

ISSA Response to UK Accelerated Settlement Task Force Technical Group Report & Consultation

Introduction

In its December 2023 white paper, ISSA's T+1 Global Impacts Working Group (now renamed Accelerated Settlement Working Group) made four recommendations to the industry and regulatory bodies that are contemplating the possibility of accelerating their market's settlement cycles to work together collaboratively on. Those four recommendations are listed in the Appendix to this comment letter.

Given the focus on the following essential areas, ISSA feels the UK Technical Group is working within the spirit of the ISSA recommendations and we commend you on your rigorous approach to planning for Accelerated Settlement:

- Early planning and identification and implementation of all market practice changes well in advance of the assumed implementation date.
- The approach of calling for a "Code of Conduct" which, while not currently included in legislation or regulation, all UK market participants will be expected to adhere to by their trade and settlement counterparties.
- The creation of a "Playbook" and "Command Centre" to guide actions over the transition period.
- The extensive discussion of the implications to international investors, especially regarding FX trading and settlement and time zone implications (FX Recommendations plus the FX Analysis Summary in Appendix 2), and the plan to conduct outreach to global market participants. ISSA suggests, that as part of its "Lessons Learned" workstream agenda, the UK Technical Group explore whether any increased funding/FX costs have been incurred by non-US investors, as a result of the US T+1 implementation, and document how investors have adjusted FX practices to avoid or minimize these increased costs and how they expect the investors to address FX for cross-border trades of UK securities. This does not need to be completed by January, when the final report is published, but might be targeted for the first half of 2025.

Regarding the discussion questions listed in the Draft Recommendation Report & Consultation, ISSA respectfully offers the following comments for your consideration.

1. Do you believe that the recommendations for the scope of the UK transition to T+1 settlement, including for the potential provision of exemptions for Exchange Traded Products (ETPs) and Eurobonds, are sufficiently clear and workable?

a. If not, please outline which areas you think need further clarification.

ISSA agrees with the scope including the exemptions for ETFs and Eurobonds.

However, ISSA further urges additional focus on the treatment on dual-listed instruments. Dialogue between regulators in the UK and EU should be promoted to ensure international convergence, including a recommendation for the settlement convention for each trading line to align with the settlement convention of the primary listing exchange. For example, an instrument with the UK as the primary listing, but which is also listed and traded on the French stock-exchange, should trade and settle on a T+1 basis, whereas an instrument with France as the primary listing, also traded on the UK stock exchange, should trade and settle on a T+2 basis (assuming that is the UK and EU move to T+1 on separate implementation dates).

We also suggest that it be made clear that OTC transactions are recommended to follow the same settlement convention of the trading line, regardless of the place of settlement, although parties may agree otherwise at the point of trade.

We emphasize the aspiration for a coordinated UK, EU and Swiss migration to avoid the exemptions which, in any initiative of this scale, will challenge implementation and potentially orderly market behaviour.

We also encourage greater transparency and consider it beneficial for trading venues to publish the list of tradeable instruments and their default place of settlement, making this information available to all participants (rather than only to trading venue members). A public record on the FCA FIRDS database could be a single, coordinated means to achieve this.

ISSA also considers it beneficial for the final recommendations on scope to clarify the treatment of derivatives.

2. Do you agree with the Principal recommendations related to the completion of post-trade, pre-settlement activities on Trade Date, and do you think these measures are sufficient to support timely settlement on T+1?

a. If not, please outline which areas you disagree with or think need further clarity

ISSA agrees with the UK Technical Group that allocations of trades by asset managers to executing brokers and the subsequent confirmations from the executing brokers back to the asset managers, should be in electronic form and completed on Trade Date.

However, ISSA suggests that the UK Technical Group further discuss the merits of going one step further, to include in the “Code of Conduct” encouragement of the asset manager’s agreement (performed by electronic matching or electronic acknowledgement) of the details of the trade listed in the confirmation, on Trade Date. It may be a critical success factor for an efficient T+1 implementation for the trading parties to agree the details of all trades before moving to the settlement steps by their settlement agents that have accounts at the CSD.

Regarding the consideration of an extended settlement instruction deadline for trades by international investors, ISSA commends the Technical Group’s intention of extending accommodations for international investors to help mitigate the challenges they have due to time zone and currency differences. However, this particular accommodation may not be workable for two reasons:

- It is very difficult, if not impossible, for the CSD to accurately identify cross-border trades from domestic trades input for settlement by the same CSD member firm, as settlement agent.
- If the cut-offs are different, market participants will cite the ability of the CSD to settle cross-border trades input at a later deadline as evidence that it can settle all trades input at the later deadline. Thus, the latest deadline possible should be adopted for all trades.

We do however consider it important to emphasize the expectation that all market participants send settlement instructions as soon as is practically and technologically possible, on Trade Date, to the extent possible, and we therefore encourage timely notification of execution/allocation/confirmation/trade agreement as a precursor to enable this.

3. Do you agree with the categorisation of the recommendations as Principal and Additional to the transition to T+1 settlement in the UK?

a. If not, which recommendations do you believe are incorrectly categorised?

ISSA agrees with that categorization. However, we urge the UK Technical Group to be very clear on the mandatory/optional nature of the “Code of Conduct”, making clear that while firms will not be asked to “accept” it or be legally bound by it, they will be expected by their counterparties to demonstrate their adherence to it, except for exceptional situations, and that critical mass adherence to it is necessary for the efficient operation of the UK market, upon transition to T+1. Of course, regulators will also expect adherence should the Code of Conduct or elements of it ultimately become adopted by UK legislation or supervisory policy.

While ISSA supports the merits of inventory management techniques such as shaping, which is most attributable to debt instruments, we do not consider it to be critical to the success of what is, effectively, an equity migration to T+1. We note that SETT 8.00 recommends clips at 50MN which will be attributable to debt flow for which UK GILTS are T+1 today. ‘Systematic’ also implies automation either at the point of trade or at the point of settlement, and either way there will be technical development required that may be best suited to the CREST modernization roadmap, as a separate path for UK market modernization and efficiency. We therefore recommend that SETT 08.00 becomes an ‘additional’ recommendation rather than ‘principal’.

We are also somewhat concerned with SFT 06.00 in the consideration that lending buffers represent a commercial decision for firms based on their flow, resources and risk appetite. We recommend therefore that SFT 06.00 is reclassified as ‘additional’.

4. Are there any recommendations that you think are incorrect, unnecessary or need to be further clarified?

a. If yes, please identify the recommendations and why you think they’re incorrect, unnecessary or need greater clarity

While ISSA is an advocate for settlement efficiency, some of our members have concerns with regards to SETT 07.00 and the obligation members have to uphold the high standards of asset safety in the UK market as prescribed by UK CASS and MiFID II. Custodians need to closely monitor clients’ resources to ensure cash and securities adequacy - this is particularly relevant for partial settlement in omnibus accounts. We are of the view that SETT 07.00 would benefit from additional clarity and discussion, to ensure that the technical requirements at the CSD, and for custodians, are clear and factored into the recommendations. As a minimum, partial release functionality at the level of the CSD and replicated by custodians and other intermediaries, is essential for managing partial settlement in omnibus accounts. We believe that this analysis should be progressed before a final decision is made on what exactly the partial settlement requirement is in the UK Code of Conduct.

5. Are there any recommendations that you think are missing from this list that would be necessary for a UK transition to T+1 settlement?

a. If yes, please clarify what you think they are

ISSA agrees with the general recommendation that Securities Financing Recall Requests be made in automated form by a deadline on Trade Date agreed to by the market, for a security that is being sold on that day. While we see the desirability of having the asset manager’s sale order to the executing broker being the trigger for the recall request, ISSA urges further dialogue with the buy-side community on this, as many buy-side firms are quite sensitive about sharing confidential execution order information with anyone other than their executing broker before a trade execution is completed, due to concerns about telegraphing intent to buy or sell and potential price movements that might cause.

Further, the recommendations should be extended to clarify the timeframe for the actual return of the security out on loan. If the security is not returned on the next business day, the settlement date for the sale transaction, the sale transaction will fail (unless the seller's custodian bank is able to borrow other securities from its own inventory or it's other customers' inventory). Clearly, the Stock Lending function is a critical activity to enable short selling, which itself is critical for accurate price discovery, to function. Thus, we urge the UK Technical Group to continue discussions with the Stock Loan community to determine the market practice for the actual returns of securities out on loan, in the T+1 settlement environment. It should be made clear that any stock loan return on T+2 of the sale trade or later, will lead to fails and a decrease in settlement efficiency in the UK. If the UK Technical Group decides there should not be a recommended deadline for stock loan returns, it should explain the rationale for having no deadline.

We note that the Corporate Action requirements do not consider 'buyer protection'. ISSA members believe that a closer review of corporate action processing is required to ensure client entitlements and protection are upheld in a T+1 operating environment, with deadlines seemingly requiring revision. Furthermore, the treatment of multi-listed securities has not been outlined in the draft recommendations. We are mindful that the UK Technical Group needs to consider the potential for the UK to migrate ahead of the EU at every stage of the execution to post execution lifecycle.

We suggest that the potential for a moratorium on CREST settlement fail penalties during the transition to T+1 settlement be explored.

6. Do you have any other comments to make with regards to the UK transition to T+1 settlement?

ISSA understands that final target dates for implementation of T+1 settlement are not the focus of this Draft Recommendation report & Consultation. That said, we urge the UK Technical Group to make clear in the final report, that certain recommendations such as Trade Date processing and stock loan market deadlines, are not to be implemented upon the targeted T+1 implementation date, rather they are to be implemented ahead of migration date, to the extent possible, by market participants, Financial Market Infrastructures, and the vendors and utilities that support them. In this way, the UK Technical Group, market participants and regulators can be confident that the industry is truly prepared to implement T+1 in a manner that optimizes market efficiency, including settlement efficiency. To not disadvantage the industry in the 'preparatory phase', any such early implementation should not be subject to a regulatory mandate (which should only become effective upon migration - - prescribed by a change to UK CSDR Article 5.2).

Further, ISSA encourages the UK Accelerated Settlement Task Force to continue to coordinate with other jurisdictions, including the EU and Switzerland, on plans to accelerate settlement.

Finally, ISSA supports the Task Force working with industry participants and Financial Market Infrastructures on the important aspects of testing (both functionally and from a resilience perspective) and overall scheduling, including the avoidance of peak operational timings for the transition, where feasible.

Appendix

In its December 2023 white paper, ISSA's T+1 Global Impacts Working Group (now renamed Accelerated Settlement Working Group) made four recommendations to the industry and regulatory bodies that are contemplating the possibility of accelerating their market's settlement cycles to work together collaboratively on. Those four recommendations are:

- Work with sell-side, buy-side, and securities services participants in key market centres around the world that represent significant cross-border transaction volume into their markets to evaluate the known issues to be solved and identify any unknown issues. Once identified, determine the impact of them on international investors and market practice. Then, identify operational changes necessary to mitigate the issues and related risks, prior to making any final recommendations, most importantly, before setting a target date for that market to move to T+1.
- Analyze the T+1 business case, not just at a macro-industry level, but on a much more segmented level, assessing the impacts both domestically and internationally. Several surveys of industry readiness for T+1 have shown that certain segments are far less advanced in their preparations to move to T+1 than others. While this may vary from market to market, the Working Group feels that the readiness data shows that the sponsors of T+1 explorations should work very early with investment management firms of all sizes in market centres around the world that invest in their domestic market's securities. The aim should be to identify all the challenges from those firms' perspectives and develop solutions or risk mitigants, prior to making any final recommendations, including setting a target date for that market to move to T+1.
- Once the solutions and risk mitigants are agreed and scoped for implementation, the sponsors should include end-to-end testing of international transactions in their T+1 "Playbook". This ensures that transactions related to the areas of enhanced challenges for international investors are solved prior to implementation. Ideally, regulators, central banks and/or market infrastructures could require that all critical market practice changes necessary to implement T+1 settlement successfully, be in place and utilized by all market participants for a significant period prior to the targeted implementation date of T+1 settlement.
- Specifically related to Foreign Exchange (FX), ISSA recommends that domestic markets, with collaboration from investment managers in key geographic markets for cross-border transactions into their market, reach out to the FX/international payments industry to analyze the obstacles in both execution/liquidity and settlement, before finalizing plans to move to T+1 settlement.

The full white paper can be accessed via the link below.

https://issanet.org/content/uploads/2023/12/ISSA-T1-Global-Impacts_FINAL-.pdf