

PUBLIC

19 APR 1994

Our Ref. No. 94-212-CC
ASX Settlement and
Transfer Corporation
Pty Ltd
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Your letter of April 14, 1994 requests 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, as described in your letter, a registered investment company utilizes the services of the Clearing House Electronic Subregister System ("CHES") developed by ASX Settlement and Transfer Corporation Pty Ltd ("ASTC"). 1/

You state that CHES will serve as an electronic system for clearance and settlement of transactions in securities quoted on the ASX, and for transferring ownership in these transactions. 2/ CHES will not operate as a depository and will not have an associated depository. Instead, CHES, as agent on behalf of individual issuers, will operate an electronic subregister that will be recognized at law as an integral part of each issuer's principal register of securityholders. The securities recorded on CHES's subregister will be uncertificated. 3/ Participants in CHES will directly control the securities holdings in CHES. CHES will not take physical possession of or acquire any interest in securities. CHES will not change the nature of a securityholder's interest in securities. Securities holdings in CHES will be registered in the name of a participant, a wholly-owned subsidiary of a participant, or, in some instances, a sponsored holder. Securities holdings will not be registered in the name of CHES. 4/ You state that CHES will operate the subregister in a manner similar to that of a transfer agent.

-
- 1/ ASTC is a wholly-owned subsidiary of the Australian Stock Exchange Ltd ("ASX"). You represent that CHES is subject to the regulatory oversight of the Australian Securities Commission. In addition, you represent that ASTC must seek certain approvals from the Attorney-General in Australia to operate CHES.
 - 2/ CHES's electronic subregister and transfer facility will be implemented in July 1994. Securities issued by entities that are listed on the ASX will become CHES eligible over time.
 - 3/ CHES eligible securities may be held in certificated or uncertificated form. However, securities held in certificated form will be required to be converted to uncertificated form before a market transfer on CHES may be effected.
 - 4/ Facsimile from Christine Jones dated April 15, 1994.

Participants in CHESSE will include brokers and certain institutional investors, including bank custodians and trustees. You do not expect that U.S. investment companies will participate directly in CHESSE, but will gain access to CHESSE through bank custodians that participate in CHESSE. 5/ You represent that an investment company's participation in CHESSE through its bank custodian will not affect the contractual relationship between the company and its custodian.

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."

The staff has taken the position that a system that is not a depository (and does not have an associated depository) and in which securities do not come to rest is not a central system for the handling of securities within the meaning of subparagraph (c)(2)(iii) of Rule 17f-5. 6/ In effect, the staff determined that an entity that does not serve a custodial function should neither be entitled to rely on nor be governed by Rule 17f-5. You represent that CHESSE will not have any custodial role in relation to the securities recorded on the CHESSE subregister.

On the basis of the facts and representations in your letter, we would not recommend that the Commission take any enforcement action under Section 17(f) if a registered investment

5/ Of course, a registered U.S. investment company would be required to use a custodian that is qualified under Section 17(f) or the rules thereunder ("qualified custodian").

6/ Reserve Bank of New Zealand (pub. avail. May 24, 1993). Although subparagraph (c)(2)(iii) defines "eligible foreign custodian" to include foreign clearing agencies as well as foreign securities depositories, the administrative history of Rule 17f-5 indicates that the subparagraph refers to both types of entities simply because a foreign securities depository may be denominated a "clearing agency" in certain countries. Investment Company Act Rel. No. 13724 at n. 31 (Jan. 17, 1984) (reproposing Rule 17f-5). Consequently, the staff focuses on the depository function of the foreign entities seeking no-action relief under Rule 17f-5(c)(2)(iii).

company maintains its assets with a qualified custodian that participates in CHES and the company's assets are recorded on CHES's electronic subregister without treating CHES as a custodian subject to Rule 17f-5.

Julia S. Ulstrup

Julia S. Ulstrup
Senior Counsel



**AUSTRALIAN STOCK EXCHANGE
LIMITED**

ACN 008 624 691

Level 15 Tower Building Australia Square Sydney NSW 2000

PO Box H224 Australia Square NSW 2000 Telephone (02) 227 0000

Direct line (02) 227 0778

CHESS PROJECT - Facsimile (02) 251 4071

ACT ICA 81940
SECTION _____
RULE 17f-5(c)(2)(iii)
PUBLIC _____
AVAILABILITY 4/19/94

14 April, 1994

Ms Julia S Ulstrup
Senior Counsel
United States Securities and Exchange Commission
Division of Investment Management
450 Fifth Street North West
Washington DC 20549
U.S.A.

Via facsimile 0011-1-202-504-2395

Dear Ms Ulstrup,

**INVESTMENT COMPANY ACT 1940 - SECTION 17(f)
CLEARING HOUSE ELECTRONIC SUBREGISTER SYSTEM (CHESS)**

The Australian Stock Exchange (ASX), through a wholly owned subsidiary, ASX Settlement and Transfer Corporation Pty Limited (ASTC), is responsible for the development of an electronic system for the clearance and settlement of transactions in securities quoted on ASX, and for the transfer of ownership pursuant to such transactions. The system is known as CHESS and it is scheduled to commence in July, 1994.

CHESS will provide a "name on register" electronic subregister of uncertificated securities holdings. The subregister will be recognized at law as an integral part of the principal register of the issuer of the securities. CHESS will not therefore operate as a depository and will not provide an associated depository.

The introduction of CHESS has broad industry support and the support of the Australian government and the Australian Securities Commission (ASC) - the government agency responsible for regulating the securities industry.

ASTC requests assurance that the staff of the Securities and Exchange Commission (the Commission) would not recommend enforcement action to the Commission under Section 17(f) of the Investment Company Act 1940, if investment companies registered under the Act utilise CHESS services.

The following information is provided in support of our request.

DEVELOPMENT AND IMPLEMENTATION OF CHES

The CHES proposal was adopted in May 1990 by a high level steering committee established to consider proposals for reform of Australia's systems for clearance and settlement of securities transactions.

The development of CHES is the final stage in a package of reforms to Australia's systems for clearance and settlement of securities transactions conducted through ASX. CHES has been designed to bring Australia into line with the standards set out by the Group of Thirty to upgrade settlement systems worldwide.

Funding for the development of CHES was approved by the Federal Attorney-General's Department pursuant to an agreement with ASX. The agreement provides for an independent project technology auditor to advise the Attorney-General on progress throughout the development phase of CHES.

ASTC was incorporated in January 1992 as a wholly owned subsidiary of ASX with the responsibility for the development and implementation of CHES.

The directors of ASTC are:

Mr R L Coppel	(former Deputy Managing Director, ASX & Chairman of ASTC)
Professor J G Davis	(Professor of Management, Australian Graduate School of Management; Director of ASX; Chairman of Alcan Australia; Director of Australian Industry Development Corporation)
Mr L L Hall	(Investment Manager, Australian Mutual Provident Society)
Mr J C Lawson	(General Manager, Custodian Services, Westpac Bank)
Mr M L Newman	(Director of Bain & Co Ltd Group; Director of ASX; Director of Bridge Oil Limited)
Mr J C Rennie	(Company Secretary, Pacific Dunlop)
Mr A G Richards	(Managing Director, ASTC)
Mr M H Shepherd	(Vice Chairman, ASX, Chairman ASX Derivatives Board)
Mr D Rinke	(Manager, Share Department, BHP Limited)

Legislation has been enacted by Federal Parliament to provide the statutory framework for CHES. Part 7.2A of the Corporations Law deals with the establishment of the "securities clearing house" (SCH) which will be responsible for operating CHES. ASTC intends making application for approval as the SCH for the purpose of operating CHES under the legislation.

The Attorney-General may only give approval if he or she is satisfied that the applicant's business rules contain satisfactory provisions about its facilities, and the disciplining of participants for breaches of the rules. In addition, the Attorney-General must be satisfied that approval of the SCH would serve the public interest.

CHES will be implemented in two phases. Phase 1, to be implemented in July 1994, will provide the CHES electronic subregister and the electronic transfer facility. Phase 2, scheduled for implementation in February 1995, will provide delivery of securities against cleared funds (Delivery v Payment settlement).

CHESS SERVICES

CHESS services are directed primarily to the efficient settlement of ASX market transactions. These are discussed below. In addition, CHESS will provide associated reporting services, off-market electronic transfers and a service to record securities that have been accepted under a takeover scheme or pledged as cover for positions taken on the Australian Options Market.

The Electronic Subregister

CHESS will provide a subregister facility in relation to securities issued by entities that are officially listed on ASX. Once each class of securities is "CHESS approved", SCH will operate an electronic CHESS subregister for that class of securities as the agent of the issuer.

We expect that the majority of securities will become CHESS approved progressively over a period of approximately 12 months.

The CHESS subregister for a class of securities will be recognised at law as an integral part of the issuer's principal register for that class of securities. CHESS therefore does not require any change in the relationship between an issuer and its security holders and does not change the nature of a holder's interest in securities.

As previously noted, CHESS will not operate as a depository and will not have an associated depository. Entries on the subregister will be by book entry and those entries will not be supported by certificates that are immobilised in a central nominee. Rather, CHESS will operate in a manner similar to that of a "transfer agent" on behalf of the issuer of the relevant securities.

CHESS does not take physical possession of nor acquire any interests in securities held on the CHESS subregister. Those securities will be directly controlled by CHESS participants and CHESS will not have any custodial role in relation to the securities.

A participant may control holdings that are registered in the name of the participant, or in the name of a wholly owned subsidiary of the participant. Additionally, if a participant is a broker or is a prudentially regulated non-broker participant, the participant may "sponsor" holders. Sponsored holdings are registered in the name of the sponsored holder and are under the control of the sponsoring participant, in accordance with the terms of a sponsorship agreement that meets the requirements of the SCH business rules.

CHESS does not mandate the dematerialisation of securities and therefore CHESS approved securities may be held in certificated or uncertificated form, subject to the issuer choosing to continue to offer certificated holdings. However, it will be necessary for a certificated holder to convert securities to a CHESS holding before a market transfer of those securities may be effected. Market transfers are discussed below.

The introduction of CHESS will not change the nature of the contractual relationship between a US company registered under the Investment Company Act and its Australian custodian. If a CHESS participant acts as the Australian custodian for a registered investment company, those participants may hold securities on the CHESS subregister on behalf of those clients. Securities held on the CHESS subregister may be registered on the issuer's register in the nominee name of the custodian and will remain at all times under the control of the custodian participant, as is presently the case.

Electronic Transfer Service

Once a class of securities becomes CHES approved, market settlement of ASX transactions in those securities must be effected by electronic transfer.

Each broker will operate a settlement holding in that broker's nominee name on the CHES subregister for the purpose of clearing and settlement of market transactions. On the scheduled settlement date for a market transaction, securities are electronically transferred from the net selling brokers' settlement holdings to the net buying brokers' settlement holdings.

If a custodian participant wishes to effect a market sale of securities held on the CHES subregister on behalf of a client, the custodian will effect an electronic transfer to the settlement account of the selling broker in time for the scheduled settlement.

PARTICIPATION IN CHES

Criteria for participation in CHES will be set out in the SCH business rules. There will be two classes of participants, broker participants and non-broker participants.

All ASX member brokers will be required to participate in CHES.

If a non-broker applicant for participation is prudentially regulated (for example an Australian bank supervised by the Reserve Bank of Australia), the applicant will be admitted as a participant on establishing to the satisfaction of SCH that it meets the technical and performance requirements and stamp duty requirements and that it has lodged a performance bond, as approved by SCH. If the applicant is not prudentially regulated, it must meet additional criteria, such as business integrity and local establishment requirements.

We expect that institutional investors such as life offices and bank custodians and trustees will apply to become non-broker participants in CHES.

We do not expect that U.S. investment companies will participate directly in CHES but that current arrangements with an Australian custodian will continue. The Australian custodian that is a CHES participant will continue to be under the same contractual obligations to its U.S. investment company clients but will hold securities on behalf of its clients in CHES.

REGULATION AND OVERSIGHT OF CHES

CHES is subject to the provisions of the Corporations Law and to the regulatory oversight of the ASC.

Much of the operational regulation of CHES has been "delegated" to the business rules of the clearing house. The rules have been developed after extensive consultation with industry groups and the ASTC and have been subject to a 10 week period of public exposure. As mentioned above, before ASTC may be approved as the SCH to operate CHES, the Attorney-General must be satisfied that the business rules are satisfactory and that the approval as the SCH is in the public interest. The rules are also subject to the scrutiny of the Trade Practices Commission.

The rules will make provision for SCH to obtain information and records from participants and issuers in order to monitor compliance with the rules. SCH will also have broad powers to discipline participants and issuers for breaches of the rules. SCH will be obliged under the rules to appoint an independent auditor to conduct an annual review of CHES information processing facilities and the integrity of the system and to assess the integrity and security of information maintained by CHES. The results of the review are available to all participants and issuers upon request. A supplementary certificate may also be requested at any time by a participant or issuer.

Following the implementation of CHES, the legislation requires that any amendments to the business rules must be notified to the ASC. The Attorney-General, acting with the advice of the ASC, may disallow any amendment. If the amendment is disallowed, the amendment ceases to have any effect.

Additionally, the CHES legislation in Part 7.2A of the Corporations Law provides:

- that the SCH must give such assistance to the ASC as it reasonably requires for the performance of its functions;
- that the SCH must notify the ASC of any disciplinary action taken by the SCH; and
- the right of the ASC, the SCH or any aggrieved party to apply to the court for enforcement of the SCH business rules.

We trust that the above information meets your requirements to determine our request that you would not recommend enforcement action to the Commission under Section 17(f) of the Investment Company Act if registered US investment companies utilise the services of CHES.

Yours sincerely,



Christine Jones
Corporate Solicitor, CHES

S/CHRIS/LTR-0199/



**AUSTRALIAN STOCK EXCHANGE
LIMITED**

ACN 008 624 691

Level 15 Tower Building Australia Square Sydney NSW 2000
Direct line (02) 227 0778 PO Box H224 Australia Square NSW 2000 Telephone (02) 227 0000
CHESS PROJECT - Facsimile (02) 251 4071

15 April, 1994

Ms Julia S Ulstrup
Senior Counsel
United States Securities and Exchange Commission
Division of Investment Management
450 Fifth Street North West
Washington DC 20549
U.S.A.

Via facsimile 0011-1-202-504-2395

Dear Ms Ulstrup,

INVESTMENT COMPANY ACT 1940 - SECTION 17(f)

I refer to your fax of 14 April 1994 and confirm:

- (1) CHES holdings will be directly controlled by participants in CHES;
- (2) CHES holdings will be registered in the name of a participant, a wholly owned subsidiary of a participant, or in some instances, a sponsored holder; and
- (3) CHES holdings will not be registered in the name of CHES.

Yours sincerely,

Christine Jones
Corporate Solicitor, CHES

S/CHRIS/LTR-0203/15/4/94