Position

of Bundesverband für strukturierte Wertpapiere (BSW) on the call for evidence by ESMA on shortening the settlement cycle

Berlin/Frankfurt on the Main, 15 December 2023

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The German Structured Securities Association (Bundesverband für strukturierte Wertpapiere – "BSW") is the industry body which represents the leading issuers of structured securities in Germany. Members include Barclays, BNP Paribas, Citi, DekaBank, Deutsche Bank, DZ BANK, Goldman Sachs, HSBC, J.P. Morgan, LBBW, Morgan Stanley, Société Générale, UBS, UniCredit and Vontobel. Furthermore, the Association's work is supported by more than twenty sponsoring members, which include the exchanges in Stuttgart, Frankfurt and gettex, Baader Bank, the direct banks comdirect bank, Consorsbank, DKB, flatexDEGIRO, ING-DiBa, maxblue, S Broker, Smartbroker and Trade Republic, the finance portals finanzen.net and onvista, as well as other service providers.
Based in Berlin, Frankfurt and Brussels, the BSW aims to improve the political and regulatory framework for structured securities in Germany and Europe by establishing industry standards and through active communication with politicians, supervisory authorities and international institutions. The Association also focusses on positioning structured securities as key transparent elements for creating wealth, maintaining and protecting assets, being part of a contemporary investment culture.
For more information, please consult www.derbsw.de.

German Lobby Register: R001411
EU Transparency Register: 377055313623-72

Q1. Please describe the impact on the processes and operations which could result from compressing the settlement cycle to T+1 and to T+0 (...):

The settlement landscape in the securities business in Germany and the EU is much more fragmented than in the USA, for example. This poses challenges for market players, as all post-trade processes would have to be completed in a shorter period of time if settlement cycles were to be shortened.

The challenges that would arise for securities settlement are explained in detail in this CfE. It should be noted that these requirements would already arise under a T+1 regime. In our opinion, the same challenges would arise under T+0 - only more stringent, as the same post-trade processes would have to be conducted and the time available for this would be even shorter.

On the settlement side, not all settlement problems will be resolved on T+1, sometimes not even until the business day after next. A very robust matching procedure would therefore have to be set up and the degree of automation would inevitably have to be increased if settlement errors due to inefficiencies in the processes are to be avoided in the long term.

This is particularly a problem for trades that are executed late in the day, shortly before the market closes. The later the trades are executed, the less time is available to manually intervene in a settlement. A high degree of automation is therefore essential.

Additionally T+1 would result in an extension of settlement processing into so-called daily processing, which may lead to risks in the processes relating to the issuing business (settlement of the auto-dispo service at Clearstream). A delay in the auto-dispo service would result in delayed settlement and thus increase the settlement risk (as well as counterparty risk).

On the trading side, however, no major challenges are foreseeable.

Q4. Do you expect the shortening of the securities settlement cycle to have any other impacts on the functioning of the markets (trading, liquidity formation) and on the access of retail investors to financial markets? (…):

In their feedback our members did not mention any negative effects on the functioning of the market, such as trading and liquidity formation.

However, shortened settlement periods in cases where a large number of market participants are involved, for example in cross-border transactions with different depositories involved, could lead to a bank no longer offering its clients trading in the corresponding products. This would then be an - indirect - restriction of capital market access for retail clients.

Q5. What costs would you have to incur in order to implement the technological and operational changes required to work in a T+1 environment? And in a T+0 environment? (…)

Unfortunately, we are not in a position to provide quantified answers on one-off or recurring costs for technical and operational changes. The initial situations of our members may be different. Some are already working with a very high STP ratio and, according to their own statements, would be able to realise a reduction in settlement deadlines to T+1 to a large extent with their existing structures. Others would have to make considerable efforts to achieve this situation.

From today's perspective, the introduction of T+0 under the classic settlement infrastructure seems difficult to implement. T+0 would effectively mean a real-time settlement with regulation of both the securities and their consideration.

This would be conceivable if DLT-based or comparable recording systems could be used for this purpose. However, this is currently only possible under the DLT pilot regulation with the requirements and restrictions currently in place. At present, market players are positioning themselves and defining their roles. Against this background, it is currently not possible for the members of the BSW to estimate the effort.

Q6. In your view, by how much would settlement fails increase if T+1 were required in the short, medium and long term? What about T+0? (…)

Our members understand "settlement fails" less as a situation where a counterparty is unable to deliver on time (e.g. because it was unable to procure or borrow the securities covered by the contract).

Rather, according to the feedback we have received, it is predominantly the case that the instructions given by the buyer and seller are not congruent. If such a "mismatch" is only identified during the actual settlement process, this triggers a high manual workload. There is also the threat of sanctions under the settlement discipline rules.

To avoid these undesirable consequences, some banks work with so-called "pre-matching". This involves comparing the instructions available for the individual contracts in advance of settlement so that mismatches can be recognised and filtered out at an earlier stage.

If the settlement period were to be shortened to **T+1**, the banks would simply not have the time to continue carrying out this check step. In this case, a significant increase in settlement fails and in the associated cash penalties would be expected. However, this cannot be quantified at present.

Under a **T+0** requirement and within the classic settlement infrastructure, an increase in processing errors would be "even more" likely. As we have already explained in our answer to question 5, real-time settlement appears to be more feasible in the future using a DLT infrastructure. Then again, verification steps such as pre-matching could be omitted if all the details of the instructions were available in the recording system and could be matched automatically.

Q9. Do you agree with the mentioned benefits. Are there other benefits that should be accounted for in the assessment of an eventual shortening of the securities settlement cycle?

Most of the feedback we received confirmed that the main advantages of shortening settlement periods are seen as a reduction in counterparty risks and the associated reduction in collateral requirements, which can free up liquidity. One opinion considers the benefits to be only minor:

Margin requirements will only decrease slightly because most large positions take more than one day to be liquidated in the event of a default anyway, and therefore the reduction of the deadline from T+2 to T+1 is not as crucial in the calculation of requirements as one might originally think.

Q14. How would you weigh the benefits against the costs of moving to a short settlement cycle? Please differentiate between a potential move to T+1 and T+0

Regarding T+1 our members merely believe that the benefits of shortening settlement periods should be carefully weighed against the challenges, costs and risks. Depending on the respective business models, relevant markets and the current level of automation already achieved, the results of such a consideration may differ.

Q15. Please describe the main steps that you would envisage to achieve a shorter securities settlement cycle. In particular, specify: (i) the regulatory and industry milestones; and the time needed for each milestone and the proposed ultimate deadline

In addition to an expansion of automation, it will definitely be necessary to speed up the processes due to the short processing time.

As an early step this will also require the processes of Target to Securities (T2S), Clearstream Banking Frankfurt (CBF) and stock exchanges to be adapted, especially with regard to timing. E.g. T2S start of the next settlement day is at 6.45 pm, but the relevant stock exchange closes only at 10 pm with subsequent settlement processing.

The settlement of stock exchange transactions will be challenging due to the long trading hours. Challenging not only for Banks, but also for Clearstream, exchanges and other participants such as Wertpapier-Mitteilungen (WM).