April 8, 2022

TO: Secretary, Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Submitted via email to: rule-comments@sec.gov

RE: File Number S7-05-22, "Shortening the Securities Transaction Settlement Cycle"

From: ISITC (isitc.org) Board and Co-Chairs on behalf of the Membership

ISITC[1] is thankful for the opportunity to respond to the U.S. Securities and Exchange Commission ("SEC" or the "Commission") proposed rule changes in regards to Reducing Risks in Clearing and Settlement (the "Proposal") through a change to a T+1 standard settlement cycle from the current T+2 standard settlement cycle (File Number S7-05-22). We understand on the whole that the proposed changes are designed to reduce the credit, market, and liquidity risks in securities transactions faced by market participants and U.S. investors and support these goals.

We appreciate the Commission's endeavor to improve the efficiency of markets and reduce risk. We also appreciate the Proposal has been informed by coordination with multiple participants in the industry. We welcome continued interaction with the industry at large, and offer that ISITC brings a unique perspective of a key impacted cross section of participants including broker/dealers, asset/investment/fund managers, global custodians, industry infrastructure, other service providers and vendors that operate in the U.S. securities markets in both domestic and cross border arenas.

To that end, ISITC constituents would appreciate the opportunity to work with the SEC and other industry participants in examining some areas that we believe may have impacts to achieving the goals of the Proposal and look forward to more detailed discussions to further inform a path forward to enable the stated goals. This letter is aimed to be informative and educational, as opposed to advocating for any particular position, and to invite further collaboration between the SEC and the industry regarding advancing straight through processing and shortening of the settlement cycle.

We group our comments into eight main points on following pages.

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[1] ISITC, founded in 1992, is the industry trade group focused on developing standards and best practices in financial services operations globally. ISITC brings together broker/dealers, custodians, investment managers, vendors/utilities and other industry professionals to develop standards that are designed to enhance efficiencies in trade processing and related communications.
Through collaboration, ISITC's volunteer members reduce inefficiencies, lower risk and build shareholder value while developing and promoting the global securities industry. ISITC provides members with the means to revolutionize the securities-trading process. (see: https://isitc.org/about/about-isitc)

T+0

ISITC sees the move to T+1 as the next viable step to shorten the settlement cycle. We believe too much focus on T+0 issues may distract from resolving key hurdles to the jump to T+1. We feel that the work required to move to T+1 will necessarily address or act as steppingstones to any later considered move to T+0, but encourage that the focus should remain squarely on T+1.

That being said, we believe that there likely would need to be a drastic overhaul of industry and individual firms' infrastructure and operating models in any transition to T+0 on an order of magnitude higher than any T+1 considerations.

Formal Contractual Requirements (Proposed Rule 15c6-2)

Formal contractual requirements between broker/dealers and clients of asset/investment managers[2], or between broker/dealers and investment managers have previously not been required in the moves to T+3 or T+2. High level concerns include the difficulty in putting these types of contracts into place, implications of introducing contracts where none exist today, as well as enforcement of such contracts.

Any effort to put contracts in place, such that they do not exist today, would be a significant undertaking with significant associated costs for industry participants. This would not be a repapering exercise, which itself would have disruption, but would instead be a new papering exercise between entities that today do not have direct contractual obligations. This could potentially require a firm to create new contracts with hundreds (or thousands) of entities they currently do not have any contractual relationship with today.

Further, we are not confident that a legal contract between asset/investment managers and broker/dealers would have the desired effect (that is to create liquidity through a shortened settlement cycle) as there are many more parties involved as described below, not just in the trade allocation and matching process that is being targeted, but in many processes that come during and after this process that are necessary to effect clearing and settlement.

Finally, members in the ISITC Settlements Working Group[3] have raised concerns in regard to what kind of oversight would be required, and what form any enforcement would take. There were questions on how accountability would be assigned, as certain flows that would be subject to the proposed contractual agreements have multiple dependencies on different entities not identified in the Proposal.

Broker/Dealer vs Institutional Flows

When a broker/dealer trades with another broker/dealer, the resulting CNS (continuous net settlement) process is significantly different from the Institutional account Deliver or Receive vs Payment process. While both finally resolve within the involved parties' DTC accounts within DTCC, the paths taken to finally get there are vastly different.

We appreciate the SEC's clear consideration of the DTCC, ICI and SIFMA paper "Accelerating the U.S. Securities Settlement Cycle to T+1"[4], which provides excellent detail in regard to many of the concerns and challenges in any move to T+1. As such, we agree that the challenges to achieving T+1 specific to the CNS process can be addressed.

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[2] For simplicity, we use "investment managers" though this should be recognized to include the wide variety of asset and investment manager types that collectively make up what is sometimes referred to as the "Buy Side"

[3] This discussion took place during the ISITC 28th Annual Securities Operations Summit in Boston, March 20-22, 2022

[4] https://www.ici.org/system/files/2021-11/21_ppr_t1.pdf

However, we note that there may be a misunderstanding in regard to the significant differences in flows between CNS-related settlements and Institutional settlements that are destined for the confirm/affirm process in TradeSuite or the Delivery Order process at DTC, as opposed to NSCC. There are also flows that may result in CNS settlements, but have unidentified dependencies in regard to the Institutional side, such as SMA[5]'s (covered below). Indeed, the majority of the flow detail provided pertains primarily to broker/dealer to broker/dealer flows and processes as it relates to CNS and NSCC only. It also should be noted that there are different flows in regard to asset type.

ISITC agrees it would be a significant benefit to the industry to have the matching and confirm process between broker/dealers and investment managers completed on Trade Date (T), and this has been a focus for ISITC in our work in setting market practices. That being noted, this is only the very beginning of the workflow for the Institutional side. Investment managers must still pass separate instructions[6] to their custodian banks. In some cases, these instructions must come from the underlying client or an agent like Japanese Trust Banks directly, requiring the Manager to also confirm details with clients, who will then send these instructions to the custodian.

Custodians cannot operate off a broker confirmation alone, as the fiduciary responsibility is to the ultimate client, not the broker. This is a necessary check to protect the end investor. The confirm must be affirmed by a party assigned by the underlying client (and sometimes the client themselves). Many investment managers instruct the custodian bank via SWIFT messaging in order to have more control on what trades the banks will set up and are expected to affirm.

Upon receipt of the instructions from either the investment manager or affirming party, the custodian must book the trade on either DTC or US Fed platforms, depending on security type. While much of this process has been automated, flows and implementation differ. There also may be additional parties in the chain to communicate trade details, especially where investment managers may be using service providers for middle office and back office processing. Issues that arise later in the day on T that require amendments or re-bookings will be challenging to resolve prior to T+1 due to the number of parties impacted.

Additional parties that are impacted in regard to Institutional flows include, but are not limited to; third party lenders, FX providers, Fund Administrators, Fund Accountants, Trust Banks, correspondent banks, and so forth.

We also note that during periods of volatility, trade volume executed close to market close increases significantly. This then impacts the timing in which the middle offices of brokers and managers are able to match on CTM (especially in regards to resolving any matching errors). This step must complete prior to a manager instructing custodians. If managers must instruct custodians prior to full matching, this removes the benefits provided by the central matching facility of CTM, as any corrections (commission changes, fee charges, etc) will necessitate cancel and re-bookings, further delaying instructions and raising the risks of failed trades.

Automation Issues

While the top tier and many second tier firms have invested in communication protocols and standards that enable STP, there is a significant population of 2nd tier and 3rd tier managers and clients where automation investment is limited to non STP solutions, such as creating automated emails, or even PDF style documents sent

[5] SMA's – Separately Managed Accounts

[6] Instructions can include, but are not limited to, block, allocation, settlement, securities lending, accounting, and other related messages related to a complete trade settlement flow.

via email, essentially mimicking the FAX processes of decades ago.[7] This lack of automation can include clients of top tier and 2nd tier firms that otherwise may be highly automated.

There should be some consideration of these market participants, in that they could be disenfranchised if necessary technological investment costs necessary for T+1 participation outweighs their ability to operate their business, especially for regional providers.

Also, we would note that matching through CTM is not a flawless process. Higher volumes necessarily result in higher volumes of errors that need to be manually resolved. Additionally, technical issues in regards to connectivity to CTM are not uncommon which may delay a broker or manager individually being delayed in sending matching instructions.

Retail Specific

A growing and significant portion[8] of US trading is conducted by individual retail investors often facilitated by regional US brokerage firms. In addition, a growing number of US trades are cross-border, placed by retail investors in other countries often multiple times zones east of the US. Consideration should be given to retail flow in general, and in particular, the timing impact of funding requirements by international investors initiating foreign exchange transactions from their home currency to USD to effect trade settlement.

The implication for T+1 settlement is there are more parties involved in the overall workflow in retail flows than there are even in the institutional flows discussed above. Further, the issues regarding foreign exchange transactions, discussed in more detail below, linked to retail activity should be considered to have more complex implications and timing concerns.

Time Stamp

Many constituents believe that it would be a heavy lift to set up systems and reporting functions to capture and agree upon one time stamp when the confirm was billed and affirmed. There are technical and practical considerations, beyond workflow issues that will be discussed below (see Confirm/Affirm section). Time stamps are employed today, but not an agreed time stamp as envisioned in the Proposal, which would be a new administrative requirement.

Overall, there is a question on the expected benefit of some agreed upon time stamp, and what the enforcement regime would be, and to what purpose. It is unclear if enforcement of an agreed time stamp is a proxy for enforcement of confirmation/affirmation, which is understandable but may instead introduce confusion and complication in focusing efforts towards time stamping versus the ultimate goal of trying to agree all trade, matching, and settlement details by end of day on T.

This opens a further question on what is being defined as end of day on trade date in regard to time stamping. Currently, end of trading is 4 PM ET for Equity and 5 PM ET for Fixed Income. An investment manager will still

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[7] Incidentally, there still remain FAX-based messaging in existence, just as there are manual check processing for payments, that is not insignificant.

[8] The percentage of trading volume attributed to retail trading runs from 20% to over 30% of all trading. Day traders alone accounted for between 20% and 25% of daily volume in 2021 (Bloomberg; https://www.bloomberg.com/news/articles/2021-11-17/retail-traders-retreat-as-choppy-markets-challenge-easy-profits), and up to 32% of U.S. equity volume in 2021 (Reuters; https://www.reuters.com/article/us-retail-trading-numbers/factbox-the-u-s-retail-trading-frenzy-in-numbers-idUSKBN29Y2PW)

have to allocate after a trade was executed at close, which will require pushing allocation/matching processes currently performed on T+1 to after hours on T. If, due to the issues described below in the Confirm/Affirm section, these processes occur post-midnight ET, enforcement of an arbitrary timestamp requirement may incorrectly identify properly affirmed trades as non-compliant.

Practical and technical considerations include the agreement of time stamp format, evidence of time stamps (for compliance or audit purposes), natural time differences due to multiple systems across multiple participants such that these time stamps will likely not perfectly match, and new processes needed to govern resolution of time stamps that could delay trade processing when all pertinent trade details are otherwise correct and agreed.

There also should be recognition that not all flow is processed through central matching facilities in regard to Institutional workflows. And even where central matching (e.g. CTM) is employed, there are many more parties involved in the Institutional flows, outside of central matching, than in the CNS workflow. In bilateral matching, it is unclear if the Proposal would require the investment manager to provide a timestamp on allocations sent to their Custodian, which necessarily occurs after execution. In these cases, custodians will process allocations on a best efforts basis, especially when received non-electronically or near the deadline. This becomes relevant in questioning the value of the timestamp, as if an investment manager timestamps 5 minutes prior to deadline, this does not ensure the custodian has a feasible amount of time to process the instruction, especially when received manually.

Confirm/Affirm

As noted above, there is significant difference in the flows, parties involved, messaging, and coordination required when contrasting CNS Broker flows through an exchange versus Institutional flows that involve beneficiaries, custodians, lenders, correspondents, FX facilities, and other entities. There are four main points within the confirmation and affirmation process that we wish to highlight.

1. The confirm/affirm process does not apply to firms involved in the retail or SMA (Separately Managed Accounts) business. Sponsors of such programs may be broker/dealers themselves that are acting instead as a custodian in these relationships. An investment manager would need a confirm to be billed for all allocations and an affirmation set up. However, since the SMA Accounts are retail in nature and settle via CNS, a confirm would not be billed. In these types of cases, the investment manager could not comply with the proposed regulatory requirement.

2. ETF – This causes some complications both on the asset itself being traded as part of a Fund of Funds or the underlying assets making up the ETF based on funding. We appreciate the detailed analysis in regards to basic open ended mutual funds and standard ETFs. However, there are additional parties and processing involved regarding ETFs in regards to Fund of Funds and rebalancing activities that occur in regards to the constituents of an ETF based on funding.

3. Confirm/affirm as it relates to block / allocations. Some investment managers may pre-allocate with a broker/dealer before a trade is fully executed. In these cases, these allocations may not be passed on to the custodian bank, as any changes to the block execution would result in requiring cancel and rebooking of all allocations to those instructions, raising the risk of errors.

Typically, however, trades are filled and executed first, then allocated and instructed to custodians and other entities in the workflow, such as 3rd party lenders and fund administrators. The reasoning for this is that there may be partial fills where original blocks are then changed, impacting the final allocations. In the former case (pre-allocated), this results in the need to then rebook pre-allocated allocations. In the latter case, this can delay the allocation process as new calculations for allocations are performed.

4. Unidentified costs – as noted above, there exist a community of market participants that would need to make investments in technology – some significantly so – to make changes, such as migrating the current TradeSuite broker/confirm process to other processes such as the Match-to-Instruct (M2i) workflow in CTM. The potential implications for firms that currently support these processes manually but do not have the volume where there is a reasonable break even could result in their disenfranchisement (e.g. smaller regional mid tier firms may be priced out that are unable to compete with larger firms able to make more significant technological investments).

Time Zones and Foreign Investors

ISITC constituents operate globally and note that there will be impacts to non-US based asset/investment managers that are clients of US based institutions. At the most extreme, consider that any Australian-based investment manager would have to effectively operate on a T+0 basis, given the time differences. A non-US investment manager might not be able to fill and execute their US securities trades before their local close of business thus they would not be able to comply with the allocation, confirmation and affirmation process on trade date. This has particular impact in regard to being able to fund settlements through foreign exchange, realigning inventory, perform securities lending recalls, as well as being able to allocate (as the allocation is dependent upon an initial broker affirmation/confirmation in a different time zone). Essentially, a non-US based investor may need to fully allocate and instruct, set foreign exchange and funding, and perform realignments prior to submitting a trade execution request to their broker.

As noted above, this process can be further complicated by partial fills where a full block execution is not completed by end of T+0 in the investment manager's time zone, resulting in amendments or cancels and rebooking of trades. This process of amendments, and the downstream implications for FX, realignments and so forth, would not begin until T+1.

This can be further complicated by requirements in other jurisdictions for transaction flow to pass through additional entities, such as intermediaries like trust banks in Japan, Italy, and elsewhere.

There are also cases where an account is set up with a base currency other than USD, therefore every time the account trades a US Security an FX must be completed. This would be a challenge to be completed within the required time frames in a T+1 environment.

In regard to funding from foreign currency, the necessary foreign exchange process can be further delayed in cases where investment managers wait until net money on multiple trades are confirmed. This is done in order to set up a single foreign exchange transaction across the full net money for funding purpose, as doing so can ensure better rates and reduces risk by having full funding across all outstanding trades available versus relying on multiple foreign exchange transactions tied to individual securities transactions.

Other Issues:

Funding – Some ISITC members have raised a question if there is a requirement to pre-fund in order to trade US securities in a T+1 environment. Many institutional accounts will have margin agreements set up with the custodian bank to borrow cash in order to settle trades. However, there are many accounts that are not or cannot be set up that way. This can be due to regulatory restrictions in how those accounts are managed and funded that could conflict with being able to satisfy such prefunding requirements.

Collateral Management – For firms using a non-Triparty provider and posting equities in USD, there are disconnected workflows required to move collateral properly. There is a need for more automation in order to settle collateral outside of non-Triparty providers, but this may not relieve the timing issues necessary to achieve T+1.

Corporate Actions – There is activity specific to trading strategies focused around Ex-Date, especially involving voluntary corporate actions. ISITC members raised the question that this type of activity does not appear to be covered in the discussed workflows. Given the variety of corporate action events, there could be other concerns.

Securities Lending – We do note that the broker side of securities lending issues has received attention. Our focus, though, remains on the institutional flows. Currently the recall time is 3 PM ET on T+1. Some lending agents use a batch process for recalling shares whereas others will recall intra-day. As noted above, there can be a challenge in the custodian receiving trade instructions in a timely manner in regard to the institutional workflows. Where the lending agent is also the custodian bank, then, any securities lending recalls would not begin until after this trade instruction workflow reaches the custodian. If a third party lender is involved, this creates a secondary, bifurcated flow that can be similarly delayed. A third party lending agent must be separately instructed, and subsequently must have the shares recalled and back into the custody position at the bank, in order for it to be delivered in time.

New accounts and New issues – There are challenges around timing for setting up new accounts, as well as setting up new issues. For new accounts, there is a dependency where an investment manager informs a broker/dealer of a new account. As necessary Know Your Client (KYC) processes must be performed, this may delay account setup on a broker's systems even though the investment manager's KYC process has completed and the client is cleared for trading. Similarly, when new issues begin trading, there is a challenge in setting up the necessary reference data in regards to the security information. While the issue is known and available to trade on secondary markets, the required identifier needed to settle at DTC is many times not yet disseminated, or necessary reference data points for the security master may not yet be verified. Even in cases where an alternative identifier may be utilized, DTC-eligible securities can only be instructed using a specific identifier. Instructions using alternative or 'dummy' identifiers need to be amended and re-booked prior to any settlement instructions being issued. Both new accounts and new issues may be delayed by a day.

Bilateral claims – The claiming process is largely manual between parties across the industry. Operational inefficiencies magnified within a T+1 environment increases dependency on the parties to resolve disputes via claims; notably delays in securities lending and collateral management.

Conclusion

ISITC, as stated, is a volunteer-run, vendor-neutral, market practice organization focused on education and collaboration for finding common solutions to shared problems within the global securities industry. We wish to be clear that our letter and statements here are presented in that vein only, i.e. to educate and provide information based on the expertise of our participating membership. We are not advocating for or against any position in regard to the question of moving to T+1 or not. The views of ISITC are its collective views as market experts and are not necessarily representative of any individual firm's position.

Since 1992, ISITC has been committed to moving the industry, via collaboratively created market and best practices, to a straight through processing environment, through automating messaging and communication across the many varied participants involved in the post-execution trade flow.

To that end, ISITC would be pleased to continue to openly engage with the SEC, and other industry participants, in any productive way, including through our focused Working Groups and Forums, or providing time at upcoming meetings to directly interact with the SEC and other industry participants on the items noted above[9]. In addition, ISITC oversees many of the US Securities Industry Market and Best Practices. Therefore, as the SEC proposal to shorten the settlement cycle gets closer to finalization, our membership engagement will help in updating these documents[10].

Our member firms are committed to the SEC's goals of reducing the credit, market, and liquidity risks in securities transactions as well as creating more efficiency through agreed market practice. ISITC concurs with the SEC's ultimate goals and hopes to help inform and educate in areas that could have impacts to achieving those goals, or reduce the effectiveness of the envisioned benefits.

For purposes of communication, as of April 2022, the SEC should contact and include (contact information provided via email):

Kristin Swenton Hochstein (Chair)
Richard Robinson (Vice Chair)
Grace Kang (2nd Vice Chair)
Jason Brasile (Chair, Industry Relations and Member of the Board)
Gary Heald (Co-Chair, Settlements Working Group)

[9] ISITC holds three in person conferences a year; March – Boston, September – Baltimore / Washington D.C. area, and December – Fort Lauderdale. In addition, Working Groups and Forums hold regular meetings via conference call or virtually, and we host ad-hoc virtual and in person panels on current topics as deemed relevant by the Board.

[10] https://isitc.org/market-practices/market-practices