



State Street Corporation

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Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

Via e-mail: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

**Proposed Rule – Shortening the Securities Transaction Settlement Cycle**  
**(File Number: S7-05-22)**

Dear Ms. Countryman:

State Street Corporation (“State Street”) welcomes the opportunity to comment on the proposed rule issued by the Securities and Exchange Commission (“Commission”) to shorten the standard settlement cycle for securities transactions in the United States (“US”) from trade date plus two business days (“T+2”) to trade date plus one business day (“T+1”), supported by various additional measures designed to improve the efficiency of institutional post-trade processes. This includes new requirements for the same day affirmation of securities transactions, amendments to the recordkeeping obligations for investment advisors relative to trade allocations, confirmations and affirmations, and obligations for central matching service providers (“CMSP”) to facilitate the adoption by their customers of straight-through processing.

In addition, the Commission expresses strong interest in the potential implementation, over time, of same-day settlement (“T+0”) in the US securities market, and requests comments on potential pathways and challenges to adoption. While we appreciate the Commission’s proposed rule and broadly agree that the industry has, without regulatory intervention, made substantial progress in laying the groundwork for a shortened settlement cycle in the US securities market, we note that the implementation of T+1 settlement is a significant undertaking for the industry that may require more time to implement than envisioned by the Commission. Furthermore, we note that the challenges presented by T+0 settlement for the industry are vastly more complex than generally assumed, including considerations relative to

payment systems and bank business models that require the considered input and guidance of the prudential regulators. As such, we recommend that the Commission consider a more deliberative approach to the issue of T+0 settlement via a separate advance notice of proposed rulemaking (“ANPR”) issued in conjunction with the federal banking agencies.<sup>1</sup>

Headquartered in Boston, Massachusetts, State Street is a global custody bank which specializes in the provision of financial and investment services to institutional investor clients. This includes investment servicing, investment management, data and analytics, and investment research and trading. With \$43.7 trillion in assets under custody and administration and \$4.1 trillion in assets under management, State Street offers its clients the ability to transact and hold assets in more than 100 geographic markets.<sup>2</sup> State Street is organized as a US bank holding company, with operations conducted through several entities, primarily its wholly-owned state-chartered insured depository institution subsidiary, State Street Bank and Trust Company. Among other entities, the State Street organization includes State Street Global Markets, LLC, a direct wholly-owned subsidiary of State Street and a US registered broker-dealer regulated by the Commission, as well as various other entities comprising its investment management arm, State Street Global Advisors.

We appreciate the opportunity to offer our perspective on the proposed rule, informed by our role as a custody bank, a role that is widely understood by the market and by the regulatory community as providing important benefits for the safety of client assets and the stability of the financial system.

## **THE CUSTODY BANK BUSINESS MODEL**

Custody banks, such as State Street, employ a highly specialized business model focused on meeting the financial services needs of institutional investor clients globally. These clients, which include asset owners, asset managers and official sector institutions, contract with custody banks to ensure the proper safekeeping and administration of their investment assets. This includes access to the global settlement infrastructure in order to complete the purchase or sale of investment securities, and various asset servicing functions, such as the processing of income and other interest payments, voluntary and involuntary corporate action events, tax reclamations, and client subscriptions and redemptions. This also includes the provision of various banking services, notably access to deposit accounts used to facilitate day-to-day transactional activities. Custody banks are subject to prudential regulation, including stringent capital and liquidity mandates, as well as obligations relative to operational resilience and recovery and resolution planning. Custody banks are also subject to ongoing, day-to-day supervisory oversight.

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<sup>1</sup>Board of Governors of the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

<sup>2</sup> As of December 30, 2021.

In order to facilitate settlement in global financial markets, custody banks maintain an extensive network of relationships with sub-custodian and correspondent banks, as well as direct and indirect links with financial market infrastructure (“FMI”), such as central securities depositories (“CSD”) and national payment systems. Assets held by custody banks belong to the client and are fully segregated from the custody bank’s own assets. As such, custody banks provide services to their clients as a directed agent, meaning as an entity that does not have discretion over assets, acting solely in accordance with instructions received.

Consistent with this highly specialized business model, the custody bank balance sheet is liability driven and expands not through asset growth, but through the establishment of client servicing relationships that over time generate incremental volumes of stable deposits. These deposits, rather than various sources of wholesale funding, comprise the largest part of the custody banks’ liabilities. For instance, as of Q4 2021 client deposits made up more than 75% of State Street’s total balance sheet. The deposits held by custody banks are used to purchase large, highly-liquid and well-diversified portfolios of investment assets which generate conservative amounts of net interest revenue. Importantly, custody banks acquire deposit liabilities as a direct result of the services which they provide to their clients. In other words, the cash deposits that come on to the custody bank balance sheet are driven by customer-related activities and not by the custody banks’ own financing decisions.

Below we offer a series of observations on the Commission’s proposals related to the implementation of T+1 settlement, followed by a series of initial high-level observations on the implications of same-day (T+0) settlement for various operational processes and investment products which are central to the custody bank business model.

## **PROPOSALS FOR T+1 SETTLEMENT**

Reflecting on the history of progressive reductions in the settlement cycle for securities transactions in the US, and the ongoing work of the industry to implement T+1 settlement<sup>3</sup>, the Commission proposes to mandate the adoption of T+1 by March 31, 2024, while also proposing several additional measures designed to improve the efficiency of existing post-trade processes. The Commission notes, in this respect, that ‘market participants have made substantial progress in identifying the technological and operational changes that would be necessary to establish T+1 settlement’ and that there is ‘significant industry support for such a move.’<sup>4</sup> We agree with this characterization of the role which the industry has played in facilitating a reduction of the settlement cycle for securities transactions in the US, and we broadly support the adoption of T+1 settlement in a manner that allows for and supports an

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<sup>3</sup> ‘Accelerating the US Securities Settlement Cycle to T+1’, Joint Report from the Depository Trust and Clearing Corporation (“DTCC”), the Securities Industry and Financial Markets Association (“SIFMA”) and the Investment Company Institute (“ICI”) (December 1, 2021).

<sup>4</sup> Proposed Rule, pages 40041.

‘orderly transition’.<sup>5</sup> This includes sufficient time for market participants to ‘plan for, implement and test changes to their systems, operations, policies and procedures’, and also to ‘engage in outreach and education’ with the broad range of investors of different size and sophistication that will be impacted by such a move.<sup>6</sup>

As noted by the Commission, the adoption of T+1 settlement can be expected to materially reduce risk in existing post-trade processes. This includes a decline in the length of exposures to trading counterparties, lower margin requirements for clearing members, and a reduction in both market and liquidity risk. Furthermore, moving trades more quickly to settlement will help drive improvements to risk management processes throughout the industry and enhance overall operational efficiencies. We welcome, in this respect, the Commission’s acknowledgment that ‘same-day affirmation’ represents industry best practice, although it’s not clear to us that this goal is best achieved via a requirement governing the contractual relationship between the counterparties to a trade. Instead, we recommend that the Commission require broker-dealers and other entities subject to Commission registration to implement written policies and procedures reasonably designed to achieve compliance with ‘same day’ affirmation. Furthermore, we also support measures intended to enhance the ‘straight through processing’ capabilities of CMSPs, including the annual publication of data on matching rates and other similar efficiency metrics.

Notwithstanding the considerable benefits of T+1 settlement for the securities market, we would caution against the assumption made by the Commission that a reduction in the settlement cycle will materially reduce overall systemic risk. Similarly, we note that T+1 settlement does not address the policy concerns that may exist regarding payment for order flow, margin requirements for broker-dealers and other practices cited by the Commission in its initial assessment of market volatility associated with the trading of ‘meme’ stocks in January 2021.

As emphasized in the joint report issued by DTCC, SIFMA and the ICI, the implementation of T+1 settlement in the US is a significant undertaking that requires careful planning and coordination by market participants, in conjunction with CSDs and other FMI. This includes substantial changes to existing operational systems and processes and extensive industry-wide testing of new functionality that may be difficult to achieve by the intended March 31, 2024 implementation deadline. Among the considerations that the industry will need to address in its planning efforts are changes to trade matching systems and processes, tighter deadlines for the receipt of client trade instructions and the resolution of pre-trade problems, and the implications of T+1 settlement for various asset servicing functions, such as the processing of corporate action events. The implementation of T+1 settlement will also require a reassessment of existing industry processes in the foreign exchange and securities lending markets, and the operational model for exchange traded funds (“ETFs”), considerations that

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<sup>5</sup> Proposed Rule, page 107.

<sup>6</sup> Proposed Rule, pages 107-108.

will take time to complete. The challenges of T+1 settlement are particularly acute for non-US investors, due to the greater complexity of trade processing flows and the need to convert base currency into USD.

In view of these factors, we strongly encourage the Commission to provide the industry with additional time to complete the transition to T+1 settlement. Specifically, we urge the Commission to require implementation of T+1 settlement a full two years after adoption of a final rule and its publication in the Federal Register.

## **PATHWAYS TO T+0 SETTLEMENT**

Beyond its immediate focus on the implementation of T+1 settlement in the US securities market, the Commission allocates a considerable amount of its attention in the proposed rule to the larger and ultimately far more complex issue of how to achieve same-day settlement. This includes an initial assessment of different operational models for T+0 settlement, varying pathways to its adoption in the market, and a request for feedback on the practical challenges which T+0 settlement presents for certain key processes and activities, such as the use of multilateral netting, the organization of money settlement, processing requirements for mutual funds and ETFs, institutional trade processing, securities lending, pre-funding obligations, settlement cycle mismatches and dematerialization.

While we acknowledge the Commission's interest in the potential benefits of same-day settlement, as well as its desire to begin a dialogue with the industry on how to understand and address the many challenges that such a move presents, we are concerned that the Commission may be underestimating the complexity and breadth of the issues raised by T+0 settlement, many of which have implications for matters well outside of the remit of market regulation. This includes, for instance, the organization of the US payment system, as well as the structure of key banking functions, such as the provision of deposit accounts and the extension of credit. Furthermore, while it may be possible for the industry to achieve greater efficiencies in certain post-trade processes, ultimately same-day settlement will require a fundamental overhaul of the existing clearing, payment and settlement ecosystem for the US securities market. This includes, in our view, the broad use of emerging technologies, such as tokenized assets and instantaneous or near instantaneous payment functionality, to drive further automation and efficiencies. In this sense, the substantial 'investments in new technology and operations undertaken (by the industry) to achieve T+1 settlement' are unlikely to materially facilitate the further transition of the market to T+0 settlement, in the manner envisioned in the proposed rule.<sup>7</sup>

As such, we believe that the Commission would be better served if it were to adopt a different and more deliberative approach to its engagement with the industry on the issue of T+0

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<sup>7</sup> Proposed Rule, page 112; see also Question 2, page 53.

settlement, specifically via the issuance of an ANPR in conjunction with the federal banking agencies. In the interim, we offer below some initial high-level observations on certain of the practical matters raised by the Commission where we have a strong interest and where we believe that we can offer constructive feedback. It is our hope that we will be able to supplement these observations with additional, more granular insight over time through further and appropriately designed rulemaking.

### **Multilateral Netting**

Custody is, at its core, an agency activity involving the safekeeping of client assets and the provision of various asset administration services that result from that safekeeping function. This includes the settlement of trades on behalf of clients in the various markets where the client may choose to invest. The settlement of trades is undertaken in accordance with specific instructions received from the client. As such, the custodian does not have discretion over the transactions entered into by its clients, nor does it assume economic risk that may result from the execution of these transactions in the market (either counterparty or market risk). In effect then, any expansion of the role of the custodian to include direct membership in the National Securities Clearing Corporation (“NSCC”) (and therefore the assumption of principal risk for client transactions) would represent a fundamental change in the business model that custody banks (and their regulators) are unlikely to accept. Direct membership in NSCC could also result in both increased capital costs for custody banks and the need to pool assets on behalf of clients, the latter of which is antithetical to the fundamental nature of segregated client accounts. In practice, therefore, the suggestion made in Question 74 of the proposed rule to allow custody bank’s access to multilateral netting systems is not, in our view, a viable solution to meet the challenge of T+0 settlement in the US securities market. Instead, existing post-trade processes, including the clearing function, will need to be completely redesigned using emerging solutions that support real time or near real time payment functionality.

### **Same Day Settlement**

While the transition of the US securities market to T+1 settlement can generally be achieved via the compression of existing post-trade processes, this is not true for T+0 settlement which as noted above, will require the fundamental restructuring of the existing payment, clearing and settlement infrastructure. Similarly, it will also be necessary to redesign the systems that support various asset administration functions, such as the processing of corporate action events and income payments that are not necessarily aligned with the settlement of market transactions. Due to timing-related considerations, we would envision, in this respect, far greater volumes of breaks in the receipt of corporate action entitlements and income payments for our clients, thereby necessitating the establishment of new processes to manage the often time consuming work of retrieving missed entitlements from other market participants. Even then, disputes could arise in instances where a client is prevented from participating in a voluntary corporate action event due to the misdirection or misidentification of entitlement, an area of potentially significant operational risk for the industry. We therefore strongly urge the Commission to broaden its view of the operational considerations that will need to be

addressed in the pursuit of same-day settlement, including functions which are specific to the administration of client assets.

## **Money Settlement**

While it may be possible to make certain incremental changes to the existing US payment system to help support greater functionality in the settlement process, for instance by extending the close of the Fed Wire system beyond 6:30 pm, these changes are unlikely to be sufficient to support same-day settlement activity on any significant scale. Instead, T+0 settlement will require the adoption of new payment mechanisms capable of supporting the instantaneous, or near instantaneous movement of cash. This includes, for example wholesale interbank payment structures that rely on omnibus master accounts at the Federal Reserve (*e.g.* utility settlement coin), or even the implementation of a wholesale central bank digital currency. In effect then, meaningful progress in the development of payment solutions for same-day settlement cannot occur without the active support of the Federal Reserve, in a manner not currently contemplated by the Commission.

## **Mutual Fund/ETF Processing**

From an operational perspective, the success of the ETF business model is predicated on both the accuracy of the fund valuation process and the minimization of transactional and other expenses. This requires the implementation of scalable systems and practices that reduce costs and that minimize the gap between the timing of ETF pricing and the valuation of the underlying portfolio holdings. Furthermore, pricing is best undertaken when liquidity in the market is at its highest, generally at or near the market close. Given these considerations, we do not believe that the widespread use of multiple intra-day net asset value (“NAV”) calculations for ETFs, as envisioned by the Commission, is a viable solution to the adoption of T+0 settlement in the US securities market.

Although intra-day NAV calculations do take place today for a limited number of ETFs, including our SPDR® Bloomberg 1-3 Month T-Bill ETF (“BIL”), this practice is intended to meet a specific use case (to provide institutional investors with an investment vehicle than can serve as collateral) and is not scalable on an industry-wide basis. Indeed, even in the case of BIL, while the 12:00 p.m. NAV for same-day settlement is provided as an option, the vast majority of creation and redemption orders are for T+1 settlement using the 4:00 p.m. NAV. This likely reflects the additional cost of capital that the broker-dealer must incur when entering into a creation or redemption order ahead of the settlement of client trades in the secondary market, cost considerations that would vastly increase in importance were intra-day pricing to be adopted at scale. Similarly, intra-day NAV calculations would also result in additional administrative cost for the ETF, including greater staffing and operational expenses and the appointment of a third-party pricing vendor that is willing to offer such a service. Ultimately, these additional costs would likely translate into higher bid-ask spreads and transaction fees, to the detriment of the investor community.

As a practical matter, if an ETF were obligated to calculate its NAV prior to the close of the market (*e.g.* at 2:00 p.m.) due to the implementation of same-day settlement, the sponsor would establish a cut-off time for the acceptance of orders that would be based on the time that the NAV is struck. This would, in turn, mean that for the remainder of the trading day (in this case from 2:00 pm to 4:00 p.m.) the ETF would trade in the secondary market without the ability for the broker-dealer to create/ redeem shares, resulting in larger intra-day premiums/ discounts (*i.e.* dislocations between the price of the ETF and the underlying value of the portfolio holdings), wider bid-ask spreads and reduced secondary market liquidity.

From a broader perspective, in a T+0 environment essentially all of the major systems and processes that support the day-to-day operations of mutual funds would have to be reinvented using emerging solutions, such as distributed ledger technology (“DLT”), that eliminate friction in the flow of information between market participants, greatly reduce the need for reconciliations and permit the real-time or near-real-time movement of both assets and cash. These changes are extensive and encompass functions which are performed today by FMI; such as the processing of corporate action entitlements, income payments and proceeds from maturing assets; specialized capabilities which are offered by third party entities, such as pricing agents; and various fund administration services performed by custody banks, notably the processing of investor subscriptions and redemptions and the daily calculation of a fund’s NAV. We do not believe that the considerable costs and complexity that these changes entail are in the best interest of the investor community at this time, especially in the absence of any demonstrable market failure associated with T+1 settlement.

### **Institutional Trade Processing**

As previously emphasized, the adoption of T+0 settlement in the US securities market would be a transformational event for the industry that would require a complete reassessment of existing post-trade processes and systems. This, in turn, would inevitably have material implications for the relationship between institutional investors and their custody banks, as well as the competitive landscape more generally. For instance, the adoption of T+0 settlement is likely to lead to a much more integrated relationship between custody banks and their clients, with greater reliance on automation and extensive investments in information technology systems. These considerations are likely to place a further premium on the achievement of scale that will add to pressure to smaller market participants that are already struggling to keep up with both rising complexity and costs. More broadly, we would also expect the custody relationship to become more credit intensive, with a greater focus on meeting the client’s need for short-term extensions of credit (either intra-day or overnight) to address delays in the receipt of covered funds. This is especially true for foreign clients that will look to their custody banks for solutions to address challenges that will result from the timing mismatch between same-day settlement of securities transactions and the settlement of the related foreign currency transactions.



## Securities Lending

The systems which currently support the securities lending business in the US market are not designed to accommodate same-day settlement. As such, the advent of T+0 settlement would require the development of costly new systems using emerging solutions, such as DLT, that enable the real-time movement of securities across market participants and platforms. Even then, the increased costs associated with securities lending program in a T+0 environment and the greater risk of settlement fails/buy-in costs will likely discourage client participation, with substantial implications for market liquidity. This is particularly true for foreign clients operating in a different time zone, where a shortened settlement cycle will add further complexity to the loan recall process, in a manner that may undermine the economic benefit of participation in a securities lending program. Similarly, T+0 settlement would likely further complicate the issue of corporate action entitlements due to the overlap between recall day and settlement day, in a manner that could dampen the willingness of clients to support lending activity at critical times in the market.

Faced with increased risk, agent lenders may seek to manage their exposure by reducing the number of shares they make available to lend, further limiting the supply of inventory and compounding liquidity constraints. This includes greater restrictions on the availability of 'hard to borrow' securities which are generally sourced at the end of the business-day when liquidity is often already challenged. Similarly, greater costs would be particularly impactful in the general collateral market, where margins are already paper thin and where existing revenue streams barely cover the agent lender's cost of capital.

## Pre-Funding

The implementation of T+0 settlement in the US securities market would almost certainly require either: (i) the greater prefunding of transactions by clients (notably for smaller clients with less ability to negotiate commercial terms), or (ii) the extension of credit by custody banks and other service providers, to bridge the gap between the settlement of trades and the movement of covered funds. While this is clearly the case for clients engaging in cross-border transactions (due to the lag in the settlement cycle for foreign exchange transactions), this is also true for clients that invest across asset types or investment products. Given normal trading volumes in the US securities market, the cumulative cost of these extensions of credit are likely to be significant, with substantial implications for the custody business models and the management of risk. As such, we believe that a meaningful discussion of the benefits and challenges of T+0 settlement in the US market can only be undertaken in conjunction with the federal banking agencies.

## Settlement Cycle Mismatch

The adoption of T+0 settlement in the US securities market is likely to create pressing challenges for institutional investors that transact across asset classes due to the lack of alignment in settlement cycles. For instance, an institutional investor that sells a US Treasury

security (T+1 settlement) in order to purchase an equity security (T+0 settlement) will face a gap in the receipt of covered funds that will require it to either (i) delay the execution of its investment strategy, (ii) ensure the pre-funding of its investment account, or (iii) secure an extension of credit from its custody bank. A similar dynamic may also result for transactions that settle through international central securities depositories (*i.e.* Euroclear and Clearstream), entities established to support the settlement of 'stateless' debt in various currencies (including USD), since settlement generally occurs on a T+2 basis.

While settlement mismatches have implications for market participants generally, they are particularly acute for cross-border investors. This reflects both the practical reality of operating across different time zones and the need to convert base currency into USD for settlement. Barring a parallel reduction in the settlement cycle for foreign currency transactions (which currently settle on a T+1 basis), the advent of T+0 settlement in the US securities market will therefore create enormous funding challenges for foreign investors that must be carefully considered. This reinforces, in our view, the importance of a deliberative approach to the potential implementation of same-day settlement, in a manner that appropriately accounts for the multiple, overlapping activities, functions, processes and systems that define the global post-trade system. This includes the cross border flow of payments and the implications of these flows for the management of system-wide risk.

## **Dematerialization**

As noted by the Commission, even if volumes are relatively small, the continued use of physical certificates in the US securities market creates material inefficiencies in post-trade processes that lead to 'unnecessary risk and expense to the industry'.<sup>8</sup> This was highlighted in a very tangible way in October 2012, when the DTCC vault used by many market participants to hold physical certificates on behalf of clients was flooded during Hurricane Sandy, causing damage to ownership records that are still being redressed to this day. We therefore strongly support efforts by the Commission to ensure the further dematerialization of the US securities market, as well as broader efforts to address existing manual processes in the settlement of trades (*e.g.* the use of paper instructions) that reduce efficiencies and that may present greater operational risk. In our view, these efforts should be pursued by the Commission regardless of any decision to implement same-day settlement since the benefits to the securities market are clear even in a T+1 environment.

## **CONCLUSION**

Thank you once again for the opportunity to comment on the important matters raised in the proposed rule. To summarize, while we broadly support the adoption of T+1 settlement in the US securities market, we are concerned that the proposed March 31, 2024 implementation

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<sup>8</sup> Proposed Rule, page 147.

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deadline may not be sufficiently lengthy to support the Commission's goal of an 'orderly transition'. As such, we recommend that the Commission adopt a revised implementation deadline of two-years from publication of the final rule in the Federal Register. In addition, while we recognize the Commission's interest in better understanding the pathways and challenges to the eventual adoption of same-day (T+0) settlement, we believe that the Commission is underestimating the magnitude and implications of such a change, considerations which are better addressed via a separate ANPR issued in conjunction with the federal banking agencies.

Please feel free to contact me at [jibarry@statestreet.com](mailto:jibarry@statestreet.com) should you wish to discuss the contents of this submission in greater detail. We welcome the opportunity to further engage with the Commission on the topics raised in the proposed rule and we stand ready to provide whatever assistance may be appropriate.

Sincerely,

A handwritten signature in black ink, appearing to read "JJ Barry", with a stylized flourish at the end.

Joseph J. Barry