' post-payable adjustments of payments that were made through DTC's facilities to investor clients of DTC's participants, notably global custodians and other intermediaries. As part of the Association's comments below, we identify *modifications to the rule filing that we believe are necessary pre-conditions to approval* of DTC process changes in this area. Members understand from recent discussions with DTC representatives that DTC is prepared to develop amendments along the lines suggested herein, including amendments based on needed industry consultations around the problems with, causes of, and optimal process solutions to payments adjustments.

Association members appreciate DTC's recognition of the considerable credit risk that increasing numbers of payment adjustments impose on securities processing agents, including global custodians. However, as members have discussed with officers of DTC, the changes proffered in DTC's proposed rule change would extract DTC from its current role as the central market infrastructure that facilitates adjustments, would do so in an overly-aggressive shortening of the allowed adjustment timeline, would do so without providing needed room for

¹ Association members provide safekeeping and asset-servicing functions to institutional cross-border investors, and in that capacity members are very substantial users of DTC's services. As of mid-year 2011, members informally reported an aggregate global assets under custody in excess of US\$ 82 Trillion safekept in more than an average of 87 global jurisdictions per member. Association members are listed on the letterhead above.

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participant approvals of specific late reversals, and would do so without taking steps to reduce paying agent mistakes.

Background: the Problems Created by Adjustments. The Association meets regularly with officials of the DTCC to review and comment on its development plans and to table issues or suggestions that will increase efficiency or decrease risk in the securities processing industry. As DTC's filing suggests, Association members have reviewed with DTCC on several occasions the substantial risks that reversals/adjustments of principal or interest/cash dividend payments place on intermediaries.

In members' view, too many payment errors are made and too many payment errors are discovered long past payment date. Indeed, under DTC's current procedures, post-payable adjustments, which can be tendered by issuers or their paying agents up to one year following the initial payment, create significant credit exposure -- large cash sums are debited, first against intermediaries at DTC, and then against customers' accounts at intermediaries. Although these reversals are designed to correct misdirected or misapplied payments, there is a significant possibility -- in any given case -- that a custodian's underlying customer will not have the funds available to effect the reversal/repayment. Of greater risk, particularly as time elapses, is the likelihood that the institutional customer who was paid incorrectly is no longer a client of the given custodian or has dissolved. In today's market context, the credit exposure can involve very significant dollar amounts, and in today's global risk context it is not acceptable to require intermediaries to simply absorb the financial loss created by issuers and paying agents' mistakes.

Not only are *the financial amounts* involved in adjustments significant; *the volume of adjustments* are expanding, not declining. The Association understands from DTC informally that there has been a dramatic increase in the number of adjustments since 2010. The volume of adjustments -- for structured securities alone -- that are processed by DTC tripled from 3,957 in 2010 to 14,855 in 2011, and doubled again (on a quarterly basis) to reach 8,237 in the first quarter of 2012. In addition, the percentage of adjustments beyond 60 days increased from a 60% rate in the fourth quarter of 2011 to over 80% in the first quarter of this year.

The Problematic Elements of DTC's Proposal; Recommended Amendments. When the Association initially requested DTCC, together with other large market infrastructures (notably Euroclear and Clearstream), to consider changes to existing adjustments practice, members proposed the following admittedly-aggressive payment adjustments principles: for any adjustment that is tendered "materially late", there should be an opportunity for depository participant review and a two business-day interval for participants to approve or reject the reversal (or portion(s) of a reversal) where the payment(s) cannot be recovered from the payee(s). Under the Association's proposal, an adjustment of a principal payment would be materially late when tendered to DTC more than 2 business days after the initial payment, and an adjustment of interest or cash dividends would be materially late when tendered more than 7 days after payment date.

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Under that proposal, in cases where reversals are in fact rejected, none of DTC, other CSDs, or any downstream agent, would be subject to financial risk. Rather, the party that made the payment mistake would – appropriately in members' view -- suffer the financial risk.

The Association recognizes that its proposed timeline allowances are much shorter than the 60-days-from-payment-date that DTC proposes. In that respect, DTC's proposal seems a moderate first step. However, the end-objective timeline is only part of what is needed to create effective, workable change.

In the Association's view, industry-wide review and assessment of the overall payment adjustments process is most likely necessary to provide a basis for optimal solutions for all involved parties. Given that likelihood, members have recommended to DTC that it form an industry working group to review the various causes of reversals, identify the adjustment metrics for each type of cause, consider an agreed, graduated collapsing of the allowable adjustment timeline, and design a plan for DTC to administer a suitable "adjustment claims repository".

As noted at the outset of this comment letter, DTC's rule filing proposals at present do not encompass industry-coordinated review of best ways to correct a market-related problem, and its current proposals would transform the DTC-centered adjustment process into a process where agents initiate a rapidly growing number of income claims directly against intermediaries to recover funds. Industry review of class-action claims administration confirmed that a claims process is human resource intensive, time consuming, and itself error prone. By transforming adjustments handling – bad as it is at present -- into claims processing, DTC's current proposal will dramatically increase the volume of claims in the market, driving up costs for processing agents and ultimately delaying resolution of the errors and proper payments to the entitled investors. Those effects of the rule proposal do not seem likely to serve the rule design requirements applicable to clearing agencies under Section 17A (b)(3)(F) of the Securities Exchange Act.

In view of the foregoing, members have strongly encouraged DTC to reconsider the terms of its proposed rule change in this matter and -- prior to finalizing changes to its adjustment procedures and timelines -- engage the industry, including paying agents and processing agents, to review the current situation and analyze the root causes of payment errors. That review should include seeking industry consensus on best ways to amend those errors that cannot be avoided (due perhaps to judicial orders, etc), and best disciplines to reduce the number of errors and adjustments that can be avoided. To ensure that those elements are effectively introduced into the transition from current procedures to optimal methodology, the Association recommends that the Commission request suitable amendments to the rule change prior to approving it and/or condition approval on stated transition steps, including the following, as identified in this letter: (a) industry-based review and assessment of errors and solutions; (b) creation of a graduated reduction in the timeframe for allowable adjustments, phasing down eventually to those the Association initially proposed; (c) opportunity

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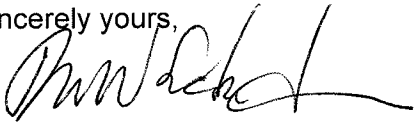
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for DTC participant review and rejection of late adjustments; and (d) inclusion of a DTC-centered form of "adjustment claims repository", particularly in respect of claims where it is no longer feasible for the relevant intermediary to effect a reversal from the original investor-payee.

* * * *

The Association appreciates the opportunity to provide the Commission with members' views on SR-DTC-2012-03, including members' concerns regarding DTC's current proposal and members' recommended amendments. Members believe that further industry discussions, under DTC's auspices, should lead to the best achievable set of solutions, including a new service role for DTC in intermediating adjustment claims that would automate the process to the benefit of all parties.

Sincerely yours,



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