

# ZENTRALER KREDITAUSSCHUSS

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## Per e-mail:

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Dr. La/sk

**Giovannini barrier 6**  
**AZ ZKA: 413-EU-CS**  
**AZ BVR: EG-CLEA**

Dear Mr Bodart, dear Mr Hrovatin,

Please let us approach you with regard to the Giovannini barrier 6 in your capacity as chairpersons of the Harmonisation of Settlement Cycles Working Group (HSCWG). The harmonisation of settlement cycles is of strategic importance for the European financial industry sector as a whole and gives reason to intervene on behalf of the ZKA which is the voice of the German banking industry<sup>1</sup>. First of all, we are grateful for the constructive way you are tackling this issue in this well weighted Working Group. You have focused

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<sup>1</sup> The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)*, for the cooperative banks, the *Bundesverband deutscher Banken (BdB)*, for the private commercial banks, the *Bundesverband Öffentlicher Banken Deutschlands (VÖB)*, for the public-sector banks, the *Deutscher Sparkassen- und Giroverband (DSGV)*, for the savings banks financial group, and the *Verband deutscher Pfandbriefbanken (vdp)*, for the mortgage banks. Collectively, they represent more than 2,200 banks.

on bringing some more clarity to the precise definition of the decision we are facing now in Europe which will result in a recommendation for the CESAME2-meeting in February.

Following the deliberations at the last CESAME2-meeting, we would like to take the opportunity to present our view on several aspects on which the recommendation of the Settlement Cycles Working Group should be based.

### **1. Stabilising financial markets by risk reduction**

The European Commission's and the financial industry's common aim is to stabilise financial markets. The lesson learned from the global financial crisis is to look for means how to reduce unnecessary risks. A European regulatory, systemically sound and competitive framework with a strong focus on market stability and investor protection will be one major target for the future.

### **2. Future-orientated aim**

The Working Group followed so far the approach of harmonised settlement cycles in Europe since this should lead to a more efficient internal market. From the perspective of long-term strategic development, any decision should be aimed to reach all efficiency gains achievable. Therefore, the already most efficient market practice should be the benchmark for the internal market in Europe. The comparative lack of process efficiency in certain T+3 markets should not be used as an argument for conserving this regime due to the higher costs of T+2 operation, or even for imposing it on T+2 markets. This is also in line with projects like Target2-Securities (T2S), for example, focussing on future SWIFT standard 20022 and not on the status quo (ISO 15022).

Many markets already settle at a shorter interval than T+3. For example, many government bonds already settle on T+1 or even T+0. To be frank, we do not understand the reluctance of many market participants with regard to T+2 for the standardized regulated markets, since every market – and T2S – have to be able to settle all different settlement cycles. Last but not least, the European Union should be aware of the growing competition with other financial centres in the world, especially in Asia, realising already short timeframes for the settlement of securities like in China/Shanghai (T+1), Hong Kong (T+2 or less).

### **3. Factual findings**

Hard facts in numbers should support the Working Group's recommendation, since these seem to be more objective. Nevertheless, they should be considered with care. E. g., the sole comparison of failure rates of different market does not seem to be appropriate. The figures of different Euroclear markets showed well that the dependency on market discipline is stronger than on the length of the settlement cycle. Moreover, as discussed in the 4<sup>th</sup> meeting of the HSCWG, when the UK market moved from T+5 to T+3, this did not cause a decrease in settlement efficiency, the situation just before the change compared to the situation a year later. In many markets the main reason for settlement failures is a lack of cash or securities. However, penalties exist to reduce the settlement failure rate. A number of market measures, for example such as the introduction of CCPs, partial delivery, penalties, buy-ins, have improved the settlement rate. In addition, failure rates per settlement cycle should correctly be compared to get the right findings, i. e., not T+2 versus T+3 but T+2+1 and T+3 to capture the closed transactions one day later, otherwise there will be an uneven comparison.

When trying to figure out the costs of harmonisation, not only the start-up costs and the operational costs but also the opportunity costs should be considered long-term. Therefore, an increase of around 30% in margin collected for equity in a move from T+2 to T+3 does not only affect T+2 markets but also T+3 markets. A shorter cycle stands for reduced margin requirements for the CCPs with the effect of decreasing blocked liquidity. In general, a positive impact on trading should be possible because of lower collateral requirements and limited market price risks.

### **4. Risks**

There should be common awareness that the risks of a longer settlement cycle are of increasing importance. Therefore, reducing counterparty and settlement risk in post trade is in line with the effort of public policy to eliminate sources of risk and to reduce it in general. This aspect is clearly observed by the IOSCO/CPSS-Recommendations for Securities Settlement Systems: "The longer the period from trade execution to settlement, the greater the risk that one of the parties may become insolvent or default on the trade. The larger the number of unsettled trades, and the greater the opportunity for the prices of the securities to move away from the contract prices, thereby increasing the risk that non-defaulting parties will incur a loss when replacing the unsettled contracts..."

We are aware that following through an economic impact analysis will mean to discover that there are hard facts as well as soft factors to value. For example, the shorter the cycle the better should be the discipline in pre-settlement processes like trade allocation and trade confirmation. Furthermore, we are confident that such an economic impact analysis will reveal certain arguments brought forward by the supporters of T+3, for example as regards the lower settlement efficiency of T+2, to be invalid. Nevertheless, the conclusion should be focused on how to ensure the better standard for the sake of harmonisation and a new regulatory, systemically sound and competitive framework in Europe.

## 5. Conclusion

ZKA as the voice of the German banking sector welcomes the initiative to harmonise the industry barrier on settlement cycles. Nevertheless, we do have serious concerns about the transition of the settlement harmonisation towards a less efficient model compared to well-established domestic standards. In our opinion, a movement of the settlement cycles from T+2 to T+3 will not explore the chance to reduce risks to stabilise financial markets. Having that in mind, we do not see arguments with substance for changing the current German practice.

We are sure that you will take notice of these components when preparing the decision on how to tackle the Giovannini barrier 6 in due time. Please feel free to contact Mr Diedrich Lange in case you need more information. We would be happy to stay in contact with you on this subject.

Yours sincerely,

on behalf of the Zentraler Kreditausschuss  
Bundesverband der Deutschen  
Volksbanken und Raiffeisenbanken e.V. BVR  
National Association of German Cooperative Banks



Gerhard Hofmann



by proxy

Dr. Diedrich Lange