Frankfurt,
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BVI position on the EU Commission proposal on T+1

We[1] welcome the EU Commission CSDR proposal[2] to shorten the settlement cycle for EU securities to T+1 by 11 October 2027.

We support the aim to achieve an efficient, integrated and safe market for securities clearing and settlement in the EU, particularly for cross-border transactions. Efficient and safe securities settlement systems with an EU wide harmonized settlement discipline regime will benefit all investors and further strengthen the efficiency and competitiveness of post-trade financial market services in the EU, which are vital to a well-functioning Savings and Investments Union (SIU)**.** We strongly embrace the announcements by UK/CH to align their settlement cycles to T+1 with the EU and also move on 11 October 2027.

Highly regulated investment funds (UCITS/AIF) and asset managers are part of the so-called buy-side of wholesale financial services. They are users of the post trading market infrastructure rather than providers of post trade services (e.g. CCPs, CSDs). The investment fund market in Europe is rather fragmented in terms of trade and post-trade operational models. The value chain of fund investing (subscription/redemption) and occasionally secondary market trading of fund shares, and settlement, custody and asset servicing usually works very efficiently in local markets in the EU and for most local funds.

German investment fund management companies are not directly involved in the value chain of clearing and settlement of securities transactions. They instruct the custodians of the relevant investment funds to match and settle securities (e.g. equity, bonds, ETFs, fund units) belonging to such investment portfolios. The custodians have a direct access with the CSDs. Investment fund management companies have to rely on the information obtained by the custodians in order to react in cases of settlement fails. The (fund) custodians have to ensure that all relevant settlement information needs to be sent as fast as possible to the fund management companies. This will enable the investment fund management companies to solve all discrepancies for unsettled and failing trades where a decision is required by the custodians from the investment managers. A fast transformation of settlement information from the fund custodian to the asset manager is of utmost importance if the settlement cycle will be shortened to T+1.

(Institutional) investors defined as professional clients in MiFID are not involved in the clearing and settlement process of securities transactions. There is a direct relationship between the fund management company, the counterparty of the transaction (e.g broker/dealer) and the fund custodian.

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[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 115 members manage assets of EUR 4.5 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] Settlement cycle: T+1

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Investment funds (may) delegate primary market and issuing functions to Transfer Agents (TA, transfer agent model) or Issuing Agents (IA). This function may also sit with the asset manager, a depositary bank or another specialised third party provider, usually a custodian bank. Traditional markets where a dedicated service provider performs this function, the so-called Transfer Agent (TA), are amongst others the UK and Ireland. In France and Germany this function is normally performed by the custodian, acting also as Issuing Agent for the shares in the national and cross-border CSD's.

The open-ended investment fund (in case of contractual type funds, e.g. Trusts, FCPs or "Sondervermögen" in Germany) or fund shares (in case of company type funds, e.g. Open Ended Investment Company (OEIC), Investment-AG, SICAV) differs from other financial instruments. The key differences are that fund units or shares are issued or redeemed continuously during the lifetime of the fund, and subscriptions or redemptions do not always settle at an EU-CSD.

There are currently two ways to process subscription/redemption for funds: the "Transfer Agent Model" and the "CSD model". The difference is important for open-ended investment funds as they are distributed globally. To suit global distribution, it is important to cater for all clients and not only to watch regional specificities, e.g. T+1 settlement in Europe.

Besides the classic, actively managed investment funds there is an increasing number of funds which are listed on stock exchanges, which often track indices, and whose main form of trading occurs in the secondary market, the so-called Exchange Traded Funds (ETFs). ETF producers rely on sophisticated IT solutions for the day-to-day portfolio building and risk management tasks. When a physically replicating ETF wants to create new shares of its fund, whether to launch a new product or meet increasing market demand, it turns to a designated market maker or Authorized Participant (AP). It is the AP's job to acquire the securities that the physically replicated ETF wants to hold. For instance, if an ETF is designed to track the XYZ 50 Index, the AP will buy shares in all the index constituents in the exact same weight as represented in the index, then deliver those shares to the ETF. In exchange, the ETF gives the AP a block of equally valued ETF shares, called a creation unit. The exchange takes place on a one-for-one, market-value basis. The AP delivers a certain amount of underlying securities and receives in subscription the exact same value in ETF shares, priced based on their net asset value (NAV), and on not the market value at which the ETF happens to be trading. The process also works in reverse. APs can remove ETF shares from the market by purchasing enough of those shares to form a creation unit and then delivering those shares (redemption) to the ETF issuer. In exchange, APs receive the same value in the underlying securities of the fund.

We strongly support the EU Commission proposal to further maintain the current CSDR scope of transactions only to transferable securities which should adhere to the new settlement cycle T+1. All securities traded via an exchange/MTFs (equities, bonds) as well as transferable securities not executed via these trading venues should move to T+1.

Fund management companies and asset managers should continue to have the option, as it is already today market practise, to decide independently which settlement cycle they wish to use when settling fund unit transactions (subscription/redemption of fund units). Generally, investment funds that are traded outside of stock exchange could also switch to T+1. However, some asset managers consider the flexibility of an additional or further day to be necessary for practical settlement (T+2/3). A shortening of the settlement cycle for fund units involves an even faster preparation of the net asset value (NAV) with the involvement of the custodians. A transposition of fund unit is therefore significantly more complex than a "purely technical implementation" compared for the asset classes equities and bonds. The NAV of the trading day for fund units is currently only known on T+1 (usually in the afternoon).

Furthermore, we would like to highlight the following points:

- **Temporary suspension in combination with a de-minimis threshold for CSDR cash penalties**

We are in favour to establish a temporary suspension mechanism of the payment of settlement penalties under the CSDR framework in the context of the introduction of T+1. Currently, German asset managers face significant technical, operational and regulatory challenges as they must adapt their systems/procedures with the EU move to a T+1 settlement cycle. As our members are fully committed to make the transition a successful project, we cannot completely exclude that settlement fails will increase during the initial period. Such an event is more likely to happen in a fragmented and complex EU infrastructure, especially in cross border instructions, and in market segments with shallow liquidity than in jurisdictions with more homogeneous markets like the UK or the US. The continuation of the existing cash penalty system without any suspension period would foresee no unexpected events will occur. However, unforeseen disruptions could arise, making it better to have protection in place. However, at this stage, it is impossible to predict if the settlement fail rates will be higher over long period of time compared to the current settlement cycle in Europe.

Furthermore, the introduction of the CSDR cash penalty regime in February 2022 has not improved the settlement efficiency for the German Buy-Side. Asset managers must rely on the information/accuracy obtained by the (fund) custodians in order to react in cases of settlement fails. The custodians have to ensure that all relevant settlement information needs to be sent as fast as possible to the fund management companies. This will enable the investment fund management companies to solve all discrepancies for unsettled and failing trades where a decision is required by the custodians from the investment managers. According to our observations the main reason for settlement fails are missing securities, instructions that are sent too late to the markets or problems with the settlement instructions (SSIs).

The introduction of the CSDR cash penalty system has increased the operational burden for the Buy-Side as they have to monitor every penalty of a failed trade which belongs to investment funds without any additional value for the settlement efficiency. German asset managers are generally responsible only for a very small fraction of settlement fails and are therefore in a position to be a net receiver when it comes to the CSDR cash penalties.

However, there are various approaches in place to negotiate the redistribution and penalties for the final investor of the investment fund in respect of a debit penalty. In this case, fund management companies often incur the costs although they are not responsible for the debit. (Low) value debit cash penalties generate disproportionately high operational burden for the German Buy-Side. For instance, some German Asset manager strongly insist on a EUR 10 debit cash penalty being reimbursed as they argue they cannot bear debits due to the stringent legal interpretation either of the EU fund regulation (UCITS/AIF) and the German fund law even though the operational costs and custody fees are much higher than the reimbursement value.

We acknowledge the fact that the CSDR cash penalty system should bring down all settlement fails, not just those above a certain market threshold (e.g. AFME Guideline with a de-minimis threshold of EUR 500).

Whilst it could be argued that creating a de-minimis threshold may remove the incentive for the biggest offenders to improve their processes, the counterargument is that these will not be prioritised for resolution anyway. Brokers/Dealers could face large numbers of net debits comprised of an array of values and are likely to have a relatively high threshold to write-off low value cash penalties and will look to resolve and solve for the larger values. We appreciate, that some of the operational impact of processing these penalties could be a further deterrent behind settlement fails, but these are also felt by some of the entities being failed into who may have little influence in resolving the root cause of the settlement fail (e.g. German Buy-Side).

In this context, it is worth to mention that European Central Bank (ECB) has pointed out that the settlement discipline regime should be based on the principle of proportionality and that the "*review of the settlement discipline regime should take as its starting point the aim of sanctioning only those settlement fails that result in adverse financial effects for the counterparty of the failing party*".[3]

Therefore, we propose to introduce a de-minimis threshold for EU-CSDs to be applied for cash penalties before these are processed. This would provide a more operationally proportional system, while still providing sufficient incentive to improve the settlement infrastructure within European CSDs. Furthermore, such a de minimis threshold will remove the operational pressure of investigating, processing and reconciling cash penalties and will give our members more capacity to further investigate and solve real settlement causes thereby improving settlement rates.

- **SFT exemption**

We principally agree to exempt SFT transaction from the scope of the CSDR in the context to introduce T+1. SFTs are critical to the smooth operation of financial markets. SFTs do not have a standard settlement cycle and require full flexibility in terms of the start (=settlement) date (and end date). The possibility for firms to use SFTs as a means to secure funding and/or invest cash for future dates (including beyond T+1) as part of their normal day-to-day activities is a critical function of those markets and essential to firms' efficient asset and liability management, providing them with the ability to manage their future liquidity and funding needs, as soon as these become known - whether this is on a same-day basis (T+0), for start/settlement on the next day (T+1), or on any date further in the future, ie T+2 and beyond. Imposing a standard settlement cycle on SFTs is therefore inappropriate and risks constraining firms funding arrangements.

[3] Publications Office