Press release

AFME calls for industry discussion on shortening settlement cycles in Europe

Association supports cautious approach and calls for detailed assessment of risks and benefits

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The Association for Financial Markets in Europe (AFME) has today published a new paper discussing whether Europe should move to a one-day settlement cycle (known as T+1). In Europe, the current settlement cycle for most transactions in equities and fixed income markets is two business days ('T+2'). The paper follows announcements by the US and other jurisdictions earlier this year of their intention to move to shorter settlement cycles.

Pete Tomlinson, Director of Post Trade at AFME, said: "*An industry move to T+1 would follow the historic trend towards shorter settlement cycles, and could result in reduced market risk and associated costs. However, a move to T+1 could be the most challenging migration yet because it would remove the* <u>*only*</u> *business day between trading and settlement, creating significant pressure on post-trade operations, particularly for global participants. The barriers to timely settlement in the current model need to be fully understood and addressed before Europe can move to T+1. A rushed or uncoordinated approach is likely to result in increased risks, costs and inefficiencies, particularly given the unique nature of European markets which have multiple different market infrastructures and legal frameworks. For this reason, AFME is calling for an industry task force to be set up to conduct a detailed assessment of the benefits, costs and challenges of T+1 adoption.*"

The paper, "**T+1 Settlement in Europe: Potential Benefits and Challenges"** highlights the key benefits of moving to a shorter settlement cycle, including:

- **Reduction of risk**: shortening the number of days between trade execution and settlement will reduce counterparty, market and credit risk, especially during periods of high market volatility.
- **Significant reduction of associated costs:** by limiting firms' open exposures over the settlement period, there will also be a reduction in margin requirements, allowing market participants to better manage capital and liquidity risk.
- **Maintaining global alignment:** given that some major jurisdictions will be adopting T+1, the end users of capital markets may benefit from Europe following the same approach.

The paper also outlines the various barriers to overcome before such a migration can take place, including:

- **Post trade activities compressed into shorter time frame**: there would be significantly fewer hours between trading and the beginning of the settlement cycle for post-trade operational processes to take place. While it might be assumed that moving from two days to one day would reduce the available post-trade processing time by 50%, AFME actually estimates market participants will be moving from having 12 hours to 2 hours of post-trade operations time, an **83% reduction**.
- **Possible increase in settlement fails:** the migration could also lead to an increase in the number of settlement fails in the market, which will incur cash penalties under Central Securities Depositories Regulation (CSDR) rules, as well as having capital impacts under Basel III requirements.

- **Greater operational complexities for global participants:** time zone differences will impact the possibility of same-day matching processes for investors from outside Europe, vastly reducing the time available to communicate and resolve any breaks or exceptions. This impact would be particularly significant on cross-currency transactions which have an FX component.

- **Securities Lending impact:** moving to a T+1 settlement cycle compresses the timeline to identify and recall securities, which could lead to breaks in the process, resulting in an increase in settlement fails and cash penalties unless there is a modification to existing processes, technology and overall behavioral changes.

- **Impact for Exchange Traded Funds (ETFs) and Securities-based derivatives more pronounced:**
    - Due to the global composition of many ETFs, which contain underlying securities from several jurisdictions, this can often lead to settlement delays in a T+2 environment, due to time zone differences, market holidays and cross-border settlement complexity. These challenges would be even more pronounced in a T+1 environment.
    - Challenges will also exist for securities-based derivatives with further assessment required to identify impacts to the swap lifecycle, such as margining calculation and collection.

AFME's paper strongly recommends that further cross-industry discussion is required to identify and quantify the benefits and challenges of moving to T+1 settlement. AFME cautions that a successful migration will require coordinated industry effort, from an initial impact assessment through to the development of a detailed implementation plan.

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About AFME:
AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.
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