

**PUBLIC**

4 AUG 1994

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 93-751-CC  
The Canadian Depository  
for Securities Limited  
File No. 132-3

Your letters of November 15, 1993 and August 3, 1994 request our assurance that we would not recommend enforcement action to the Commission under Section 17(f) of the Investment Company Act of 1940 ("1940 Act") if The Canadian Depository for Securities Limited ("CDS") 1/ serves as an eligible foreign custodian for registered U.S. investment companies under subparagraph (c)(2)(iii) of Rule 17f-5. 2/

You represent that CDS is the major securities depository and clearing corporation in Canada. 3/ You also represent that CDS is the only national securities depository and clearing corporation in Canada. CDS participants include broker-dealers, banks, trust companies, credit unions, insurance companies, and other financial institutions. CDS delivers services to its participants through a branch network with locations throughout Canada. Each branch provides, among other things, a securities clearing center as well as custodial and vaulting services. Participation in the clearing services is elective, and participants may choose only to use CDS's depository services. Participation in the depository is mandatory, however, for participation in the clearing services.

CDS is the exclusive depository and clearing agency for (1) equity securities traded on the Toronto and Montréal exchanges, (2) securities traded over-the-counter across Canada, (3) corporate and government debt securities traded across Canada, (4) new issues of Government of Canada bonds during their primary distribution period, and (5) government and corporate

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1/ CDS is a private business corporation established in 1970. Its shareholders include Canada's six major banks, four major trust companies, and certain broker-dealers.

2/ Section 17(f) governs custodial arrangements for investment company assets. Rule 17f-5 under the 1940 Act permits a registered management investment company to deposit foreign securities in the custody of an "eligible foreign custodian." Rule 17f-5(c)(2)(iii) defines the term "eligible foreign custodian" to include "a securities depository or clearing agency, incorporated or organized under the laws of a country other than the United States, which operates the central system for handling of securities or equivalent book-entries in that country."

3/ The value of securities on deposit at CDS on November 1, 1993 was CAN \$594.2 billion.

bond residues and coupons stripped physically or by record-entries traded, reconstituted, or repackaged in Canada. CDS also has developed and currently is implementing Canada's only on-line, real time depository and same day clearing and settlement service for marketable government debt, corporate debt, and money market instruments. With respect to securities traded on the Vancouver and Alberta exchanges, CDS and the West Canada Depository Trust Company ("WCDDTC") both serve as depositories. 4/

The Ontario Securities Commission and the Commission des valeurs mobilières du Québec regulate CDS. Recognition as a clearing agency by these securities commissions is required to conduct securities clearing and depository activities in these jurisdictions, and validate securities transfers and pledges effected by record-entries at a clearing agency. Recognition is not required in the jurisdictions of Alberta and British Columbia. Similarly, although the Canadian federal government does not regulate securities trading or clearing agencies, CDS has entered into a federal oversight agreement with the Bank of Canada, the central bank. Under the agreement, CDS will provide information of a regulatory nature to the Bank of Canada and abide by directives of the Bank of Canada required to reduce systemic risk in securities clearing and settlement systems.

You point out that CDS is the only securities depository and clearing agency in Canada with which a Canadian custodian of mutual funds may deposit securities. In addition, you state that, under Canadian federal regulations, CDS is authorized specifically to act as prescribed custodian of securities for federally incorporated financial institutions such as banks, trust and loan corporations, insurance companies, and pension funds.

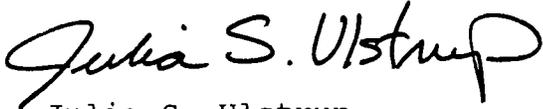
You state that physical securities on deposit with CDS may be held under contract by certain external custodians approved by CDS's board of directors. A registered U.S. investment company must maintain its assets with a custodian that is qualified under Section 17(f) or the rules thereunder, including Rule 17f-5 ("qualified custodian"). Consequently, to the extent that an external custodian holds the securities of a registered U.S. investment company on deposit with CDS, the external custodian also must be a qualified custodian under the 1940 Act and its rules.

On the basis of the facts and representations in your letters, we would not recommend that the Commission take any enforcement action under Section 17(f) if CDS serves as an

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4/ The value of securities on deposit at WCDDTC on November 5, 1993 was approximately CAN \$8 billion. Telephone conversation with Toomas Marley on August 2, 1994.

eligible foreign custodian for U.S. registered investment companies. 5/ You should note that any different facts or representations might require a different conclusion. Moreover, this response expresses the Division's position on enforcement action only and does not express any legal conclusions on the issues presented.



Julia S. Ulstrup  
Senior Counsel

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5/ We note that CDS was cited in the original proposing release for Rule 17f-5 as an example of the type of foreign securities depository intended to be covered by the Rule. Investment Company Act Release No. 12354 (Apr. 5, 1982) n.51.



THE CANADIAN  
DEPOSITORY FOR  
SECURITIES LIMITED

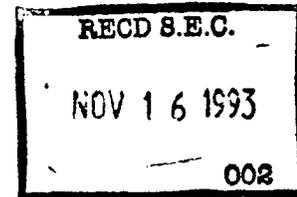
85 Richmond Street West  
Toronto, Ontario  
M5H 2C9

1940 Act/Rule 17f-5(c)(2)(iii)

15 November 1993

ACT IEA of 1940  
SECTION \_\_\_\_\_  
RULE 17f-5(c)(2)(iii)  
PUBLIC \_\_\_\_\_  
AVAILABILITY 8/4/94

Thomas S. Harman, Esq.  
Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
Washington, D.C. 20549  
United States of America



Dear Mr. Harman,

We are requesting your Division's assurance that it will not recommend that the Securities and Exchange Commission take any enforcement action for non-compliance with Rule 17f-5(c)(2)(iii) under the Investment Company Act of 1940, as amended (the "1940 Act"), should we act as a foreign custodian of assets of investment companies registered under the 1940 Act.

We believe that, by operating the central system for handling of securities or equivalent book-entries in Canada, we meet the requirements of the above noted Rule and, therefore, would be permitted to act as an "eligible foreign custodian".

We note that in your Commission's Investment Company Act Release No. 12354, at note 51, CDS was cited as an example of the type of securities depository intended to be exempted by the Rule as originally proposed.

**1. Description of CDS:**

***Corporate affairs:***

The Canadian Depository for Securities Limited, or CDS, is the major securities depository and clearing corporation in Canada. We are a private business corporation, incorporated federally in 1970 under the Canada Corporations Act and continued in 1980 under the successor Canada Business Corporations Act.

Our shareholders are Canada's six major banks, four major trust companies and broker-dealers through the Investment Dealers Association of Canada, The Montréal Exchange and The Toronto Stock Exchange. Each of the bank group, the trust group and the broker-dealer group owns one-third of our issued common shares.

Our Board of Directors comprises our Chairman and Chief Executive Officer, our President and Chief Operating Officer, three representatives of each of the three owner groups, and two independent directors. Quorum at meetings of the Board of Directors requires at least one representative from each of the three owner groups.

Eligible Participants are not required to be our shareholders provided they meet our qualifications and standards, equally applicable to shareholder Participants.

***Regulation:***

We are regulated by the Ontario Securities Commission and by the Commission des valeurs mobilières du Québec pursuant to the Securities Acts in these jurisdictions. Recognition as a clearing agency by these Commissions is a pre-requisite (a) to conducting securities clearing and depository activities in these jurisdictions, and (b) to validate securities transfers and pledges effected by record-entries at a clearing agency. Recognition is not required in the jurisdiction of Alberta and British Columbia but CDS also reports to their securities commissions as though they regulated CDS.

Although the Canadian federal government does not regulate securities trading or clearing agencies, we also cooperate with the federal Office of the Superintendent of Financial Institutions as if it were our regulator, because many of our Participants, namely banks and trust companies, are regulated by this federal authority. Under federal regulations, we are specifically authorized to act as prescribed custodian of securities for federally incorporated financial institutions such as banks, trust and loan corporations, insurance companies and pension funds. In order to maintain our good standing as a prescribed custodian, CDS files with this federal regulator all that is required under the securities acts and by the securities commissions' staff of Ontario and Québec.

Under section 7.01(9) of National Policy 39 - "Mutual Funds" of the Canadian Securities Administrators, applicable throughout Canada, we are the only securities depository and clearing agency in Canada with which a Canadian custodian of mutual funds may deposit securities.

Pursuant to Part XIII of The Toronto Stock Exchange By-laws, all trades made at sessions of the Exchange must be settled through us. Equally under Rule 6021 of the Montréal Exchange, all equity transactions effected on the Exchange floor must be cleared and settled in accordance with our rules and operating procedures.

In addition, pursuant to the uniform settlement rule of The Montréal Exchange Rule 10, The Toronto Stock Exchange By-law 11.58 and the Investment Dealers Association of Canada Regulation 800.31, deliveries of securities to effect settlement of institutional securities transactions must be made through a recognized securities depository, such as CDS.

***Depository and Clearing Services:***

We perform clearing and depository services for our Participants. There are at present, 100 Participants of CDS: 65 broker-dealers, 15 banks, 15 trust companies and 5 other financial institutions. CDS' Participants, because of their diverse nature, service a wider range of investors in extensive ways. For example, the non-broker-dealer Participants act as custodians and settlement agents for their own clients who are other financial institutions like insurance companies, mutual funds, foreign banks, clearing corporations and depositories.

Our services are delivered through a branch network with locations in Montréal (Québec), Toronto (Ontario), Calgary (Alberta) and Vancouver (British Columbia). Each branch provides a securities clearing centre, custodial and vaulting services, Participant support and a facility to distribute Participant reports.

Participants may utilize only the depository services as their participation in the clearing services is elective. However, participation in the depository is mandatory for participation in the clearing services.

Our clearing services include: (a) trade reporting, reconciliation and confirmation (matching); (b) clearance of trades by the trade-for-trade system or the continuous net settlement system; (c) settlement twice daily in certificates or by record-entries in the depository account; (d) settlement of transactions in new issues during the distribution period prior to closing date, and (e) various support services not relevant to this

request.

Depository services consist of: (a) custodial services: deposits, withdrawals and segregation and safekeeping sub-accounts for segregating client securities; (b) record-entry transfers, pledges and deliveries of securities; (c) ledger reconciliation and ledger balance reporting; (d) on-line real time Participant access from their in-house terminal to their CDS accounts for inquiries and to effect pledge transactions; (e) securities entitlements processing and information services; (f) armoured courier services across Canada and the United States of America; and (g) the link with West Canada Depository Trust Company in Vancouver discussed on the last page of this letter, the inbound links from Japan Securities Clearing Corporation and the Nominee Amsterdam Stock Exchange N.V. for custody of their Canadian securities, and the outbound links to the SICOVAM, Euroclear and Cedel and to The Depository Trust Company, through sponsorship by National Securities Clearing Corporation. We have applied for direct membership in DTC to service our institutional Participants who only use the trade for trade system to clear their trades effected by their United States representatives.

***Contractual relationship:***

The respective obligations and rights of CDS and our Participants are all contained in what is defined as the "Legal Documents". They comprise (a) the common form Participant Agreement, signed by a Participant and CDS upon acceptance of its application to become a Participant; (b) the Service Rules which are subject to approval by our Board of Directors and by CDS' regulatory authorities, after notification to Participants for review and comments during a thirty-day period; and (c) operational Procedures for each service, subject to the review and recommendations of the Operations Advisory Committee appointed in accordance with the direction of the Board of Directors.

The following provisions of our Services Rules are particularly relevant to this request:

- (a) securities are held by CDS as a nominee for Participants and subject to their instructions;
- (b) fully paid securities in Participants' depository accounts are not subject to any right, charge, security interest, lien or claim of any kind in favour of CDS or its creditors, not even for CDS' fees and charges;
- (c) Participant information can be released by CDS to the Participant's regulator, and to its auditors when reasonably required to perform their duties;
- (d) CDS gives Participants written notice of a material reduction in the amount or coverage of its insurance. Insurance policies are at all times open to Participant inspection;
- (e) a "debit ring" provides that where lost securities would exceed our insurance coverage, we may allocate the loss by pro-rata debits to all Participants having a position in the same security. Participants may claim their portion of the allocated loss against their insurance; and
- (f) CDS' liability for loss is limited to the extent that such a loss can be recovered from our insurers, couriers, custodians or any other responsible party.

**2. Protection of assets in custody:**

The protection of securities on deposit at CDS results from a combination of factors: a security and controls programme, adequate insurance coverage, and our performance in depository services.

We have a comprehensive programme of security and controls in all our services. The following ones, in place to safeguard assets in our custody, are relevant to our depository services:

- (a) securities deposited for custody are registered in CDS' nominee name (CDS & CO.) and must be re-registered into the name of the Participant or its client prior to withdrawal, as CDS certificates are not released in endorsed form;
- (b) physical securities on deposit with us are kept in various locations in vaults of the highest rating; or they are held under contract by approved external custodians meeting CDS' financial, physical security and internal controls standards that are approved by the Board of Directors. Our custodians must assume full liability for any loss of securities.
- (c) an automated certificate inventory management system tracks movements and location of certificates and is balanced daily to total ledger positions and discrepancies are resolved;
- (d) bi-monthly and annual independent physical counts of certificates, and reconciliation to Participant's ledgers occur under the supervision of our internal and external auditors;
- (e) certificates lodged with external custodians are balanced with internal monthly reports and independently confirmed by auditors at least annually;
- (f) reports are provided twice daily, once weekly and monthly to Participants to allow them to verify by negative confirmation the accuracy and completeness of their securities transactions and positions;
- (g) month-end ledger balance reports are verified by random positive confirmation with Participants as part of our annual audit;
- (h) access to depository system and data is restricted to authorized users;
- (i) depository systems and data are maintained and backed-up daily for recovery purposes, at our site by us and at a remote location by a reputable vendor of computer services.

This programme is supervised by four external and internal groups and professionals addressing risk management:

- (a) our Corporate Security Division, which reports to the President and Chief Operating Officer, works with all levels of management to focus attention on the identification, implementation and monitoring of processing controls, and is responsible for the physical security, employee screening and bonding, logical security, data backup, insurance coverage, disaster recovery and business resumption;
- (b) our Internal Audit Department, which reports to the Chairman and Chief Executive Officer, performs an ongoing audit and appraisal of our operations, activities, assets in custody, records and computer systems;
- (c) our external auditors, Peat Marwick Thorne, report yearly on (1) CDS' ledger balance positions, (2) depository systems control procedures and (3) clearing systems control procedures, all in accordance with the guidelines of Section 5900 on "Opinions on control procedures at a service organization" of the Canadian Institute of Chartered Accountants Handbook. This section 5900 enables our Participants' auditors to render their opinion by relying on those reports of our external auditors; and

- (d) the Audit Committee of our Board of Directors, comprised of four directors who are not officers or employees of CDS, reviews all annual and interim financial statements and the risk reduction and insurance programmes. It must be satisfied that assets of Participants are safeguarded. Corporate Security and Internal Audit report to the Committee at its regular quarterly meetings.

The value of securities on deposit with us as at the opening of business on Monday, November 1, 1993 was CAN \$594.2 billion.

Our financial institution bond insurance coverage is currently set at CAN \$200 million. Since the inception of our depository services in 1981, there have been 59 instances requiring the replacement of lost certificates. Although certificates were lost in transit, in transfer envelopes or in the course of transfer and not in our custody, we assumed their replacement as a service to our Participants. None of the losses have had any impact on our Participants and have not impeded the normal course of our operations or services. We have not experienced a single loss of securities since 1991.

During our fiscal year of November 1, 1992 to October 31, 1993, we have processed CAN \$32.4 billion in dividends and interest which we paid on time 99.66% of the time.

By owning and operating our own data centre, we have the resources and latitude to respond at our pace to situations that may not be considered as emergencies or high priorities by an independent provider of computing facilities.

### **3. CDS as "Eligible Foreign Custodian":**

Rule 17f-5(a) provides that a United States investment company registered under the 1940 Act

"may place and maintain in the care of an eligible custodian the company's foreign securities, cash and cash equivalents in amounts reasonably necessary to effect the company's foreign securities transactions....".

Rule 17f-5(c)(2)(iii) defines an "Eligible Foreign Custodian" as:

"A securities depository or clearing agency, incorporated or organized under the laws of a country other than the United States, which operates the central system for handling of securities or equivalent book-entries in that country."

We are Canada's only national securities depository and clearing corporation, having offices and clearing centres in all Canadian cities where there is a stock exchange: Vancouver (Vancouver Stock Exchange), Calgary (The Alberta Stock Exchange), Toronto (The Toronto Stock Exchange) and Montréal (The Montréal Exchange).

We are the exclusive depository and clearing agency for:

- (a) equity securities traded on the Toronto and Montréal exchanges, where 75% of the securities listed are industrials;
- (b) securities traded over-the-counter across Canada;
- (c) corporate and government debt securities traded across Canada;
- (d) new issues of Government of Canada bonds during their primary distribution period; and

- (e) government and corporate bond residues and coupons stripped physically or by record-entries traded, reconstituted or repackaged in Canada.

We have developed and are currently implementing Canada's only on-line, real time depository and same day clearing and settlement services for marketable government debt, corporate debt and money market instruments.

The clearance of trades in equity securities on the Vancouver and Alberta exchanges, where the majority of listings are junior mining and oil and gas, is fulfilled exclusively by West Canada Clearing Corporation ("WCCC"). Clearance of trades in bond options, equity options and stock index options is fulfilled exclusively by Trans Canada Options Inc. However, we are a depository for securities traded on these two exchanges, and our facilities are fully integrated with the specialized functions of those other clearing agencies: through our links with these clearing agencies and the other depository in Canada, West Canada Depository Trust Company ("WCDTC"), our Participants can settle those exchange trades and their exercised options from and to their securities accounts with us.

The following figures may help you in your assessment of CDS. WCCC - WCDTC have 75 members, mainly broker-dealers, some trust companies and credit unions. WCCC settles approximately 10,000 trades per day valued at CAN \$40 million before netting; the value of securities on deposit at WCDTC is currently CAN \$8 billion. Meanwhile CDS settled over the last fiscal year a daily average of 39,000 trades valued at CAN \$40 billion before netting. At our Vancouver and Calgary branches the values of securities on deposit are CAN \$17.6 billion and CAN \$8.7 billion respectively.

We are the only depository and clearing agency in Canada whose Participants base is all encompassing and includes broker-dealers, banks, trust companies, credit unions central, insurance companies and other financial institutions.

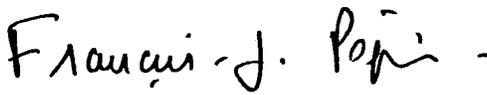
We therefore operate the only central system for handling securities or equivalent book-entries in Canada, for the entire Canadian securities industry community and for the ultimate benefit of a greater variety of investors.

In view of the foregoing, we would appreciate your acceding to our request.

Should we have provided you additional information, please do not hesitate to write to or call the undersigned at (416) 365-8598.

Yours truly,

THE CANADIAN DEPOSITORY FOR SECURITIES LIMITED

  
François-J. Pépin  
General Counsel  
and Assistant Secretary

FJP:jnf



THE CANADIAN  
DEPOSITORY FOR  
SECURITIES LIMITED

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By Facsimile  
(202) 504 2395

August 3, 1994

Ms. Julia Ulstrup  
Senior Counsel  
Division of Investment Management  
Securities and Exchange Commission  
Washington, D.C.  
20549 U.S.A.

Dear Ms. Ulstrup:

**Re: Investment Company Act of 1940**  
**Rule 17f - 5 (c) (2) (iii)**

This letter will confirm our telephone conversation from this morning wherein I provided to you updated information in respect of the regulation of CDS.

At the time of our original submission on November 15, 1993, CDS had been involved in the negotiation of a federal-provincial memorandum of understanding involving the federal Office of Superintendent of Financial Institutions and the Securities Commissions in the four provinces in which we have branches, Alberta, British Columbia, Ontario and Quebec. (The Ontario and Quebec Securities Commissions have regulated CDS since 1981 and 1984, respectively, pursuant to the terms of the Securities Acts of each province.)

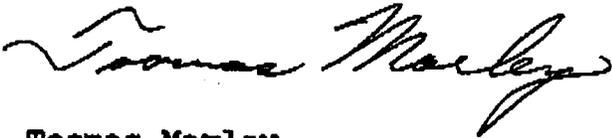
These negotiations proved unsuccessful; subsequently, CDS has entered into a federal oversight agreement with the Bank of Canada in order to satisfy the central bank's requirement for federal involvement in our systems which provide clearing and depository services for large values of federal debt instruments. As a consequence, CDS now reports on a monthly basis to the two statutory regulators, the Ontario and Quebec Securities Commissions, and to the central bank pursuant to the federal oversight agreement. Under the terms of the federal oversight agreement, CDS has undertaken to provide information of a regulatory nature to the Bank of Canada and to abide by directives of the Bank of Canada required to reduce systemic risk in securities clearing and settlement systems.

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I trust this updated information is satisfactory for your purposes and I look forward to the receipt of your response at your earliest convenience.

Yours very truly,

A handwritten signature in cursive script, appearing to read "Thomas Marley".

Thomas Marley  
Vice-President, Legal, and  
Corporate Secretary