INVESTMENT COMPANY INSTITUTE® ICI Global

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Submitted electronically to

Ajay Tyagi
Chairman
Securities and Exchange Board of India
chairman@sebi.gov.in

Sudeep Mishra
General Manager
Market Regulation Department
sudeepm@sebi.gov.in

Re: SEBI Circular Introducing T+1 Rolling Settlement

Dear Mr. Tyagi and Mr. Mishra,

ICI Global[1] has a keen interest in the Securities and Exchange Board of India (SEBI) regulations that are applicable to foreign portfolio investors (FPIs). Our member firms invest in markets throughout the world, including a substantial amount in India. As of June 30, 2021, US registered investment companies (US RICs) and EU Undertakings for Collective Investment in Transferable Securities (UCITS) held approximately US $328 billion in Indian equity securities.

On September 7, 2021, SEBI issued a circular introducing T+1 rolling settlement on an optional basis for Indian equities beginning January 1, 2022 (Circular).[2] We commend SEBI for taking action to improve the post trade infrastructure in the Indian equity market and support the objective of moving to T+1 settlement. We have, however, significant concerns about the implementation of this change and respectfully request that SEBI consider our recommendations described below. As SEBI moves forward on this project, we encourage SEBI to balance carefully the need for appropriate modernization of market structure while mitigating operational risk and maintaining an environment that fosters foreign investment in the market.

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[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of $42.5 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Brussels, Hong Kong, and Washington, DC.

[2] Available at https://www.sebi.gov.in/legal/circulars/sep-2021/introduction-of-t-1-rolling-settlement-on-an-optional-basis_52462.html.

We would be pleased to continue to engage with SEBI on this matter, as well as, more broadly, on ways to reduce barriers and facilitate greater investment by FPIs in Indian securities.

I. SEBI Should Extend the Implementation Timeline for T+1 Settlement

We support SEBI's efforts to move to T+1 settlement. We, however, strongly urge SEBI to extend the implementation timeline by 18 months and, concurrently, to further consider whether and how the move to T+1 settlement should be adjusted to better fit the unique needs of FPIs. A major market change such as this one requires significantly more than four months to implement, including consultation with various stakeholders, such as FPIs and their custodian providers, to consider fully the implications for all market participants.

Although we understand that the Circular does not require, but rather permits, stock exchanges to move to T+1 settlement for a scrip (security) on a voluntary basis, this short transition period does not provide FPIs, their services providers, and broker dealers sufficient time to make the operational and compliance changes that are necessary to accommodate a shorter settlement cycle. Further, a bifurcated optional shorter settlement cycle that is implemented by a stock exchange per scrip, rather than for all scrips, raises numerous additional challenges and is not aligned with any other capital market around the globe where many of our member firms trade daily.

Together with our member firms, we are very familiar with the undertakings required to implement a major market structure change such as shortening the settlement cycle. In 2017, ICI, Depository Trust & Clearing Corporation (DTCC), and the Securities and Futures Markets Association (SIFMA) led a successful industry effort to shorten the settlement cycle from T+3 to T+2 in the United States. Many other markets, such as Canada and Mexico, soon followed.

Beginning in May of 2021, we are leading a similar effort to shorten the settlement cycle for US equities to T+1. This project involves detailed coordination with US regulators to specify the regulatory changes required and extensive engagement with all industry participants via industry working groups and workshops to scope out the requirements for a shorter settlement cycle. In our view, this type of process is the only way to be successful in achieving our goal of modernizing the US market structure to achieve desired efficiencies while accounting for the operational, credit, or market risks that may arise from a shorter settlement cycle. Industry participants have analyzed the amount of effort, cost, and time required to get the industry ready for a successful transition to T+1. Based on this industry feedback, we have concluded that 24 – 30 months is an appropriate timeframe to implement a shorter settlement cycle (T+1) in the United States, contingent upon the successful coordination of various workstreams and activities, including an industry-wide testing period.

Similarly, particularly for FPIs, trading Indian equities can be complex due to unique market attributes. For example, shares are required to be pre-funded, FPIs are required to maintain segregated accounts, trades are pre-matched, and the Indian rupee (INR) is not a freely exchanged currency. To execute and settle a trade, FPIs use a chain of service and system providers, including global custodians, local custodians, international and local brokers. To build an efficient ecosystem in India, FPIs and their service and system providers have worked for

many years to establish the right operational model as the market developed. Any change to shorten the settlement cycle will have a direct impact on all the processes and service level agreements that are in place today. A change of such a magnitude requires detailed analysis, and firms must budget adequate time and resources to ensure successful implementation. In addition, because the exchanges have not yet published their operating guidelines for T+1, FPIs' service providers (local custodians, global custodians, and broker dealers) cannot yet provide further details or guidelines on the implementation of the T+1 settlement cycle. Therefore, if SEBI moves forward with T+1 settlement on January 1, 2022, FPIs will be subject to increased operational burden, additional currency risk and increased trading costs.

For these reasons, we strongly recommend that SEBI re-consider the effective date of January 1, 2022, and delay the implementation of the Circular by 18 months. This would provide FPIs and other market participants adequate time to review the impact of a shorter settlement cycle on their processes and undertake industry testing of the required changes. We further recommend that, as part of this process, SEBI should solicit feedback from market participants on ways to minimize operational and settlement risk in a shorter settlement cycle. We would be pleased to further engage with SEBI and provide any help and resources needed to assist in developing a market infrastructure that benefits all investors.

II. Impact of T+1 Settlement on FPIs

Implementation of T+1 settlement in January 2022, without allowing sufficient time for FPIs and their service providers to re-engineer the trade process, will have a unique and disproportionate impact on FPIs, as described below.

Compressed Trade Confirmation and Funding Deadlines Will Likely Lead to More Failed Trades and Increased Costs

A T+1 settlement cycle will compress the confirmation and funding deadlines for FPIs. Due to time zone differences, a compressed confirmation deadline will have a significant impact on FPIs, particularly those based in Europe and the Americas, including the United States, and will likely result in more failed trades. Under the existing T+2 settlement cycle, an FPI must send trade settlement instructions on T+1 for the local custodian to meet its requirement of trade confirmation by T+1. In a shorter settlement cycle, trade settlement instructions from the FPI will need to be sent to the local custodian on T (India time), to allow the local custodian to confirm the trade by close of the business day on T. Currently, an FPI does not have the capability to support this new timeline given the different time zones. To support T+1 settlement, FPIs and their service providers would need to completely re-engineer the settlement and funding process.

Similarly, until such time as FPIs have a revised process in place, the compressed funding deadline that results from T+1 settlement is problematic for FPIs. Under the current settlement cycle, FPIs execute an FX transaction to fund the trade after the equity trade has been executed by the broker. A trade confirmation is required for the local custodian to book such an FX transaction under the existing service level agreements. In a T+1 settlement cycle, to meet the

local custodian's funding deadline, FPIs may be forced to pre-fund INR. Executing an FX on T-1 will subject FPIs to additional currency risk. For example, if an FPI funds INR and then the portfolio manager doesn't trade that full position or doesn't get the full execution, the FPI is left holding a long INR balance.

With such a compressed timeline for confirmation and funding, any delay or missed deadline by a party would result in the trade not being matched. Without time to correct any error, it is almost certain that more trades will fail. For example, if a broker has not released a trade confirmation on time, this will have a domino effect on the entire processing of the trade. Absent a careful and measured transition to T+1, there will be an increased volume of un-confirmed trades for FPIs, resulting in increased hand-delivery trades as well as trade fails. Additional trade fails will lead to higher costs for FPIs, including regulated funds and their investors. In the Indian equities market, if a sale transaction fails on T+1, the mechanism to resolve this is through a buy-in at auction. We understand that the cost of purchasing an equity security at auction can be up to 20% of the trade value.

A Bifurcated Settlement System Increases Operational Risk

The suggested model of voluntary adoption by exchanges on a scrip-by-scrip basis introduces unnecessary operational complexity and risk in the settlement system. Under this model, it is possible that the same security will be on a different settlement cycle on different exchanges, settling on T+1 on one and on T+2 on the other. This is a suboptimal situation for all institutional investors in the market, but particularly problematic for FPIs. We understand that the systems used currently used by FPIs and their service providers do not have the capability to code for different settlement cycles in the same market. Therefore, it will be extremely challenging operationally to track and manage which securities are settling T+1 versus T+2. This will result in India trades requiring manual intervention during processing, delaying the process and increasing the chance for errors and operational risk, particularly during high volume volatile trading days.

These are a few examples of key areas that require further study to understand the impact on market participants – particularly FPIs – before implementing such a significant change to the settlement cycle. The goal of a shorter settlement cycle is to introduce efficiencies in post trade settlement and motivate market participants to move to as real time processing as possible while limiting any additional risk in the system. We therefore urge SEBI to afford market participants ample time to consider and resolve these challenges before permitting the adoption of T+1 settlement.

III. Exemption for FPIs

Because of the disproportionate impact of a move to T+1 settlement on FPIs, we request that SEBI grant an exemption to FPIs from the optional T+1 settlement cycle if SEBI does not adopt our recommendation above to delay the implementation date for all market participants. It is operationally feasible to exclude FPIs from T+1 settlement. FPIs are required to maintain individual segregated accounts in the local market that are designated as FPI accounts; therefore, it would be possible for brokers to identify FPI trades and exclude them from T+1 settlement.

This solution achieves SEBI's policy objective of offering the risk reduction and efficiency benefits of T+1 for domestic investors and local participants, while maintaining the current T+2 for FPIs as they work through the challenges presented by T+1 settlement at this time.

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We greatly appreciate your consideration of these issues. If you have any questions, please contact the undersigned at Jennifer Choi, Chief Counsel, ICI Global, at jennifer.choi@iciglobal.org; Eva Mykolenko, Associate Chief Counsel, ICI Global at eva.mykolenko@iciglobal.org; or Ahmed Elghazaly, Director Securities Operations, ICI at ahmed.ici.org.

Sincerely,

/s/ Jennifer S. Choi

Jennifer S. Choi
ICI Global