



STATE STREET.

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European Securities and Markets Authority
103 Rue de Grenelle
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Discussion Paper – Draft Technical Standards for the Regulation on improving securities settlement in the European Union and on central securities depositories

Dear Sir/Madam:

State Street Corporation (“State Street”)¹ appreciates the opportunity to comment on the Discussion Paper (“DP”) issued by the European Securities and Markets Authority (“ESMA”) regarding the draft Technical Standards for the regulation on improving securities settlement in the European Union (“EU”) and on central securities depositories (“CSDs”).

Headquartered in Boston, Massachusetts, with branches and subsidiaries throughout the European Union (“EU”), State Street specialises in providing institutional investors with investment servicing, investment management and investment research and trading. With USD 27.47 trillion in assets under custody and administration and USD 2.38 trillion in assets under management, State Street operates in 29 countries and in more than 100 markets worldwide.² Our European workforce of 9,000 employees provides services to our clients from offices in ten EU Member States.

As a leading global custodian that works extensively with financial market intermediaries and infrastructure utilities across the EU, State Street is deeply committed to enhancing the cross-border investment processes for our institutional investor clients. We therefore have and continue to engage in prospective industry and regulatory developments aimed

¹ State Street’s identification number in the European Transparency Register is 2428270908-83.

² As of March 31, 2014.

at enhancing operational safety and market efficiency. We have actively contributed to the shaping, monitoring and analysis of several initiatives in the clearing, settlement and safekeeping space, including the earlier Code of Conduct for Clearing and Settlement (“Code of Conduct”), the Target2-Securities (“T2S”) initiative, the recommendations of the European System of Central Banks – Committee of European Securities Regulators (“ESCB-CESR”) for securities settlement systems, ongoing industry efforts to eliminate the Giovannini barriers and the development of a potential Securities Law Directive (“SLD”). State Street also supports and has contributed to the recently adopted CSD Regulation both individually and via industry associations. We welcome a harmonized EU framework that governs the authorization, supervision and functioning of CSDs across the EU and are pleased that previously supplied views have been incorporated in the regulation text. We also welcome ESMA’s approach to developing the technical standards through this consultation process, including the consideration of the costs and benefits that proposed measures might produce.

Please find below our response to ESMA’s DP which consists of general comments on the DP’s main sections as well as responses to specific questions of importance to us.

Settlement discipline

State Street supports the development of harmonized settlement processes in the EU, including a common T+2 settlement framework. In our view, the key objective and at the same time measure of success must be an efficient, smooth and fast standardized settlement process across the EU. The CSD Regulation is an important step in that direction.

At the same time, we acknowledge that the complexity and costs inherent in this effort should not be underestimated. We highlight the importance of ensuring that changes in settlement processes and methods to address fails do not create unintended barriers to global investor access to the markets or minimize the importance of essential time sensitive cross-border processes. When settlement cycles are shortened, indirect market participants will face certain practical challenges in the performance of required post-trade/pre-settlement activities due to complexities arising from time zone differences, inconsistent pre-settlement matching protocols, and barriers that remain with respect to the full automation of messaging flows. It is important to recognize too that the contributing causes of settlement failures are not necessarily the direct CSD participants, which may be acting as settlement facilitators for underlying investors and other intermediaries. State Street therefore encourages ESMA to consider these realities during the implementation planning for T+2 and the tools utilized to address settlement fails.

Furthermore, additional costs are likely to be incurred by certain funds/ investors as a result of the move to T+2. These costs will result for funds that have an EU as well as a non-EU exposure and that will therefore have to continue to operate on a T+3 settlement, as well as redemption and subscription cycle. Because of the inconsistency between the EU settlement period for securities (i.e. T+2) and the time when the investment manager of such a fund receives subscription money (T+3 or even T+4), the investment manager

will need to extend settlement/borrow from the custodian resulting in additional costs. This issue will only be resolved once there is global consistency in settlement times which will then allow alignment of fund subscription/redemption cycles with security settlement cycles.

State Street also would like to highlight the fact that clients who trade on the over-the-counter (“OTC”) or off-exchange market and also concurrently on-exchange, where there may be instances of back to back trades for incoming positions, may create an increase in settlement fails. State Street would like to note that this will impact the credit lines of clients and may create client short positions.

In addition, we have the following comments with regard to question 8:

Q8: Do you agree with this view? If not please elaborate on how such arrangements could be designed and include the relevant data to estimate the costs and benefits associated with such arrangements. Comments are also welcome on whether ESMA should provide for a framework on lending facilities where offered by CSDs.

State Street agrees with ESMA that CSDs should not be mandated to establish lending and borrowing facilities. It should be left to CSDs to take such a decision and should they decide to establish such facilities, it has to be ensured that they are adequately regulated and supervised, as well as subject to appropriate prudential requirements.

Buy-in Procedure

With regard to the buy-in framework described in the DP, State Street welcomes that ESMA proposes to take into account the liquidity of different types of financial instruments and to adjust the relevant buy-in periods, for example for instruments such as corporate bonds and exchange-traded funds (“ETFs”). In our view, the principle of proportionality should be the guiding principle when considering the applicable buy-in period for different types of instruments.

Furthermore, as set out below, we would encourage ESMA to ensure consistency across different pieces of EU regulation with regard to the types of instruments that are considered to be liquid or illiquid.

Q13: CSDR provides that the extension period shall be based on asset type and liquidity. How would you propose those to be considered? Notably, what asset types should be taken into consideration?

State Street would like to recommend applying a similar definition of liquid and illiquid securities to that utilized in the European Short Selling Regulation. This would potentially allow existing facilities and processes to be utilized to identify a liquid security from an illiquid one. In terms of the extension period, it is important for ESMA to consider this practically as if an illiquid security were to be automatically bought in then, as acknowledged by ESMA, this could lead to a much larger chain of failed settlements in the same security. Illiquid equities and selected corporate bonds tend to be

the most common securities that can become illiquid very quickly or only very small quantities circulate in the market.

Lastly, we would encourage ESMA to consider that, prior to implementing a buy-in, a party (possibly the CSD) assesses the market liquidity for the relevant security and, if deemed poor, defers the buy-in and/or works with the appropriate parties to expedite settlement.

Q14: Do you see the need to specify other minimum requirements for the buy-in mechanism? With regard to the length of the buy-in mechanism, do you have specific suggestions as to the different timelines and in particular would you find a buy-in execution period of 4 business days acceptable for liquid products?

In our view, for liquid securities, a settlement day plus four business days (“S+4”) buy-in should be acceptable. However, we would recommend including an extension period for illiquid securities, which should be based on the specific security and should provide sufficient time for highly illiquid products.

Q16: In which circumstances would you deem a buy-in to be ineffective?

Buy-ins could be considered ineffective in the following two scenarios:

- As noted above, when a security is highly illiquid, buy-ins would only lead to an increasing number of failed settlements in the same security which would eventually completely grid lock the system. We therefore suggest undertaking a review of liquidity prior to executing such a buy-in; or
- In the case of a recall of a lent security where the borrower is having difficulty buying-in which again can lead to a build-up of failed trades.

Q17: Do you agree on the proposed approach? How would you identify the reference price?

If a buy-in were not possible, e.g. a suspended security, the determination of a cash out procedure could be very difficult as most clients will want to wait until any estate valuation were assessed and published by administrators before accepting a cash out figure. Should ESMA impose a cash-out amount and duration this could be controversial.

Penalties for settlement fails

State Street agrees in principle with introducing disincentives for settlement fails. However, we believe that such penalties are best phased in over time and consistently across all CSDs to provide markets with sufficient time recognizing the different levels of market sophistication across the EU.

CSD authorization and governance

State Street supports the objective of ensuring CSDs' appropriate and robust regulation and supervision, particularly in view of the shifting operational landscape for infrastructure utilities across the EU. CSDs provide mandatory and irreplaceable core services in the post-trade market. As systemically important market infrastructure, they should be subject to a standardized and harmonized authorization and supervisory regime which has both market stability and the need to reduce inconsistencies across the EU at its heart. This reflects their indispensable role in the functioning of modern financial markets, including the potential implications for systemic risk when engaged in commercial activities beyond their infrastructure functions.

Guiding principles and a rigorous assessment process for authorization and supervision of CSDs must therefore be applied uniformly across EU jurisdictions to ensure a level competitive playing field. While authorization and supervisory procedures for CSDs operating with multiple externalities will necessarily require additional review, there should be no material inconsistencies between the basic guiding principles and procedures applied by domestic authorities to local CSDs and those applied by an EU-wide authority to CSDs operating across borders. This also applies to any information that CSDs need to provide as well as obligations such as recordkeeping, data keeping and reconciliations.

Furthermore, the final new framework, in particular with regard to the management of risks, conflicts of interest, investment policy, etc. has to ensure the robust governance and supervision of CSDs given their important role in the smooth functioning of the financial system.

Thank you once again for the opportunity to comment on the matters raised within this DP. Please feel free to contact me should you wish to discuss State Street's submission in greater detail.

Sincerely,



Dr. Sven S. Kasper
Director EMEA, Regulatory, Industry
and Government Affairs