STATE STREET

State Street Corporation
One Congress Street
Boston, MA 02114-2016
statestreet.com

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Ms. Natalia Cazenave
Executive Director
European Securities and Markets Authority
203 Rue de Bercy
75012 Paris

Dear Ms. Cazenave,

State Street Corporation ("State Street") welcomes the opportunity to comment on the European Securities and Markets Authority's ("ESMA") call for evidence on shortening the settlement cycle in the European Union ("EU").

Headquartered in Boston, Massachusetts, State Street is a global custody bank which specializes in the provision of financial services for institutional investor clients, such as asset owners, asset managers and official sector institutions. This includes investment servicing, investment management, data and analytics, and investment research and trading. With $40 trillion in assets under custody and administration and $3.7 trillion in asset under management, State Street offers its clients the ability to transact and hold assets in more than 100 geographic markets globally[1]. State Street Global Advisors ("SSGA") is the investment management division of State Street Corporation and is the world's fourth-largest asset manager and sponsor of the SPDR® family of exchange traded funds ("ETFs").

There are a number of benefits in moving to a faster settlement cycle, and State Street supports a carefully managed move to T+1 in the EU, minimizing as much as possible settlements gaps with other major financial jurisdictions. The move to T+1 settlement should be effective as soon as practically possible and should be coordinated at the EU level with all EU jurisdictions moving simultaneously to a harmonised settlement cycle. At the same time, we consider a move to T+0 highly premature given the magnitude of transformation of the existing trading and post-trading ecosystem that it would require.

[1] As of 30 September 2023.

In this letter, we offer some high-level considerations related to the shortening of the settlement cycle, informed by our role as a global custody bank and major asset manager, which are further detailed in the accompanying questionnaire form. We share and support the responses and cost-benefit analysis conducted by AFME, the Association of Global Custodians, the Investment Association and the ICI Global. Given the importance and implications for the functioning of European securities markets, ongoing consultation and involvement of the financial industry will be key. State Street will welcome the opportunity to provide more granular insights over time as the EU further considers moving to a shorter settlement cycle.

PROPOSALS FOR T+1 SETTLEMENT

The United States ("US") Securities and Exchange Commission ("SEC") issued a final rule that sets the shortening of the settlement cycle for US securities transactions on May 28, 2024. In the US, we have actively participated in the rulemaking process and the still ongoing industry effort to implement T+1, supporting a reduction of the settlement cycle for securities transactions in a manner that allows for and supports an orderly transition. We've highlighted, in this respect, that the implementation of T+1 settlement is a significant undertaking that requires careful planning and coordination by market participants in conjunction with financial market infrastructures, in order to avoid significant additional risks, costs and disruption for market participants and investors alike.

Among the challenges that we have identified and would offer to ESMA for consideration, are changes to trade matching systems and processes, tighter deadlines for the receipt of client trade instructions and the resolution of pre-trade problems, the implications of T+1 settlement for various asset servicing functions, such as the processing of corporate action events, and the operational model for ETFs.

At their core, these challenges will remain valid also in the EU context, with the difference that moving to T+1 settlement in the EU will likely prove even more challenging given the complexity of the European financial ecosystem. A further complication might arise from an uncoordinated transition to T+1 settlement with the United Kingdom ("UK") and other major European financial centres, with the risk of greater fragmentation and a prolonged gap in transition times which would be particularly problematic to manage for market participants given the existing interdependencies. Misalignment in settlement times across jurisdictions and markets will increase costs for the end-investor and should be avoided.

Therefore, bearing in mind both EU-specific considerations and the need for a coordinated approach with the UK and other major financial centres, we think that moving to T+1 settlement is achievable with an adequate

transition period. Below we highlight some areas which will require particular attention and might necessitate legislative amendments in order to manage an orderly transition to T+1 settlement:

- The implementation of T+1 settlement has specific impacts on ETFs. There is a risk of a misalignment between the primary and secondary market for ETFs, as the settlement dates for the creation of ETF shares will need to be aligned with the settlement of the underlying basket of securities. Operationally, this becomes more complicated for EU ETFs holding a global basket of securities, settling at different times. The resulting liquidity mismatch will need to be covered either through pre-funding or overdrafts, which could potentially impinge on current cash restrictions imposed on UCITS and AIFs funds. This is likely to increase costs for the end investor and requires a focus on all functions that support the ETF markets. Unintended consequences in the form of perceived active breaches of UCITS cash restrictions need to be addressed through a regulatory solution and cannot be solved by operational fixes such as appointing a second custodian for the fund (to avoid breaching the 20% cash limit deposited with a single institution); this is not an economically viable nor operationally feasible solution given that the potential cash breaches might go well beyond the current regulatory limits.
- Prefunding of trade settlements may also be required for FX transactions, given that T+1 settlement raises the risk that transaction funding dependent on standard FX settlement cycles may not occur in time.
- There is a risk of potential settlement fails of instruments traded in multiple jurisdictions, especially if the EU, the UK and Switzerland move to a shorter settlement cycle in an uncoordinated manner. One instrument might trade on a UK venue but settle within a EU Central Securities Depository ("CSD") for example. Thus, clarity will be needed on how to manage these cross-listed products and on whether exemptions under the CSD Regulation in the short term might be needed to solve frictions, avoid cash penalties and prevent costs for the end investor.
- The shorter settlement cycle will add further complexity to the securities lending business as standard processing and security recalls will operate in a much more compressed timeframe. In particular, the loan recall process will be under risk of CSDR penalties if the security cannot be recalled in time to settle. A lack of attention to these considerations could lead to a decline in market liquidity as investors become more reluctant to offer shares to borrowers.
- Back office and middle-office processes will need to rely on greater automation and the ability to have trades matched and affirmed sooner. More generally, tighter timeframes will affect problem resolutions, market claims and corporate action activities, such as the payment of dividends.

While these challenges will require careful consideration in the transition period, we agree with ESMA's assessment as regards to the benefits of shortening the settlement cycle to T+1, among which we note the

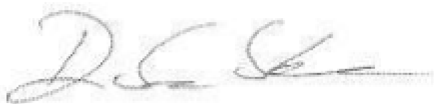
reduction of counterparty risk, encouraging additional automation and settlement efficiency, lower collateral requirements. Alignment with other jurisdictions, notably the UK and the US, will also avoid operational and trading costs and would enhance cash and liquidity management across borders. For the EU, it could also be the opportunity to continue strengthening the liquidity of the Capital Markets Union, in line with recent initiatives such as the establishment of a consolidated tape for bonds, equities and ETFs.

PROPOSALS FOR T+0 SETTLEMENT

The call for evidence seems to suggest that ESMA is also considering the potential for same-day settlement. While we acknowledge ESMA's interest in the potential benefits of T+0, as well as its desire to begin a dialogue with the industry on how to understand and address potential challenges, we would caution against underestimating the complexity and breadth of the issues that T+0 settlement would raise. Not only would the points we made above be further exacerbated, but ultimately same-day settlement would require a fundamental overhaul of the existing clearing, payment and settlement ecosystem, it would be disruptive for activities undertaken at market close, would not solve for global time zones and it would be most likely impossible without the introduction of new technology. As such, we would invite the EU authorities to focus at this stage on an orderly transition to T+1 settlement and to strive as much as possible to achieve coordination with UK and Swiss authorities, in line with North America. T+0 is a separate issue which should not be pursued at this point in time.

Please feel free to contact us should you wish to discuss the contents of this submission in greater detail. We welcome the opportunity to further engage with ESMA on the topics raised in the proposed rule and we stand ready to provide whatever assistance may be appropriate.

Sincerely,



Sven Kasper
International Head of Regulatory, Industry and Government Affairs
State Street Corporation