May 22nd 2014

ESMA
103 rue de Grenelle
75345
Paris
France

Submitted online at www.esma.europa.eu

Dear Sirs

Consultation Paper 2014/299

Omgeo is a service provider that helps automate cash equities and fixed-income post-trade processing between investment managers, broker/dealers and custodian banks. By streamlining post-trade operations such as confirmation, allocation, Standing Settlement Instructions (SSI) enrichment and settlement notification using our platform, clients are able to accelerate the clearing and settlement of trades whilst reducing operational risk and cost.

Omgeo is regulated by SEC (US), FCA (UK) and OSC (Canada).

Omgeo’s response to this Discussion Paper will focus on the process of confirming a trade between a broker/dealer and its clients. Omgeo’s CTM system has a community of more than 900 investment managers and over 1,000 broker dealers. In 2013 it processed approximately 85m transactions – of which about 80% originate in Europe.

It is important to note that the institutional trade processing model differs significantly from the process employed by broker/dealers who trade directly with an exchange. Institutional trades are settled gross – there is no netting or involvement of a CCP. Almost all trades are settled DVP at a CSD and the process is managed by a settlement agent – generally a global custodian. However there can be additional participants in the process flow – see diagram below. In its simplest model an institutional investor will use a global custodian who manages the settlement process within the CSD. In this instance there are three participants – with the addition of T2S in 2015 there will be four. A more complicated – but not uncommon – model is for the institutional investor to use an outsourcer for its middle-office processing. It is also normal for the global custodian to use a local agent (also referred to as a sub-custodian) to interface to the CSD. Therefore five entities must process the trade prior to settlement – which will rise to six when T2S also becomes involved.

It is therefore essential in a T+2 settlement cycle that full automation exists through the entire trade lifecycle. Accurate, complete and timely instruction is essential to prevent trade failure.
Buy-side trades and the T2S process flow

It is the standard viewpoint of market participants that equity trades by institutional investors are OTC transactions – because the client is not a direct participant of an exchange. The same factor applies to fixed-income transactions – where the vast majority of trades are conducted off-exchange.

It is clearly the intention of the CSD-Regulation to harmonise around a T+2 settlement cycle and it is equally beneficial for the success of T2S that all participants work on a harmonized T+2 basis. However the CSD-Regulation, from a legal and technical perspective, does not (and cannot) mandate T+2 for OTC trades. It is therefore possible, but highly undesirable, for a bifurcated market structure to exist. Broker/dealers trading on an exchange will be compelled to settle their trades on a T+2 cycle but their clients may want to operate on a T+3 cycle. Bifurcation of this type will cause operational complexity and extra costs in the following ways:

**Operational Complexity**

Today broker/dealers and institutional investors most commonly organize their operational processes around a 3 day settlement cycle. With the introduction of a T+2 settlement cycle, should institutions wish to continue to settle on T+3 for their trades (which are “over the counter”) the resulting bifurcation of the settlement cycle will increase complexity—and therefore cost”. The objective of a higher level of harmonization will also not be fulfilled

**Funding**

*Purchase:* Where a client has instructed a broker/dealer to purchase stock the broker will be compelled to settle its trade (i.e. deliver cash) to its counterparty via the exchange (or CCP) 2 days after execution. It will not receive cash from its client until the following day. It will therefore have a 24 hour cash-funding requirement – entailing a cost which will be passed back to the client.
Sale: Where a client has instructed a broker/dealer to sell stock the broker will be compelled to settle its trade (i.e. deliver securities) to its counterparty via the exchange (or CCP) 2 days after execution. It will not receive the stock from its client until the following day. It will therefore need to borrow the stock to fulfill its delivery obligation, or fail. Securities lending is operationally intensive and also incurs a borrowing fee. Clients will therefore incur additional costs and operational risks whilst broker will increase their buy-in risk.

Credit Risk

Institutional investors mitigate their credit risk by using, wherever possible, the DVP (delivery versus payment) mechanism. Simultaneous and irrevocable DVP is an excellent mechanism for mitigating risk if there is a minimal time difference between the delivery of cash or securities and the receipt of cash or securities in the opposite direction.

The bi-lateral credit risk between the IM and the BD (buy-side trade) is a function of the length of the settlement cycle. Thus an extra day (T+3 versus T+2) adds counter-party risk.

The key benefit of shortening the settlement cycle to T+2 is defeated when buy-side trades settle in an extended settlement cycle. Counter-party risk increases, which can be significant in periods of market stress when both the buy-side and CCPs execute close-out trades in markets that often lack liquidity at such times.

Omgeo Response to Question 1

Which elements would you propose ESMA to take into account / to form the technical standards on confirmation and allocation between investment firms and their professional clients?

The discussion paper advises that “Under Article 6(4) CSDR, ESMA is expected to develop RTS to specify details of the confirmation and allocation measures and of the procedures between investment firms and their professional clients facilitating settlement and the details of the tools for the management of the timely settlement of transactions”.

In order to facilitate the proposed reduction in the trade settlement cycle to two days (T+2), and to implement the settlement discipline regime, focus needs to be placed earlier in trade lifecycle to maximize the use of properly automated mechanisms for trade confirmation, allocation, rejection and affirmation. Of these processes, trade allocation and affirmation are the highest priority. As market participants will be losing 24 hours from their settlement process, this time needs to be reclaimed back via increased efficiency within their post-trade processes to enable participants to agree transactional economic detail as well as cash and security settlement information. Utilising an electronic platform or mechanism to perform trade confirmation, allocation and affirmation has been proven to increase automation and allows straight through processing (STP) which is a key factor to building a robust settlement process to improve settlement efficiency.

CSDR Technical Standards Article 6(4) should include wording that incorporates specific timeframes to complete the trade confirmation process. Trade affirmation should become a process that takes place, where possible, on the same day as trade execution. Same Day Affirmation (SDA) allows both participants to the trade to dispatch settlement notification/instruction to their respective custodians or CSD on either the same day as execution or early on T+1.

To facilitate SDA the institutional investor (Investment Manager, Asset Manager, Pension Fund or Hedge Fund) should be required to provide the trade allocations to the broker dealer as early as possible on execution date – in a properly automated format. Providing allocations on execution date is a key factor in enabling an efficient shortened settlement regime. Portfolio managers within buy-side firms already have fund allocation detail prior to
execution. Therefore providing these allocations on execution date requires a change in behavior rather than a change in process.

Within the Omgeo CTM community SDA rates are very high. In 2003 the SDA rate across all clients/markets was +94%. See data below. The clients who are within this community are therefore highly compliant with market best practice – it is the significant group of clients that have not automated this process which needs to be addressed.

**Omgeo Operational Risk Study – data from a recent Omgeo presentation to ECB T2S T+2 Task Force**

The data below is extracted from a presentation given to the T2S T+2 task-force in January 2013. It provides 2010 and 2013 SDA rates for the largest European markets.

<table>
<thead>
<tr>
<th>Market</th>
<th>Nov 2013 SDA rate</th>
<th>Oct 2010 SDA rate</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>AT 87%</td>
<td>85%</td>
<td>2%</td>
</tr>
<tr>
<td>Belgium</td>
<td>BE 88%</td>
<td>83%</td>
<td>5%</td>
</tr>
<tr>
<td>Germany</td>
<td>DE 88%</td>
<td>84%</td>
<td>4%</td>
</tr>
<tr>
<td>Denmark</td>
<td>DK 85%</td>
<td>87%</td>
<td>-2%</td>
</tr>
<tr>
<td>Spain</td>
<td>ES 87%</td>
<td>84%</td>
<td>3%</td>
</tr>
<tr>
<td>Finland</td>
<td>FI 86%</td>
<td>83%</td>
<td>5%</td>
</tr>
<tr>
<td>France</td>
<td>FR 87%</td>
<td>83%</td>
<td>4%</td>
</tr>
<tr>
<td>UK</td>
<td>GB 87%</td>
<td>83%</td>
<td>4%</td>
</tr>
<tr>
<td>Greece</td>
<td>GR 91%</td>
<td>75%</td>
<td>16%</td>
</tr>
<tr>
<td>Italy</td>
<td>IT 77%</td>
<td>68%</td>
<td>9%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>NL 88%</td>
<td>84%</td>
<td>4%</td>
</tr>
<tr>
<td>Sweden</td>
<td>SE 87%</td>
<td>77%</td>
<td>10%</td>
</tr>
</tbody>
</table>

*Source: Omgeo CTM Benchmarks*

Our analysis of this data indicates the following:

- **SDA rates are high and improving each year (2008 average 78.6%, 2010 average 81%, 2013 average 94.35%)**
- T+1 SDA rate is 98.88%, T+2 SDA rate is 99.11%
- There is some regional variety (lowest market - Italy – is 14% below the highest market – Greece)
- Equity and fixed-income SDA rates vary, but the differential isn’t large
- Fluctuating volumes do not have a significant impact on SDA rates
- The average time to complete a transaction is 59 minutes

Our conclusion, based on the above data, is that the automated community is highly efficient and likely to cope well with a T+2 settlement cycle.

Our recommendation is that CSD-R Level 2 standards should specify the timeframe for completion of the allocation and confirmation process. The Omgeo community has shown that SDA is fully achievable and therefore a deadline of midnight on T seems attainable, although the standards clearly need to be calibrated to take account of time-zone and geographical issues. This viewpoint concurs with recommendations made by IOSCO, AFME and the T2S T+2 taskforce.
It is therefore our premise that:

- a shortening of the settlement cycle requires full automation, by all participants, of the trade processing lifecycle
- accurate and timely processing in the middle-office drives efficiency at the settlement layer
- a T+2 cycle requires trades to be finalized and instructed, wherever possible, on trade-date
- there is significant benefit to all market participants from an operations, risk and efficiency perspective for SDA to be applied across the whole market

To conclude we therefore recommend that CSD-R Level 2 technical standards creates an environment where all participants aim to achieve SDA and also builds a framework that removes any justification for a bifurcated T+2/T+3 market.

We would be very happy to discuss any of these issues in more detail.

Yours truly,

[Signature]
Paula Arthus
President and Chief Executive Officer
Omgeo LLC