

Reply form

on the call for evidence on shortening of the settlement cycle



Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **15 December 2023**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

- Insert your responses to the questions in the Consultation Paper in this reply form.
- Please do not remove tags of the type < ESMA_QUESTION_SETT_0>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
- When you have drafted your responses, save the reply form according to the following convention: ESMA_CP1_SETT _nameofrespondent.

For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA_CP1_SETT _ABCD.

- Upload the Word reply form containing your responses to ESMA's website (**pdf documents will not be considered except for annexes**). All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading '[Data protection](#)'.

Who should read this paper?

All interested stakeholders are invited to respond to this consultation paper. In particular, ESMA invites market infrastructures (CSDs, CCPs, trading venues), their members and participants, other investment firms, issuers, fund managers, retail and wholesale investors, and their representatives to provide their views to the questions asked in this paper.

1 General information about respondent

Name of the company / organisation	Association for Financial Markets in Europe
Activity	Associations, professional bodies, industry representatives
Are you representing an association?	<input checked="" type="checkbox"/>
Country / Region	Europe

2 Questions

Q1 : Please describe the impacts on the processes and operations from compressing the intended settlement date to T+1 and to T+0. Please:

- (i) provide as much detail as possible on what issues would emerge in both cases and how they could be addressed with special attention to critical processes (matching, allocation, affirmation and confirmation) and interdependencies. Where relevant please explain if these are general or asset class/instrument/ trade specific.
- (ii) Identify processes, operations or types of transaction or financial instrument class that would be severely impacted or no longer doable in a T+1 and in a T+0 environment.

Please, suggest if there are legislative or regulatory actions that would help address the problems. Where relevant please explain if these are general or asset class/instrument/ trade specific.

<ESMA_QUESTION_SETT_1>

Our response to this questionnaire will address the questions in the context of a potential adoption of T+1 only. AFME's feedback in relation to a potential EU move to T+0 is reflected in the joint-association cover letter included in Annex 1. We emphasise that we do not consider a default T+0 settlement cycle for securities transactions to be a realistic or desirable near-term policy objective.

Please also refer to our separate submission Annex 2 – Overview of Current Trade Lifecycle, which provides high-level context for our response below.

Current technology and processes used by market infrastructures and their participants are already capable of processing transactions for T+1 settlement or shorter, at the discretion of the trading counterparties. This optionality is used today where necessary and appropriate, typically for securities financing transactions or collateral movements.

A shortening of the default settlement cycle to T+1 at a much larger scale represents a material compression of the time available to complete all of the post trade processes which must happen between trade execution and trade settlement. Unlike previous initiatives to shorten the settlement cycle, we consider that this will impact all actors involved at each stage of the process, including market infrastructures and trading counterparties. We encourage that ESMA's cost benefit analysis should also give due consideration to potential impacts on broader market functioning – in particular FX and securities lending markets – and any knock-on impact on this might have on trading and liquidity. Please refer to our responses to Q2 and Q4 for further details.

We consider the operational impact across several core processes, outlined below, which are necessary to ensure a transaction is “ready to settle”. The target for completion of these processes is the end of the business day prior to intended settlement date (EOD S-1) – which, in a T+1 settlement cycle is the end of trade date. To achieve this, market participants may need to adopt a “follow the sun” model and consider relocation of staff. It should be noted that it is possible for matching (and subsequent settlement) to take place on intended settlement date – although this is sub-optimal.

Using T2S as an example, approximately half of the total volumes settled on intended settlement date are in the night-time settlement (NTS) phase and half in the real-time settlement (RTS) phase. If there is not an industry-wide improvement to post-trade processes to maintain or improve the proportion of transactions that are “ready to settle” by EOD S-1, this could result in increased costs (RTS settlement do not benefit from T2S technical netting) and a change in current processing patterns for market infrastructure, potentially resulting in operational resilience risks. In a more extreme scenario, there could be a reduction in the number of transactions which settle by intended settlement date, resulting in increased costs from CSDR penalties (and possibly the introduction of Mandatory Buy-in rules), additional funding requirements and capital charges. This could also have implications for the timely settlement of contingent transactions relying on the positions of instructions that match late on settlement date, impeding the flow of inventory, in particular for less-liquid instruments

Generation and matching of settlement instructions

Both sides of the instruction must be communicated by the trading parties through the chain of custody to the CSD, and must match on core economic and non-economic values. A move to T+1 removes the sole business day between trading and settlement, significantly limiting the opportunity to process any manual or late bookings or resolve any mismatches. This will

be a particular challenge for market participants based in a different timezone (who will have limited hours of “overlap” with their counterparties), as well as smaller, less sophisticated market participants, who typically may be more reliant on manual processes.

For example, Asia-based investors may face a particularly challenging scenario where they will be required to operate, de facto, on a T+0 basis, without any overlap with a Europe-based counterparty between trading and settlement, and may be required to pre-fund the trade. For US-based participants, the EU settlement process begins midway through the US working day, compressing the time span until market close on T+1 to take remedial actions in case of exceptions. We encourage that ESMA analysis gives appropriate consideration to the impacts on international participants in EU securities markets.

Trades executed later in the business day will be particularly vulnerable. We note that European markets are generally open for trading until 17.30 with a high volume of transactions executed around market close. From a T2S perspective, instructions must be input by 20.00 for settlement in the first sequence of the NTS phase.

Timing challenges may also be more pronounced for certain asset classes, for example ETFs. Due to the global nature of ETFs, the pricing of the underlying assets may not be confirmed until early on T+1, delaying the start of the pre-settlement and settlement processes.

Allocation and Confirmation

The generation and matching of settlement instructions is predicated on trade-level matching, allocation and confirmation processes. To enable timely settlement in a T+1 environment, the allocation and confirmation process should take place on trade date, allowing sufficient time for the settlement instructions to cascade through the custody chain to reach the CSD prior to its cut-off deadline. A high degree of automation/straight-through-processing at the level of trading parties will be necessary to reduce operational inefficiencies in allocation and confirmation processes. Pre-settlement matching platforms may have to incorporate additional controls to help early identification of potential settlement issues. To prevent matching issues manifesting at the settlement matching level (i.e. at the CSD), the matching criteria used in all pre-settlement platforms will need to fully align with the market convention of the CSDs. For example, with SSIs and within the cash tolerance prescribed in CSDR’s delegated regulation for settlement discipline.

Resolving exceptions in a reduced timeframe will become even more challenging during times of high market volatility or during system outages experienced by market infrastructures or major participants.

Positioning of securities by the seller

To facilitate settlement, the relevant securities must be available for delivery in the correct CSD account. This can create challenges from several perspectives.

- a- in scenarios where delivery is contingent on the settlement of a securities financing transaction (SFT), e.g. a recall of loaned-out securities, the timeframe to initiate, instruct and settle the SFT is subject to a similar compression. As further explored in our response to Q4, this could result in behavioural changes and negatively impact market liquidity.
- b- securities positions can be held across multiple CSDs and may need to be realigned. As with the previous example, this realignment transaction is also subject to a compressed timeframe. Generally, there is an additional “lag” between cross-border settlements of at least one business day, in part due to misalignment of CSD batch times.

Market participants will need to improve inventory management processes to ensure that any additional bookings – such as recalls or realignments – that are necessary to facilitate the delivery of the securities are completed in sufficient time to avoid impeding settlement of the underlying transaction. This will require core processes, such as position management, reconciliation and settlement fails prediction, to take place on trade date after market close and before the beginning of night-time settlement processes. See our response to Q4 for further details on potential impacts to trading and liquidity.

Positioning of cash by the buyer

On the other side of the transaction, the purchasing party will need to ensure they have sufficient cash available in the correct currency. In a move to T+1 this will necessitate changes in the timings of funding and treasury operations. This will be particularly impactful for the funding of less liquid currencies (such as BGN, CZK and HUF, which have earlier cut-off times) which may require funding on trade date. Trading parties in different timezones will be particularly impacted.

As outlined in Q2(b), this is particularly challenging where FX bookings are required. A move to T+1 for securities settlement would result in a shorter window in which to access liquidity in FX markets, which would potentially increase transaction costs. This could also potentially result in a decrease in the volume of FX transactions which are settled payment vs payment (PVP) through the CLS platform, if instructions are not entered before the CLS cut-off (00.00, midnight CET). This would constitute an increase in settlement risk on the FX transaction.

Other considerations:

Clearing

To ensure the same proportion of instructions are processed in the overnight batch (we estimate approximately 80% of CCP transactions), there will be a revision to timings of processes by market infrastructure and their participants.

Clearing members will need to update their processes due to the shorter time for managing their post-trade activities. For example, to reconcile the trade date nets sent by the CCP and potentially release the market legs, should they have used the on-hold functionality.

The margin process will also need to be reviewed. Currently, CCPs calculate their margins on the evening of trade date, for collection on the morning of the following business day, to cover trades to be settled on T+2. It is not clear how margins will be processed in a T+1 scenario. For example: will CCPs still call on T+1 morning although some transactions have been settled during the overnight window? Or will they call for margins on the evening of trade date before the start of the settlement process?

Asset Servicing

A move to T+1 would also require changes to the sequencing of the key dates of corporate action and transaction management processes.

For mandatory events without options (both cash and stock distributions as well as mandatory reorganisations): Market standards, as defined by the Corporate Events Joint Working Group, mandate that the gap between “record date” and “ex date” is one business day less than the standard settlement cycle. In a T+1 environment, this implies that “ex date” and “record date” will be the same day. Systems and internal processes for all market participants must be updated to accommodate this change.

For elective events (voluntary reorganisations or mandatory events with options): Market standards mandate that there is a gap of one settlement cycle between the “guaranteed participation date” and the “buyer protection deadline”. In a T+1 environment, this would therefore be reduced to one business day. Again, systems and processes must be updated accordingly. The compression of the election period could potentially lead to an increase in requirements to pass elections and tighter deadlines by intermediaries in order to comply with their own deadlines, ultimately leaving less time available for end investors to make decisions (and having to elect whilst the security is still tradable on the market.)

If a move to T+1 settlement results in a material increase in the level of settlement fails – i.e. increases the number of unsettled transactions over record date – the consequence of this will be an increase in the number of (reverse) market claims.

We note that these challenges are generally applicable to any market which adopts a shorter settlement cycle, but may be particularly pronounced in the EU given the additional complexity and fragmentation of EU securities markets.

Our response to Q15 further elaborates on potential legislative and regulatory actions to support a move to T+1 settlement in the EU. We note that a reduction in the operational window for settlement will create challenges for the operational processes for all types of market participant, from trading parties, through the custody chain to CSDs. Therefore, a successful implementation will be dependent on a high degree of coordination and agreement across all stakeholders.

In this respect, AFME recommends establishing a task force/group of experts (as with other regulatory initiatives) including representatives from the EU authorities and all types of industry stakeholder. Any EU legislative proposal should be predicated on a robust, quantitative and evidence-based impact assessment/feasibility study to be developed by the EU authorities in cooperation with industry experts, including to determine any impacts on market functioning and liquidity. **This analysis should focus on the impact in terms of EU's attractiveness and competitiveness. Since a shortening of the settlement cycle will be a significant undertaking, this assessment is essential to ensure a unified approach across the whole industry.**

<ESMA_QUESTION_SETT_1>

Q2 : What would be the consequences of a move to a shorter settlement cycle for (a) hedging practices (i.e. would it lead to increase pre-hedging practices?), (b) transactions with an FX component?

<ESMA_QUESTION_SETT_2>

A –Hedging practices

AFME members have not identified any direct link between a shorter settlement cycle and a change in pre-hedging practices. Pre-hedging is used in order to cover the market risk for trading parties, in between the time of an RFQ and the fulfilment of the order, i.e. it is used to cover market risk, not settlement risk.

Regarding hedging more generally, settlement cycles between a securities trade and the corresponding hedge need to be aligned to avoid liquidity and market risk. It is expected that for very liquid cash stocks hedging practices will be largely unaffected. However, in the case

where a discrepancy in settlement cycles between EU and UK or other major jurisdictions persists then hedging requirements may become more widespread. This may be the case for certain instruments such as ETFs or ADRs, where underlying instruments exist on different settlement cycles. When EU securities markets moved from T+3 to T+2, industry protocols were updated to reflect this. AFME considers that a similar adjustment is likely to be required for a move to T+1. It is also noted that costs to trade and settle a certain instrument may increase owing to consequent effect that the compressed time may have on fail rates with resulting in CSDR cash penalties. This may lead to an impact on the pricing of such instruments and hedging behaviour may need to adapt to this outcome. In addition, given that timeframes to do so are reduced, the ability to do portfolio hedging or hedging on a net basis may be impacted.

B – Transactions with an FX component

Accelerating EU securities settlement to T+1 impacts related FX transactions and could increase the risk that the funding of the security transaction (which is dependent on FX settlement) may not occur in time. It is therefore critical that any changes which could impact the ability to safely execute and settle FX transactions are carefully considered. The FX market is cross-border by definition, operating across multiple jurisdictions and time-zones, and it is critical that there is sufficient time to enable these lifecycle functions to be performed by market participants who need to contact each other across multiple jurisdictions (i.e. multiple time zones).

Whilst the wholesale FX market can and does execute T+1 and T0 transactions today, volumes specifically for T0 are limited due to the inherent challenges in performing these lifecycle functions/processes within a considerably shortened timeframe.

Within the FX industry, there is widespread and longstanding focus on leveraging payment versus payment (“PVP”) processes to mitigate FX settlement risk, also referred to as “Herstatt Risk”. One way in which this is achieved is through the use a multilaterally netted PVP platform, such as CLS.

Market participants may be required to execute an FX transaction during periods of reduced liquidity, especially when intending to settle the FX transaction within the operating hours of CLS. This may require enhanced levels of communication between divisions, including Treasury and Trading to ensure that funds are available in the right currency at the right time/place.

Similarly, to transaction execution models in the US, some equity transactions are executed at “Market-On-Close” (MOC) in the E.U., meaning the equity transaction is executed at 17:30 CET. The exact amount of currency needed to be transacted becomes known at that point.

Depending on the location of the market participant, this could result in more next day (i.e. T0) trading for Asia based participants.

The critical cut-off time for T+1 transactions processed inside of CLS is 0000 (midnight) CET on trade date, noting that this may allow some T0 Asia trades to be included in CLS for settlement. Nostro agents can often enforce their own cut-off times prior to the CLS cut-off, to help ensure all transactions are captured and processed into the CLS system. FX transactions that miss the CLS cut-off time can still be booked for T+1 value providing they are processed before any associated cut-off times (including the local central bank currency cut-off times) and will be settled outside of CLS. Whilst Settlement Risk reduction techniques can be used, these will not involve CLS and therefore may attract increased levels of Settlement Risk.

The ability to trade and settle on a T+1 basis (noting the industry-wide desire to reduce FX Settlement Risk) will depend on multiple timing deadlines including:

- Local currency cut-off times: Each country has its own local currency cut-off times for same-day currency payments. This ultimately determines whether an FX transaction can be settled on time, and is dependent on the operating hours of the settlement systems of the central bank in which currency is settling. In the EU, the T2 is the relevant RTGS system, and its operating hours are generally between 0700 – 1800 CET.
- Nostro agents and custodians: Nostro agents and custodians may enforce their own processing deadlines to ensure they have sufficient time to complete their own controls/processes, which will be independent to either CLS or local central bank operating hours. Market participants need to consider this in their ability to trade and settle on a T+1 basis.

<ESMA_QUESTION_SETT_2>

Q3 : Which is your current rate of straight-through processing (STP), in percentage of the number and of the volume of transactions broken down per type of transaction or per instrument as relevant? In case STP is used only for certain processes/operations, please identify them. Which are the anticipated challenges that you envisage in improving your current rate of STP?

<ESMA_QUESTION_SETT_3>

As outlined in Annex 2, post-trade processes between trading and settlement are complex and typically involve “hand-offs” (the exchange of information) between multiple actors. The process can vary significantly according to the type of transaction, the type of instrument, and the actors involved.

There are both “horizontal” processes – whereby information is transmitted between the buyer and seller (or intermediaries acting on their behalf), and “vertical” processes – whereby information is transmitted from the buyer/seller through the chain of custody to the CSD. It should be noted that ‘STP’ could have different meanings, depending on where the participant sits in the vertical (custody) and horizontal (trading) chain, and the role being performed.

Considering the number of actors involved, no single entity has a clear end-to-end view of a particular transaction to determine whether there was a manual intervention at any point in the transaction lifecycle. Further, there are good reasons why a particular actor may not allow the straight-through processing of a transaction. For example, provision checks must be completed by custodians before sending an instruction to the CSD, and parties must conduct AML/sanction screening processes. It should be noted that a high percentage of trades will not result in any exceptions or manual intervention in the post trade process; however, these may still fail due to lack of inventory. In addition, a move to T+1 could change processing flows and timings, which could impact IT capacity and resiliency, which will also need to be factored into any decision-making and technical standards by firms and the EU’s FMIs.

As outlined in our response to Q1, a core condition of transitioning to T+1 is achieving a high level of matching at the CSD by end-of-day on trade date. This is not directly analogous to “STP” – a transaction could require manual intervention at some stage in its processing but still result in a matched CSD instruction by EOD on T+0. Conversely an instruction could be received by a custodian after intended settlement date and processed “STP”. Generally, however, we consider that instructions matched at the CSD by EOD on T+0 have been processed efficiently with minimal to no manual intervention by the various parties on either the “vertical” or “horizontal” axis.

We therefore believe that it is instructive to measure the proportion of instructions which are processed on trade date as an approximation of STP rates across the market.

Preliminary feedback from AFME members, acting as settlement intermediaries, indicates that between 50% and 75% of client instructions are received and transmitted onwards by 22.00 CET on trade date. It is important to note that this doesn’t mean that these instructions are matched at the CSD and ‘ready to settle’.

Current challenges to STP across the trade lifecycle can include:

- Exchange of economic and non-economic trade data in a non-machine readable format – for example the provision of allocations or SSIs via email, instead of a central platform.
- Matching issues not being identified until instructions reach the CSD – it is estimated that this could account for 10-30% of settlement fails. This can be caused by

important data fields, in particular place of settlement and matching of cash values in line with CSD tolerances, not being exchanged during pre-settlement matching processes.

- Automated partial settlement not being fully supported by all CSDs, nor used optimally by all market participants.
- Data quality issues, in particular in relation to SSI accuracy/ completeness, and settlement instructions not formatted in accordance with market standards leading to STP breaks.

Although we consider that AFME members are typically well-placed to support increased levels of automation and straight-through-processing, it should also be noted that there will be a cost (both in terms of implementation and ongoing running costs) for smaller, less sophisticated firms to bear, which must be factored into any cost-benefit analysis.

Please refer to the AFME report “Improving the Settlement Efficiency Landscape in Europe” for further details on current inefficiencies in post trade and settlement processes.

<ESMA_QUESTION_SETT_3>

Q4 : Please describe the impacts that, in your views, the shortening of the securities settlement cycle could have beyond post-trade processes, in particular on the functioning of markets (trading) and on the access of retail investors to financial markets. If you identify any negative impact, please identify the piece of legislation affected (MiFID II, MiFIR, Short Selling Regulation...) and elaborate on possible avenues to address it.

<ESMA_QUESTION_SETT_4>

Functioning of Markets / Trading

It is difficult to gauge the exact impact on trading and liquidity, but overall patterns in trading in the most liquid instruments [such as changes in trade sizes, or in trading strategy or mechanism preferences, or in timing of trading through the day] are not expected to be significantly impacted. As noted in Question 1, trades executed late in the day will be more susceptible to covering, funding and settlement issues and this may bring focus to the large amount of trading conducted towards the end of the trading day and potentially the timing of

the close. As the market adapts to the shortened settlement period, liquidity could be constrained, especially for instruments which are already not very liquid/available for lending, where liquidity providers on one side, and lenders on the other side are faced with the requirement to navigate more narrow timeframes to satisfy their respective delivery obligations.

As the cost of carrying inventory for liquidity providers is high, they may seek to reduce their willingness to provide liquidity, especially in volatile markets or where lending inventory is scarce, leading to a further deterioration in market liquidity, and an increased risk for anyone who wants to trade in or out of a position.

Market-makers are essential to the provision of liquidity in particular in less-liquid instruments. Given capital constraints, they in many cases offer two-way pricing of securities which they do not immediately hold within their inventory. A shorter settlement cycle constrains the time available to source any securities on which they execute a sale. Liquidity providers will have less time to cover potential short positions, as they will need to cover any short delivery (i.e. not covered by existing inventory or a pre-agreed borrowing) in a much reduced timeframe. Whereas in today's environment any such positions are usually covered on T+1 (for delivery next day in order to cover the T+2 settlement), the liquidity provider will need to ensure it has initiated a stock borrow or inventory realignment on trade date, so that the inventory is in place to ensure settlement can take place on T+1. Alternatively, the stock borrow will need to be instructed on T+1, for same-day settlement. This could be more feasible in more liquid markets, with professional dealers providing liquidity to one another on electronic trading platforms. It is less likely to be possible on less-liquid instruments and may result in a smaller pool of liquidity providers (i.e. is limited to those lenders who can facilitate a same-day settlement.)

On the other side, lenders will need to be able to recall any securities on loan or being financed in a similarly reduced timeframe. If they sell a position which is out on loan /being financed, in a T+2 environment they can initiate the recall/substitution on T+1 (i.e. the day after the sale) for delivery next day, in order to cover the T+2 settlement. In a T+1 environment, they will need to initiate the recall/substitution before the end of trade date, to allow delivery on T+1.

Especially for securities on loan, which have been used by the borrower to satisfy other delivery obligations, the borrower will need to initiate another stock borrow (again in a much reduced timeframe) to satisfy the recall they are being faced with, creating a knock-on impact on other parties in the chain.

Within the EU, securities financing transactions are typically collateralised by non-cash assets (i.e., other securities) and often via tri-party agents. A compression of the settlement cycle would create friction in collateral processes, potentially meaning trading parties post excess collateral. This would result in reduced capital efficiency. Clients may require additional financing from service providers in order to facilitate trading activity, creating additional costs

for end-investors and utilising a greater proportion of intermediaries' balance sheets, thus reducing the amount available to be leveraged for other services.

We also wish to note that divergence between settlement cycles within the European region would add further complexity to functioning of markets, in particular for instruments which are traded and settled in multiple jurisdictions. Within the Union, we consider that the migration of in-scope securities should be effected on a single migration date in order to avoid disorderly trading markets. We would also urge that Member States across the Union make the move simultaneously to avoid needlessly promoting dislocation for securities lending and trading that could be caused by Member States implementing divergent effective dates. Further, a coordinated approach across the European region, including the EU, UK and Switzerland would minimise the potential disruption to markets.

Retail Investors

AFME members support further focus on potential measures to improve the attractiveness of EU capital markets to retail investors. We generally consider that any costs and benefits that accrue in wholesale markets will ultimately be experienced by retail investors.

<ESMA_QUESTION_SETT_4>

Q5 : What would be the costs you would have to incur in order to implement the technology and operational changes required to work in a T+1 environment? And in a T+0 environment? Please differentiate between one-off costs and on-going costs, comparing the on-going costs of T+1 and T+0 to those in the current T+2 environment. Where relevant please explain if these are general or asset class/instrument/ trade specific.

<ESMA_QUESTION_SETT_5>

We consider that, at this early stage, it is not possible to quantify the expected implementation costs, until a detailed roadmap has been developed by the industry to outline the specific technology and operational changes that are necessary to support T+1.

Currently, AFME members can and do process transactions for T+1 settlement – in particular for certain types of transaction such as securities financing transactions and collateral

movements. Current systems and processes are therefore capable of working in a T+1 environment. The challenge is to adopt T+1 as a default for all types of transaction, without creating additional risks (such as increased settlement fails), costs (such as increased CSDR penalty costs) or inefficiencies (such as additional resource requirements). We believe that this will require changes by market participants to adopt more efficient ways of working and increase levels of automation and standardisation.

AFME has identified an initial set of potential changes which can be considered as some of the critical building blocks for transitioning to T+1 in a way which does not result in additional risks, costs or inefficiencies. This list will require validation and supplementing by other industry stakeholders.

AFME has surveyed members to assess current sentiment towards the expected level of investment required to support each of these changes. This is a preliminary, qualitative analysis which will need to be supplemented by a more detailed cross-industry cost-benefit assessment further in this process.

For each of the below areas A – G, where changes are envisaged, AFME members were asked to select which of the statements 1 – 5 most closely aligned with their current sentiment.

1 – Our systems and processes are already fully capable of supporting this at scale. Minimal changes are envisaged – main focus will be on education/testing to ensure client, counterparty and infrastructure readiness. No staffing costs are expected post-implementation.

2 – Minor changes are anticipated to improve existing processes and enhance systems / connect to industry platforms. Some staffing costs are expected on an ongoing basis to support these changes. These changes are broadly in line with what should be expected as normal business investment.

3 - A moderate level of changes are expected to processes, staffing and systems, requiring additional investment outside of normal business investment.

4 – Our current operating model is not capable of supporting this at scale. We anticipate a substantive level of investment is necessary, including ongoing staffing costs and building/buying of new systems.

5 – Core systems need to be replaced, representing a significant multi-year undertaking and major investment.

Survey Responses

- Adoption by all trading parties and settlement intermediaries of an automated means to complete allocations/confirmations

Average: 2.4

Range: 1-3

- Adoption by all trading parties and settlement intermediaries of an automated means to store and exchange SSIs

Average: 2.6

Range: 1-3

- Enhanced exception handling and resolution

Average: 2.9

Range: 2-4

- Changes to core CSD operating hours

Average: 3.3

Range: 2-4

- Greater use of automated partial settlement solutions

Average: 2.1

Range: 1-3

- Changes to securities lending processes

Average: 2.8

Range: 1-4

- Changes to FX processes

Average: 2.6

Range: 1-4

The survey results indicate that AFME members, acting as intermediaries in securities markets, generally consider that they are well-placed already to support the adoption by other market participants of greater levels of automation in allocation/confirmation and partial settlement processes. From an operational perspective, a moderate to substantial level of change is anticipated to facilitate the necessary changes to securities lending and FX processes, and to enhance resolution of exceptions – including efficient communication with counterparties and clients. The biggest anticipated change is to accommodate changes to CSD operations, such as extensions of the window for input and matching of settlement instructions at a CSD, or changes to cut-off times.

Please note that this survey is intended to provide qualitative analysis of the up-front implementation costs of these changes. For example, respondents were not asked to consider any potential increase in costs arising from changes to the availability of securities on securities lending markets.

Respondents were asked to consider costs across the following dimensions:

- People – i.e. staff costs, covering both the planning and project management phase as well as ongoing post-implementation costs.
- Internal Systems – i.e. estimated costs of making upgrades required to internal software/hardware.
- Connection to external platforms – i.e. one-off and ongoing costs where firms will need to establish new connections to external platforms (e.g. matching utilities, data providers, communication channels)
- Legal and Compliance – i.e. costs of repapering/updating contractual terms to comply with any legal or regulatory changes related to T+1

<ESMA_QUESTION_SETT_5>

Q6 : In your view, by how much would settlement fails increase if T+1 would be required in the short, medium and long term? What about T+0? Please provide estimates where possible.

<ESMA_QUESTION_SETT_6>

It is important to note that the impact of a migration to T+1 will be, to some extent, dependent on the timeline for adoption. A short-term move to T+1 – i.e. one which did not allow sufficient time for the completion of the “critical building blocks” outlined in Q5 – would result in a significant increase in settlement fails.

One possible way to approximate this is to again compare:

(a) Current proportion of transactions which are matched in T2S/CSD by end-of-day on trade date

(b) Current proportion of transactions which are matched in T2S/CSD by end-of-day on trade date + 1

All other things being equal, the difference between the top would represent the potential decrease in settlement efficiency in moving to T+1.

We understand that this would be a complex process for T2S to provide this analysis, and they were not able to provide this data for inclusion in our response. Nevertheless, we consider that this would be a helpful starting point for estimating the potential impact on settlement fails, and encourage authorities to conduct this analysis.

We note that there are limitations to this method and it would represent an approximation only. It does not consider that some transactions will match and settle on intended settlement date. On the other hand, it also does not take into account potential ‘cascade effects’ – i.e. that any additional settlement fails may cause further onwards fails on contingent transactions. As outlined in Q15, we believe that the move to T+1 should be supported by industry and regulatory efforts to improve the proportion of transactions which are matched at the CSD by the end of trade date. This may require revised CSD operating hours, both the NTS cut-off on S-1 and the RTS cut-off on settlement date.

It is worth noting that matched settlement fails, which typically result from a lack of inventory, are widely acknowledged to make up the larger proportion of overall fails. A reduction of the settlement cycle will have knock-on impacts on inventory management that will result – at least in the short-term – in an increase of settlement fails, given the period of disruption that will be expected after a T+1 settlement go-live.

Should the transition to T+1 be conducted in an appropriate timeframe, and supported by industry and regulatory initiatives to improve levels of harmonisation, standardisation and automation of post-trade processes throughout the industry, it is possible that a long-term reduction in settlement fails could be achieved.

As mentioned in the recently published AFME paper on for 'Improving the Settlement Efficiency Landscape in Europe', we reiterate the need to continue industry initiatives towards the improvement of settlement efficiency. Collaboration across all sectors, including the CSDs, will be key for understanding the root causes behind settlement fails, and will ultimately help set the path to T+1.

<ESMA_QUESTION_SETT_6>

Q7 : In your opinion, would the increase in settlement fails/cash penalties remain permanent or would you expect settlement efficiency to come back to higher rates with time? Please elaborate.

<ESMA_QUESTION_SETT_7>

AFME believes it will be instructive to observe, where possible, the impact on settlement fails in other markets which transition to T+1 before the EU. For example, we note anecdotal evidence that there was a temporary spike in fails in the Indian market after moving to T+1, with fails returning to normal levels. It will be helpful to observe whether there is a similar impact in North America – although we caution against direct comparison between US and EU settlement rates due to lack of available data and the differences in market structure and settlement convention. AFME members are not aware of any other jurisdiction that conducts the same level of settlement fails monitoring and analysis as the EU. In addition, the T+1 model may differ depending on the country and thus may be more or less easy to implement (for example in India there is a requirement for prefunding and an individual segregation).

Generally speaking, AFME members believe that the existence of CSDR cash penalties will continue to act as an effective incentive for market participants to improve processes where possible to minimise 'preventable' settlement fails.

It should be noted that the potential impacts of T+1 on the cost and availability of borrowing securities could result in a more permanent effect on settlement fail rates. Again, it will be instructive to observe how securities lending markets are impacted by the US migration to T+1.

<ESMA_QUESTION_SETT_7>

Q8 : Is there any other cost (in particular those resulting from potential impacts to trading identified in the previous section) that ESMA should take into consideration? If yes, please describe the type of cost and provide estimates.

<ESMA_QUESTION_SETT_8>

As the market adapts to a shortened settlement cycle, it is envisaged that that fail rates will increase at least in the short-term giving rise to greater CSDR cash penalties. As noted in our response to Q15, public authorities should consider a temporary suspension of payments of cash penalties during this initial migration period. This cost increase will impact also the implicit cost to trade in certain stocks as their pricing and/or spreads are likely to adjust.

<ESMA_QUESTION_SETT_8>

Q9 : Do you agree with the mentioned benefits? Are there other benefits that should be accounted for in the assessment of an eventual shortening of the securities settlement cycle?

<ESMA_QUESTION_SETT_9>

Generally, AFME members identify the “community” benefits of (a) maintaining the global alignment of settlement cycles across major jurisdictions and (b) reducing overall levels of settlement risk in the ecosystem, as the core drivers of moving to a shorter settlement cycle.

Recent years, in particular the period most acutely affected by the outbreak of COVID-19 pandemic (February-April 2020), have been characterised by significant increases in trading volume and volatility, increasing levels of counterparty risk in the system. We note that reducing levels of counterparty risk in the system was identified by US SEC as a key driver of their decision to adopt T+1. However, the legislative European framework (and firstly CSDR) allowed the EU to not face the same issues the US market encountered (GameStop, AMC Entertainment).

As noted in our response to Q10, an eventual reduction of CCP collateral requirements is expected, which would free up capital to be used elsewhere, potentially generating an improved ROI. However, some market actors have indicated that they do not expect the collateral savings to be significant, and that these must be balanced against the impact of changes to securities lending processes potentially resulting in posting excess margin, reducing capital efficiency.

From a risk and resilience perspective, a shortening of the settlement cycle would reduce the number of “open” transactions at any point in time (theoretically by as much as 50%). In the event of any market issue – such as a technology outage by a major infrastructure – the impact will be reduced.

As noted in our response to Q15, in order to capture these benefits, the migration to a shorter settlement cycle must be supported by broader changes to existing processes throughout the industry, to ensure that it does not result in the creation of new risks.

We note that these benefits may be less tangible and may not translate into a directly measurable cost saving. Benefits are also likely to accrue over a longer time-horizon than costs, and may materialise differently for different market participants – both in terms of scale and timing. For example, a reduction in margin requirements would benefit direct clearing participants immediately, and would be expected to benefit investors in the long-term as the cost savings resulting from greater capital efficiency are passed through.

Further consideration should be given to the impact of moving to T+1 on the attractiveness of EU markets, in the context of broader CMU objectives. It is not clear that this is a benefit to investors in other regions, in particular those in APAC where the time difference would result in a significantly compressed window in which to conduct necessary post-trade and ancillary activities necessary to facilitate settlement. It has been noted that this could potentially result in APAC-based investors having to instruct FX bookings on a T+0 basis.

<ESMA_QUESTION_SETT_9>

Q10 :Please quantify the expected savings from an eventual reduction of collateral requirements derived from T+1 and T+0 (for cleared transactions as well as for non-cleared transactions subject to margin requirements).

<ESMA_QUESTION_SETT_10>

AFME members are not able to quantify this. However, we strongly recommend that this analysis is undertaken through a collective industry effort involving regulators, CCPs and clearing members.

We note that margin requirements for non-cleared transactions typically relate to OTC derivatives, i.e. are not within the scope of CSDR Article 5. Further to this, most margin posted to CCP is related to derivatives transactions and would thus not be affected by a shortening of the settlement cycle.

It should also be noted that in EU securities markets, banks and other institutions typically provide collateral in asset form (rather than cash), which results in multiple settlements related to the same transaction. A large part of borrowing activity is collateralised via tri-party agents, who may be unable to move collateral without friction on a same day basis. This could lead to institutions posting excess collateral at tri-party agents, reducing capital efficiency.

<ESMA_QUESTION_SETT_10>

Q11 : If possible, please provide estimates of the benefits that you would expect from T+1 and from T+0, for example the on-going savings of potentially more automated processes.

<ESMA_QUESTION_SETT_11>

We caution against factoring cost savings arising from increased automation as a benefit of T+1, as these would be achievable without shortening the settlement cycle.

Although it is not possible to quantify the benefits of increased levels of efficiency and harmonisation of post-trade processes, we note that these benefits are likely to be accrued long term (compared to implementation costs which occur in the short term). The materiality of such savings will depend on multiple factors. It should be noted that market participants will benefit from the actions of others. In other words, the efficiency of any individual firm is also dependent on the efficiency of the counterparties, clients and service providers that they interact with. Collective efforts to improve levels of efficiency and harmonisation will create benefits and, ultimately, cost savings throughout the chain.

We note that, even for fully automated processes, human oversight is still required. It is anticipated that the move to T+1 would need to be supported by a longer working day on trade date, including possibly relocation of human resources, to ensure as many transactions as possible are “ready to settle”.

<ESMA_QUESTION_SETT_11>

Q12 : How do you assess the impact that a shorter settlement cycle could have on the liquidity for EU markets (from your perspective and for the market in general)? Please differentiate between T+1 and T+0 where possible.

<ESMA_QUESTION_SETT_12>

As noted in our response to Q4, increased pressure and complexity in securities financing transactions (SFTs) could result in additional costs and/or a reduction in the volume of securities made available in SFT markets. Deep, liquid and efficient securities lending markets support the liquidity and efficiency of broader capital markets.

As the market adapts to the shortened settlement period, liquidity could be constrained, especially for instruments which are already not very liquid/available for lending, by the combination of the impacts on liquidity providers on one side, and one lenders on the other side, faced with the requirement to navigate more narrow timeframes to satisfy their respective delivery obligations.

As the cost of carrying inventory for liquidity providers is high, they may seek to reduce their willingness to provide liquidity, especially in volatile markets or where lending inventory is scarce, leading to a further deterioration in market liquidity, and an increased risk for anyone who wants to trade in or out of a position.

Where CSDR cash penalty rates may increase in the short or longer term for less liquid stocks or for ETFs/ADRs this may decrease or make non-compelling investments in some of these assets. An EU settlement cycle made regionally divergent without carefully implementing a coordinated and orderly migration could impact the attractiveness of EU investments. Investors are already deterred by unnecessary regulatory complexity upon trading market structure and further divergent practices in the end-to-end ecosystem risks deleterious effects to liquidity and investment allocation to EU markets. For multi-listed instruments which would be subject to different settlement cycles following the US move to T+1, it will be important to observe any impacts to trading activity and liquidity across jurisdictions.

It is hoped that as recent proposed reforms to research and listing rules begin to take effect that the benefit of improving liquidity in the EU will emerge. This benefit may become difficult to discern in the short term by the impacts generated in moving to T+1.

<ESMA_QUESTION_SETT_12>

Q13 : What would be the benefits for retail clients?

<ESMA_QUESTION_SETT_13>

AFME members support further focus on potential measures to improve the attractiveness of EU capital markets to retail investors. We generally consider that any costs and benefits that accrue in wholesale markets will ultimately be experienced by retail investors.

<ESMA_QUESTION_SETT_13>

Q14 : How would you weigh the benefits against the costs of moving to a shorter settlement cycle? Please differentiate between a potential move to T+1 and to T+0.

<ESMA_QUESTION_SETT_14>

In general, it appears that costs and benefits will occur over different time horizons for different market participants. It is likely that the costs incurred by the industry will be immediate, or short-term, and that benefits are realised over the medium or long term. As noted, the less-tangible “community” benefits arising from reduced risk and increased efficiency must be appropriately considered in any evaluation of costs versus benefits.

The potential costs associated with any knock-on impact on market liquidity should also be considered. A better understanding of the potential knock-on impacts will be gained from observing the transition to T+1 in the US.

Since a transition to T+1 will require significant financial investment and human resourcing, it is advisable that any move be considered against the broader regulatory landscape and other policy objectives.

<ESMA_QUESTION_SETT_14>

Q15 : Please describe the main steps that you would envisage to achieve an eventual shorter securities settlement cycle. In particular, specify: (i) the regulatory and industry milestones; and (ii) the time needed for each milestone and the proposed ultimate deadline.

<ESMA_QUESTION_SETT_15>

High-level Roadmap

Any decision by public authorities to adopt a T+1 settlement cycle should be based on a detailed cost-benefit analysis and must incorporate sufficient time to observe the impacts of moves to T+1 in other jurisdictions. Authorities must also consider how to prioritise this against other competing policy objectives, noting the industry's expectation that this would be significant resource-intensive undertaking.

Should such a decision be taken, we envisage that the implementation project will be a multi-year, multi-stage process, involving input from a broad range of market stakeholders. This could include:

- Preparation of appropriate delegated regulations, including public consultations and publication
- FMI and vendor discussion / assessment on what technical changes are required for T+1, publishing details of changes to their systems, processes and T&Cs including a timeframe to implement
- Formation of an Industry Steering Committee and development of an “industry playbook” with a mandate to define some of the more technical aspect of the migration process.
- Legal repapering / client outreach where required
- Full and complete end-to-end industry testing in accordance with a governance schedule agreed by the Industry Steering Committee, including sign-off by relevant NCAs

Industry Changes

AFME's recent white paper “Improving the Settlement Efficiency Landscape in Europe” sets out a number of practical recommendations for industry participants to take forward to improve efficiency in post-trade processes. We consider that many of these recommendations will become essential to deliver a successful transition to T+1.

As noted in our response to Q5, an important milestone to achieve would be ensuring that there is no degradation in the proportion of instructions which are matched at the CSD by the end of the business day before intended settlement date. Industry participants should collaborate to ensure the conclusion of allocation/confirmation processes on trade date. We recommend that the method used to exchange this information should enable straight-through-processing.

We consider that market infrastructure must be provided with sufficient time to make any technology or operational changes to their platforms – such as changes to operating hours, timings of certain processes, or enhancements to functionality such as real-time settlement or

auto-partial. With respect to the adoption of technology solutions to support the move to T+1, some industry participants have observed “bottlenecks” when market participants try to rapidly connect to a new platform or service provider, impacting on costs and time to delivery.

It is envisaged that changes to timings of post-trade processes conducted by FMIs will be required. For example, an extension of the cut-off for T2S night-time settlement.

As a general comment, we consider that a successful implementation project will be contingent on generating widespread industry momentum and support for the move to T+1, which will require clear identification of the benefits to the industry as a whole of shortening the settlement cycle.

Regulatory Changes

Should the EU take a decision to adopt a T+1 settlement cycle, AFME considers that certain amendments to CSDR may be required:

Article 5.2 of CSDR mandates that the “settlement date shall be no later than on the second business day after the trading takes place”, which is not inconsistent with a T+1 settlement cycle. However, we believe an update to this article will be required, to ensure a fully harmonised adoption of T+1 across all in-scope market participants and trigger a ‘call to action’ similar to what the SEC Final Rule achieved in the US.

Further amendments to the Settlement Discipline RTS will also be required:

- Article 10 (Partial Settlement): Would benefit from an update to mandate of the provision of partial release functionality by CSDs. Derogation from the requirement to provide partial settlement should be removed, to ensure all CSDs provide a consistent service.
- Article 11.4 (Additional Facilities and Information): Would require amendment to mandate the provision of real-time gross settlement for all settlement instructions, including partials, in all CSDs.

Regulators may give consideration to invoking a temporary suspension of the payment of CSDR cash penalties around the migration period, until fail rates normalise. Regulatory scrutiny of settlement fail rates, and consideration of changes to the current settlement discipline rules (including potential mandatory buy-ins), should take into account the anticipated short-term disruption that could arise from a move to T+1.

<ESMA_QUESTION_SETT_15>

Q16 : Assuming that the EU institutions would decide to shorten the securities settlement cycle in the EU, how long would you need to adapt to the new settlement cycle? And in the case of a move to T+0?

<ESMA_QUESTION_SETT_16>

AFME members consider that, in order to appropriately answer this question, it will be necessary to build on the various responses to Q15 received from different constituencies, and develop an agreed cross-industry implementation roadmap.

A helpful reference point may be the most recent EU initiative to shorten settlement cycles. The uniform adoption of T+2 settlement for in-scope transactions took place in most EU markets in October 2014, in order to meet the requirements of CSDR Article 5. This was approximately 31 months after the draft text of CSDR Article 5 was first proposed by the European Commission, in March 2012.

We note that a move to T+1 settlement is generally considered as a more challenging implementation project than the move to T+2 (indeed, some markets such as Germany already operated on T+2 for certain instruments) and will likely require more complex changes by more different types of market participant, including market infrastructures (e.g. T2S).

<ESMA_QUESTION_SETT_16>

Q17 : Do you think that the CSDR scope of financial instruments is adequate for a shorter settlement cycle? If not, what would be in your views a more adequate scope?

<ESMA_QUESTION_SETT_17>

AFME members consider that the current scope of financial instruments outlined in CSDR Article 5.2 is adequate for a mandatory shorter settlement cycle.

We note that Article 5.2 specifically applies to transferable securities executed on trading venues and where settlement takes place on an in-scope CSD (and not money market instruments, units in collective investment undertakings and emission allowances as is suggested by ESMA in paragraph 44.)

<ESMA_QUESTION_SETT_17>

Q18 : Is it feasible to have different settlement cycles across different instruments? Which are the ones that would benefit most? Which least?

<ESMA_QUESTION_SETT_18>

Please refer to the answers provided to Q17 in regard to the scope of financial instruments that we consider could fall into the remit of a reduced settlement cycle.

<ESMA_QUESTION_SETT_18>

Q19 : Which financial instruments/ transaction types are easier to migrate to a shorter settlement period in the EU capital markets? Does the answer differ by asset class? Should it be feasible/advisable to have different migration times for different products/markets/assets? If yes, please elaborate.

<ESMA_QUESTION_SETT_19>

AFME members generally consider that it is preferable to adopt a single migration date for all in-scope markets, transaction types and asset classes. We caution against a phased migration approach which splits migration dates within an asset class or by transaction type. This would create additional complications for cross-border settlement, and increase the overall duration and cost of the implementation project for the industry. Settlement chains can be formed of a multitude of different transaction types, and therefore migrating a subset of transaction types will break chains and create settlement fails.

As outlined in our response to Q4, the impact of a shortened settlement cycle will be more pronounced for some asset classes. We consider that it will be easier to support a shorter settlement cycle for more liquid financial instruments. For example, in markets such as the UK and US, highly liquid government bonds currently operate on a T+1 settlement cycle, with other asset classes on T+2.

We also draw particular attention to ETFs, which can often contain underlying securities from several jurisdictions, and have grown substantially in terms of trading activity and liquidity in

recent years. Because settlement of newly created units is contingent on the settlement of the underlying constituents, 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, with less efficient primary markets for ETFs resulting in a drop in liquidity in secondary markets.

Further industry analysis will be required to determine if there is the need to exempt certain asset classes from T+1, if this would effect the functioning of the market in that security type. However, this would be contingent on a clear way for all market participants to identify the relevant settlement cycle for the instrument – i.e. this would need to be included in a publicly accessible single database.

<ESMA_QUESTION_SETT_19>

Q20 : Do you think that the settlement cycle for transactions currently excluded by Article 5 of CSDR should be regulated? If you think that the settlement cycle of some or all of these transactions should be regulated, what would be in your view an appropriate length for their settlement cycle?

<ESMA_QUESTION_SETT_20>

No. AFME members believe that the current scope of CSDR Article 5(2) is sufficient.

We do not think it is necessary or desirable to mandate a settlement cycle for other types of transaction such as those conducted off-venue, for which a different settlement cycle might be preferred by both counterparties. Where practicable and appropriate, we anticipate that off-exchange transactions will align with the settlement cycle for on-venue transactions. This was evidenced during the previous initiative to shorten the settlement cycle to T+2 in 2014.

<ESMA_QUESTION_SETT_20>

Q21 : Please describe the impact(s) that the transition to T+1 in other jurisdictions has had or will have on your operations, assuming the EU remains on a T+2 cycle.

<ESMA_QUESTION_SETT_21>

A reduction of the settlement cycle in other jurisdictions (e.g., the US or Canada) will require changes to the operational processes and technology systems used by financial institutions

that connect to those markets, including EU-based firms. In effect, a misalignment of settlement cycles across different jurisdictions will impact a number of process areas; however, it is worth noting that some issues will still occur even in the event of the EU moving to a shorter settlement cycle.

Issues arising from the misalignment of settlement cycle (whilst EU remains on T+2):

- Exchange-Traded Funds (ETFs), multi-listed securities and depository receipts: ETFs typically exhibit lower settlement efficiency compared to other asset classes, primarily stemming from the misalignment between the primary market (which requires creation/redemption by authorised participants) and the secondary market. A reduction in the settlement cycle for a portion or the entirety of the ETF portfolio is likely to increase this inefficiency. Similarly, multi-listed securities and depository receipts are cross-border instruments that might end up with misaligned settlement cycles in different jurisdictions. This could result in increased costs and risks which translate to increased bid-ask spreads or costs for the issuer.
- Corporate actions: Depending on the timing of various global implementations of T+1, there will be a period of misalignment, whereby there will be securities listed across multiple markets operating on different settlement cycles. If there is a misalignment in the key dates of the different listings, this could create distortive impacts on the pricing of the security with entitlements determined or paid out on different dates.

Issues that would still continue occurring (even if the EU moved to a T+1 settlement cycle):

- Allocations, confirmations & affirmations: Firms will encounter more stringent deadlines for trade allocation, confirmation and affirmation in other jurisdictions with reduced settlement cycles (most notably, the US). It will become imperative for them to ensure the efficient and timely allocation of trades, confirmations with counterparties, and the submission of trade details to the corresponding systems and platforms.
- Securities financing: Securities financing transactions (SFTs), including repo and securities lending, play pivotal roles in inventory management. These transactions are crucial for funding, enabling dealers to effectively handle their trading positions, particularly in market making. Consequently, SFTs frequently settle on a shorter cycle than the underlying cash trades. Therefore, a reduction in the settlement cycle for the cash market adds extra pressure to these activities.

- **Time zones:** Conducting operations across various time zones presents communication and coordination challenges for EU and other global market participants. In the current operational setting, there is a one-day window between trade date and settlement date, that allows for the resolution of potential issues that could impede timely settlement. Other jurisdictions transitioning to T+1 will eliminate this period. Furthermore, achieving timely exchange of trade details and the completion of associated processes, such as FX, will demand efficient coordination across disparate time zones, a task complicated by the constraint of limited overlapping working hours.
- **Foreign exchange, funding and liquidity management:** A reduced settlement window in other jurisdictions will require a review of the timing of the FX trade in relation to the security trade, and the full settlement process for both the FX and the security trades. Furthermore, firms will need to be aware of local currency cut-off times, public holidays and currency controls, along with custodial and commercial/nostro bank currency cut-off times for same day FX transactions.
- **Operational resilience:** Given the global interconnectivity of financial markets, EU-based firms will be required to implement stricter controls and monitoring mechanisms to identify and mitigate operational risks that could arise in other jurisdictions that transition to a shorter settlement cycle.
- **Corporate actions:** There will be a shortened timeframe for receiving instructions on voluntary events when trading into a position right before a corporate action-related deadline. This rises the demand for timely and accurate trade bookings and client instructions, particularly for investors located in a different time zone.

<ESMA_QUESTION_SETT_21>

Q22 : Can you identify any EU legislative or regulatory action that would reduce the impact of the move to T+1 in third countries for EU market participants? Please specify the content of the regulatory action and justify why it would be necessary. In particular, please clarify whether those regulatory actions would be necessary in the event of a transition of the EU to a shorter settlement cycle, or they would be specific only to address the misaligned cycles.

<ESMA_QUESTION_SETT_22>

EMIR CCP Temporary Recognition Regime (EMIR TRR)

US market-wide data suggests that affirmation rates are relatively lower for non-US domiciled entities. Given the significant volume of US securities traded and settled by EU-based institutions, work is required to improve these rates to avoid a potential increase in settlement fails.

In addition to the SEC requirement, there needs to be an additional commercial incentive for EU firms to affirm their trades on T+0, however there is no ability to clear/net transactions through the US clearing house (NSCC), which would provide such incentive. NSCC are currently not admitting any EU firms as clearing members because the EU EMIR Temporary Recognition Regime will last until 31/12/23, and is only renewable by the EU authorities on a periodic basis.

We have identified that ESMA could help EU firms preparing for US T+1 by (i) granting permanent equivalence, (ii) extending the renewal period or (iii) providing more certainty to NSCC that the equivalence will be renewed each time.

By introducing more commercial incentives, any adverse impacts of US T+1 on EU firms will be lessened, helping support a harmonised transition and more efficient settlement.

Regional Coordination

It is notable that the timing of a move to T+1 has been coordinated by several jurisdictions in the Americas – including the US, Canada and Mexico. We strongly emphasise the importance of keeping a coordinated approach with other jurisdictions in the European region that may be considering a move to T+1, including the UK and Switzerland.

UCITS Borrowing Limits

As per Article 83(2) of UCITS, a UCITS fund may not borrow more than 10% of the fund's net asset value (NAV). As noted elsewhere, the move to T+1 in the US creates a one-day settlement funding gap for EU-regulated funds with exposure to US securities.

EU authorities should consider amendments to UCITS borrowing limits, e.g. to create an exemption for breaches due to settlement cycle mismatches. This will enable EU funds to continue facilitating end investors' access to US markets.

<ESMA_QUESTION_SETT_22>

Q23 : Do you see benefits in the harmonisation of settlement cycles with other non-EU jurisdictions?

<ESMA_QUESTION_SETT_23>

Given that some major jurisdictions will be adopting T+1, the end users of capital markets – companies seeking to issue capital and consumers seeking to invest capital – may benefit from Europe following the same approach. This would also avoid a potential gap in the perceived competitiveness of European markets vis-à-vis its global peers.

An alignment of settlement cycles would likely bring benefits for the optimisation of cross-border settlement, cash and liquidity funding.

Assuming the T+1 models are identical in terms of scope, dual-listed securities would also benefit from harmonised settlement cycles as it would ensure a level playing field which would prevent distortions on market activity, liquidity and pricing.

Processing alignment across major markets will also be beneficial to both buy-side and sell-side participants, reducing operational complexity and avoiding non-standard settlement requests, and funding gaps.

We emphasise again the importance of regional coordination, and advocate for harmonised settlement cycles across EU and non-EU markets within geographical Europe. If the EU moves to T+1 in line with neighbouring jurisdictions, this will avoid any impact to market liquidity and reduces scoping complexities. For example, on securities traded and settled in both EU and UK markets, it would avoid (a) any confusion as to the correct settlement cycle; (b) settlement cycle being a factor in trading decisions. It would also create a shorter and more streamlined implementation project for participants active in both jurisdictions.

It should be noted that these benefits will only be realised if the transition to T+1 in the EU is effected in a controlled and coordinated way, and supported by the necessary market changes to avoid the creation of new risks or costs.

We further note that the appropriate framework for T+1 settlement may be distinct between jurisdictions, depending on variables such as local law and market structure or types of investors.

<ESMA_QUESTION_SETT_23>

Q24 : Would reducing the settlement cycle bring any other indirect benefits to the Capital Markets Union and the EU's position internationally?

<ESMA_QUESTION_SETT_24>

Whilst not being a pre-requisite, a move to T+1 could facilitate increased attention by industry and regulators towards the removal of barriers to cross-border settlement. It could also be a driver for further automation and further efficiency in European capital markets.

Further harmonisation (e.g., greater compliance with T2S standards or tackling cross-border challenges) is still required at EU level, in order to help support a move to T+1 settlement.

We would support for the establishment of a coordinated approach, particularly with UK and Swiss public authorities, to manage the transition. This would be critical in order to mitigate any potential disruptions that may arise during the transition period, which could have negative effects on the EU's international position.

<ESMA_QUESTION_SETT_24>

Q25 : Do you consider that the adaptation of EU market participants to the shorter settlement cycles in other jurisdictions could facilitate the adoption of T+1 or T+0 in the EU? Please elaborate.

<ESMA_QUESTION_SETT_25>

EU firms could potentially benefit from lessons learned from the migration to a shorter settlement cycle in other jurisdictions. Other jurisdictions undergoing a migration to a shorter settlement cycle have set out industry playbooks and testing cycles which can provide valuable insights and could potentially be leveraged by EU market participants.

Typically, firms do not have a single global process, technology stack, or settlements team – therefore a potential EU move to T+1 will be a separate project to the US T+1. It should not be assumed that the experience of the US T+1 migration will enable globally active firms to migrate to T+1 in EU securities markets on a shorter timeframe. We also note that not all EU market participants are active in other jurisdictions which have already moved to T+1.

We also repeat that the EU ecosystem is significantly more complex than, for example, the US, making an implementation of T+1 settlement a considerable undertaking.

<ESMA_QUESTION_SETT_25>

Q26 : Would different settlement cycles in the EU and other non-EU jurisdictions be a viable option?

<ESMA_QUESTION_SETT_26>

It is clear that European jurisdictions can not move to T+1 in May 2024, and therefore market participants must be prepared to manage a period of misalignment between Europe and the Americas. We note that between 2014-2017, there was also different settlement cycles between the EU and US, which still operated on a T+3 basis.

Some AFME members have expressed that, given the growing activity in global products such as ETFs in recent years, this forthcoming period of misalignment may be a less-viable long-term option.

One of CSDR's main goals was to bring harmonisation of settlement cycles across European capital markets. The implementation of different settlement cycles within the EU should not be considered.

<ESMA_QUESTION_SETT_26>

Q27 : Please elaborate about any other issue in relation to the shortening of the securities settlement cycle in the EU or in third-country jurisdictions not previously addressed in the Call for Evidence.

<ESMA_QUESTION_SETT_27>

Considerations on potential impacts to non-EU investors

Any decision by EU authorities to adopt a T+1 settlement cycle should give appropriate consideration to potential impacts to investors in other jurisdictions (i.e. time zones). We

recommend that outreach with these stakeholders is conducted as part of the cost-benefit analysis process. Any shortening of the settlement cycle should be effected in a way which does not disincentivise foreign investors from accessing EU securities markets.

Operational resilience

A reduced settlement cycle will amplify the impact of any major issues (such as infrastructure outages or cyber-attacks) that take place between trading and settlement. All market participants will need to review resilience and contingency measures to help minimise the risks that could arise from such an incident.

<ESMA_QUESTION_SETT_27>