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C H A N C E

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Further to our meeting on 17 May and telephone conversations today, I attach revised drafting notes reflecting the position we have agreed in principle. I appreciate that you said you would ask your law draftsman to consider the precise wording, but the wording attached was agreed in principle.

The only point still outstanding is Section 72, which you said the FSB would consider further. I think you understand the Group's position. The custodians are of course in any event "on the hook" to the trustee. In paragraph 5(b) of Schedule 3 the custodian gives an indemnity for any losses attributable to fraudulent, dishonest or negligent acts committed by delegates.

Kind regards

Mark Shipman

Hkg-1/214187/02

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MPF - Drafting Notes

- *position agreed in principle following meeting with FSB and MPFA on 17 May 2000*

1. Section 65

- Amend the first part of Section 65(2)(a)(iii) and (b)(iii):

"at the time the borrowing was made, it was unlikely that the period of the borrowing would exceed....."

- Add new Section 65(4):

(4) "For the avoidance of doubt, any encumbrance created over scheme assets of a registered scheme that is, at the time of creation, consistent with subsection (2) shall remain valid throughout the period for which the borrowing remains outstanding."

2. Section 72

[This is not yet agreed. The alternatives discussed were:

- Repeal Section 72; **OR**
- Amend Section 72:

"Any agreement entered into between a custodian of scheme assets and any delegate of the custodian shall be on terms that are not inconsistent in substance with the requirements specified in Schedule 3"; **OR**

- Add additional language to Section 72 or Schedule 3 expressly excluding the application of paragraphs 5, 6(1)(a), 6(2) and 7(a) to sub-custodial agreements; **OR**
- Do nothing.

From the Group's perspective any of the first three options would be acceptable. The fourth option would pose serious problems for reasons previously stated resulting in a more restrictive and therefore less competitive market.]

Schedule 3

3. Paragraph 1(b):

- Amend Paragraph 1(b):

(b) "to be entrusted to the custodian for safe keeping;"

- Add new paragraph 1(c):
 - (c) "entrusted to the custodian:
 - (i) which are in registered form, to be registered in the name of the custodian or its delegate or otherwise recorded and controlled by the custodian or its delegate in such manner as may be customary and prudent in the relevant market; or
 - (ii) which are in bearer form, to be held in the physical possession of the custodian, or its delegate;"
- Add new paragraph 1(d):
 - (d) "be segregated from the custodian's and its delegates' own assets."
- Add new Paragraph 1A:
 - "For the avoidance of doubt, scheme assets:
 - (a) comprising cash held by a custodian which is an authorised institution or an approved overseas bank may be held by such custodian in its capacity as a bank;
 - (b) may be deposited by the custodian and its delegates with, and held in, any central securities depository on such terms as such central securities depository's customarily operate".
- 4. Paragraph 3
 - Reflect in paragraph 3 the same changes as sections 65(2)(a)(iii) and (b)(iii), described under 1. above.
 - Add new Paragraph 4A:
 - "Any encumbrance created over scheme assets of a registered scheme that is, at the time of creation, consistent with paragraph 3 above shall remain valid throughout the period for which the borrowing remains outstanding."
 - [This mirrors new Section 65(4), described under 1. above].
- 5. Paragraph 5(a)
 - Amend the first part of paragraph 5(a):
 - "for any direct losses incurred by scheme members that are....."
 - [The MPFA waiver in relation to the custodial agreement complying with paragraph 5 will no longer be required].