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](http://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](http://www.esma.europa.eu) under the heading ‘[Data protection](https://www.esma.europa.eu/about-esma/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.

# General information about respondent

|  |  |
| --- | --- |
| Name of the company / organisation | The Investment Association |
| Activity | Associations, professional bodies, industry representatives |
| Are you representing an association? |  |
| Country / Region | UK |

# Questions

1. : Please describe the impacts on the processes and operations from compressing the intended settlement date to T+1 and to T+0. Please:
2. 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.
3. 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>

**About the Investment Association**

The Investment Association (IA) champions the interests of the UK-based investment management industry. We represent over 250 firms, a third of which are headquartered in the EU and operate from 642 offices across Europe.

Our members put €9.9 trillion to work across the economy, representing 35% of the total €28.4 trillion of assets managed in Europe. In 2022, IA members managed €2.7 trillion on behalf of European clients and invested €820 billion into EU businesses and projects needing capital, all while providing European clients access to global investment opportunities.

**Executive Summary**

The Investment Association welcomes the opportunity to respond to the ESMA Call for Evidence of a shortening of the Securities settlement cycle. We have been deeply engaged with our members in preparation for the North American transition in May 2024 and have thus looked to understand the costs, benefits, impacts and potential solutions to that transition and lessons learnt that can potentially apply to an EU move.

**Our headline positions are that.**

* **The EU should look to align settlement cycles with the US.**
* Alignment across global settlement cycles reduces frictions to trade which ultimately results in lower costs for the end investor.
* **That the EU markets should learn from the US transition.**
* The US transition to T+1 settlement still has a lot of open questions around scope of instruments, whether extended settlement is permitted and the impact on ancillary processes such as FX and cashflow management. The EU should ensure that any transition and go-live resolves for these issues.
* **The EU should retain the ability to move at pace.**
* Learning from the US transition and go-live does not necessarily mean that a “wait and see” approach is adopted, but rather that the market stands ready to tailor its transition approach and potentially its timeline as necessary. One of the additional costs of the US transition is a misalignment in global settlement cycles causing frictional costs, potentially to the detriment of the end investor and particularly for popular products representing global baskets of securities like ETFs (exchange traded funds). A potential way to mitigate some of this cost is for the EU to transition to T+1 settlement to realign settlement cycles, though this should be considered against the costs of the transition.
* **The EU and UK should align in their transition to T+1 settlement.**
* As discussed above, a key challenge is the fragmentation of security settlement cycles and go-live dates. The market and ultimately the end investor is better served in reducing the number of transition projects that firms must undertake. The UK is a key market for alignment. We encourage the EU to utilise the newly signed memorandum of understanding between the European Commission and HM Treasury to preferably align on a date.
* **A discussion on the acceleration of the mutual fund subscription and redemption cycle should be encouraged, but not mandated.**
* Alongside a securities settlement move to T+1 settlement, we welcome a discussion of fund subscription and redemption settlement cycles. Currently fund subscription and redemption cycles within Europe range across T+2 to T+4, with T+3 most common. We believe that many funds will likely move to T+2 for subscription and redemption if security settlement moves to T+1, but that flexibility should remain with the fund manager to decide.
* **A move to T+0 security settlement should be considered separately.**
* Whilst a move to T+1 settlement is achievable under current infrastructure, a move to either T+0 (end of day) or T+0 (atomic settlement) would require a wholesale change of market infrastructure and key processes. We believe that these discussions should be held separately. Unless otherwise notated, responses below relate to T+1 rather than T+0 Settlement.

The IA and its members appreciate the ongoing engagement of European legislators. Whilst we have answered this survey based on current member views, these are likely to evolve over the coming months with the North America transition, so we encourage ESMA and the European Commission to regularly look to take stock of firms’ views.

Any transition to T+1 Settlement must ultimately benefit the end investor.

**Start of response to question 1**

**Trade matching – allocation and confirmation**

Depending on what the requirements are alongside a move to T+1 in Europe, it would and should be reasonably expected to come with a requirement to allocate and confirm an EMEA trade by end of day on T, as was seen with the US move.

Once a broker fill notification has been sent, the asset manager will typically look to allocate the trade. The broker will then send a confirmation before the custodians of both counterparts upload the trade and pre-matching occurs at the CSD.

This will be a challenge across the different timezones in EMEA and APAC. The close of markets in Europe around 4PM CET translates to 11PM Singapore/Hong Kong time, leading to challenges from Asia investors to accommodate for any manual processes within different markets. Even the 4:30 PM close in Portugal equates to 6:30 PM towards the east of the EU (e.g. Finland).

That being said, many EMEA and APAC investors will already have adjusted processes for the US trade matching process, which presents the same challenges but with a timeline a further 5+ hours out. Some of the preparation done by asset managers and their clients ahead of the US move should assist with the UK/EU move.

**FX Settlement**

A key part of trading FX to settle European stocks is access to the right currency (e.g. SEK for Sweden, EUR for France, etc). A key market utility for members looking to settle FX transactions into these currencies is CLS Settlement, offering Payment vs Payment netting. This allows transactions to go through concurrently to mitigate counterparty risk and nets transactions into a more manageable number.

The deadline to access this for next day settlement is midnight CET. Currently in a T+2 world, some firms will make use of the day on T+1 to calculate FX requirement, execute the trade and send it for settlement in time to settle netted through CLS for next day. A change to T+1 will mean that this either has to happen late on T (preferable, given overnight batch settlement of the security trade), or first thing on T+1 (settlement date), to ensure the currency is in place once the settlement windows open.

This is a significant challenge for our members with regards to US T+1 settlement, but should have a lower impact in Europe given:

* There’s more time in between the European market closes (~5PM CET depending on market) and the CLS deadline (12AM CET) than the US market close (10PM CET)
* The European markets align more with our members current operational hours.
* End of day in Europe aligns to current FX liquidity pools
* Our members will have adapted some processes for US T+1 already.

It will be a further challenge for APAC investors, though they may similarly have solutions put in place following the US transition, whether it’s adjusting the FX instruction process to allow more time or whether it’s accommodating a greater amount of bilateral cash settlement.

**FX liquidity**

A transition to T+1 will likely further concentrate FX transactions relating to securities trades towards close of trading on T. This is a bigger problem in the US, where this period does not relate to pre-existing liquidity pools, whereas in Europe ~4-5PM CET already provides decent liquidity.

If European firms decide instead to execute and FX to settle on T+0 early on settlement date of the T+1 security trade, it may mean that settlement of the security trade is delayed whilst the FX is bilaterally settled as gross. Additionally, FX liquidity is less available (currently) at this time.

**Fund settlement – cash-flow management**

Across many European jurisdictions, mutual finds operate on a T+3 or even T+4 settlement cycle for subscriptions and redemptions into a fund. They have an existing funding misalignment against capital markets trades on T+2, which would be exacerbated by a move to T+1.

Currently, firms alleviate for this funding gap by utilising short term credit facilities (overdrafts), extending settlement on the security transaction or holding a cash buffer for funding gaps. These are necessary to address the gaps but can lead to fund performance drag (excessive cash) or possible UCITs breach issues (concentration of assets and persistent borrowing).

Where using an overdraft facility from the custodian, these are often on an unsecured basis, which means that funding cannot be relied upon and may be particularly difficult to obtain during times of tight credit or low activity (e.g. around end of year holiday season).

Our members are currently considering moving some of their fund ranges to T+2 settlement in preparation for the North American transition. Whilst this would alleviate some of the issues in the funding gap cited above, there are blocks to transition, with different countries having different fund administration infrastructure, differing levels of investor appetite to transition and an unclear view from different European jurisdiction regulators on whether a fund settlement cycle change represents a significant change and whether significant notification, regulator approval and re-documenting is necessary or not. Another challenge is that fund ranges prefer to have all sub-funds within the same umbrella on the same settlement cycle, such that they wouldn’t want to transition a North America focus sub-fund without transitioning the rest. Currently it looks like a low proportion of EU based mutual funds will look to change subscription and redemption cycle as a result of the North American transition.

A decision to transition fund settlement cycle would become more compelling if Europe moved to capital markets T+1 settlement to join North America. This would be a large undertaking across an investment manager, fund manager, transfer agent and platform and would depend on the ability of the national jurisdiction’s infrastructure for change.

Separate from funds; some segregated accounts or clients, particularly those from the APAC region, may not permit overdrafts (custodian borrowing). This further reduces the ability of asset managers to manage cash flow. As a worst-case scenario, the client may opt to remain uninvested when buying into securities for the period where cash flows are misaligned, though many arrangements mandate that the client must remain invested and do not allow for this.

**Securities lending**

Investors and funds are often the asset owners of stocks lent out via securities lending, with the fund manager often electing to appoint a securities lending agent to perform the activity on behalf of the assets, earning an additional revenue for the fund.

This is largely an invisible process for the investor or fund and the portfolio or investment manager. They may not be aware of which assets are out on loan or not and, in theory, this does not impact them as the agent lender should have a process to recall the stock in time for the onward sale of the security, if it’s sold.

With a move to T+1 settlement, it should not impact the ability of the market to initiate a stock borrow/loan transaction and settle it in time, these transactions can occur on T+0 (same-day) today if collateral is available.

The challenge comes where a security has been instructed to be sold but is out on loan. In such a case, the asset manager will instruct the sale on the security to the custodian. The custodian will then notify the agent lender (or the relevant team internally if the custodian is appointed as the agent lender), and attempt to get the stock recalled in time to settle. This is a big challenge under today’s T+2 settlement cycle, with many CSDR cash penalties caused as a result of stock being out on loan and unable to be recalled on time. A move to T+1 will exacerbate these fails further.

This may have a knock-on impact on short selling, with security lending often used to accommodate a short position. Given the potential need for a security lending position to be closed out quickly under a T+1 settlement cycle, it may be that the short selling position would have to close out quickly or in the least, may face additional costs in servicing the position.

**ETFs (Exchange traded funds)**

Exchange traded funds will generally track an index and basket of securities. Rather than traditional funds, the process involves authorised participants (APs) and market makers to provide a market for ETFs and to keep bid/offer spreads as tight as possible for the end investor. APs are incentivised to find pricing differences and in doing so drive prices down for the end investor.

Given the nature of the product, ETFs in particular benefit from aligned settlement cycles globally, given they’re able to align any buys or sells from investors (currently on a T+2 basis), with the create/redeem process between the AP and issuer (also T+2), which matches the capital markets settlement cycle for the underlying basket of securities (T+2).

The US transition to T+1 has created an added complexity. Many ETFs track global indices which have heavy US weightings given the size of their capital markets (around 65% is typical). Given these securities will now have to be funded to be bought on T+1 (with ETFs still traded T+2 on EMEA markets), this presents a difficult funding gap. The ETF market is looking to adapt by moving creates to T+1, and leaving redeems at T+2, which allows for settlement. Challenges remain, especially in large creations or redemptions, in that ETFs may be left with large cash balances (causing a breach under the UCITS framework) or may have to increasingly leverage an overdraft (with a 10% limit). EFAMA (of which the IA is a member), has articulated this challenge to ESMA and the European Commission.

A move to T+1 in Europe and the UK would benefit the ETF in terms of alignment of global settlement cycles, but may present additional challenges given the tighter timeline of a T+1 creation and redemption process.

Further assessment would have to be done by European market participants to understand how an ETF with a T+1 secondary market settlement cycle in EMEA would be able to operate, given these additional timing challenges.

**Collateral management and rehypothecated securities**

Similar to the challenges around the sale notifications of loaned stock, securities may be posted as collateral, which may then be recalled to be sold.

This posted collateral may then be rehypothecated to be re-used elsewhere, meaning the collateral taker may have a flat (0) position in their clearing account. Should the pledged collateral be instructed to be sold, the collateral taker would then have to source alternate liquidity before being able to return the collateral, which would then have to settle the onward sale notification. It’s difficult to see how such a transaction would be able to settle in time.

**General market settlement**

The European market relies on “overnight” or “start of day” settlement, when the bulk of settlement due for that intended settlement date happen in one window. The market largely operates in that the majority of trades are eligible to settle first thing on settlement date, with any failing transactions as exceptions that may need manual intervention, or themselves are failing due to a failing receipt.

With a move to T+1 Settlement, more and more business processes may become “BAU” processes on intended settlement date itself, meaning that fewer securities transactions are able to settle in the overnight batch. This may include, but is not limited to:

**FX transactions** – Needed to fund the trade, these may be completed on intended settlement date, which means the trade can only settle later.

**Securities lending recalls** – If a security is out on loan as agreed by the agent lender, the asset owner (and if applicable the asset manager) may not be aware as they try to sell it. In such a case that recall may happen on intended settlement date.

**Collateral substitution –** Securities posted as collateral may face a similar recall issue as that of sec lending. These collateralised securities may also be rehypothecated for further use by brokers, which makes the recall more difficult still.

Trade not settling in the overnight batch will impact the settlement of onward deliveries, potentially shifting settlement to later in the day and a more manual process.

The other potential impact is that some of the recall processes will recall stocks through FOP (Free of Payment) transactions, which typically have a later settlement window in Europe than the more standard DvP/RvP (Delivery/Receipt vs Payment). This may mean the recall settles but is too late to settle the onward transaction.

**Client onboarding and static data**

With a move to T+1 settlement, having the correct static data for settlement becomes even more crucial, with additional importance on having a robust onboarding process to ensure that client data is correct (e.g. incorrect SSIs on onboarding will make it very difficult to settle a trade on T+1).

It’s also important that custodians are able to disclose where stock is held to the client and their delegated manager, such that the trade can be instructed in the correct settlement location (e.g. vs an ICSD or local CSD).

As part of a potential move to T+1 settlement, we believe that it’s important that custodians be mandated to include the current settlement location of any inventory (e.g. a custodian may notify holdings of 100 shares at a local CSD in France and 100 shares are held in Euroclear).

<ESMA\_QUESTION\_SETT\_1>

1. : 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) The IA don’t propose to comment.

(b) For the buy-side, FX transactions represent a key component in ensuring that funding in the correct currency is in place to ensure settlement by the prescribed date for overseas investors or funds.

A common practice today is that an aggregated FX requirement is calculated either at end of day on T, or next-day on T+1 once security trades are confirmed (e.g. 10 million Euros is required from an Australian client to settle transactions in Germany and France so an EUR/AUD FX transaction is necessary). The FX transaction is then traded and booked to settle on settlement date of the underlying trades, by default on T+2.

A key component of FX is to leverage Payment vs Payment netting for settlement, which mitigates counterparty risk and makes FX settlement more operationally simple by netting down all of the receipt and debits for the relevant currency. CLSSettlement is the only PvP netting provider for many major currency pairs currently. Their deadline is currently 12AM CET for next day settlement, with nostro and custodian banks adding a further deadline, which is generally 90 minutes but may be longer. With a move to T+1 this means that an FX transaction would have to be instructed and sent for settlement on trade date of the security trade if firms wish to benefit from PvP netting.

This may be relatively straightforward for a Western Europe buy-side firm, which can extend its business hours by 1-2 hours to accommodate the FX trading and settlement, but more difficult for an APAC firm which will not see regular business hours until next day and may therefore miss the CLS cut-off. Conversely, the APAC firm looking to leverage PvP netting for USD will have put measures in place to address the US T+1 transition in May 2024. They may have adopted practices to resolve for this challenge or may have accepted greater bilateral gross FX settlement and the risks that come with it.

We expect this issue to have been addressed by some firms getting ready for the US transition to T+1 in May 2024. Given that many of our UK/European based member firms, and buy-side firms globally, will have prepared for T+1 in the US, and the more difficult timezone challenges of trading USD between market close and CLS cut-off (4PM EST/10PM CET and 6PM EST/12PM CET respectively), we do not foresee FX being as much of an issue for EU T+1 Settlement as long as liquidity is available.

<ESMA\_QUESTION\_SETT\_2>

1. : 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>

Our members have discussed the difficulty in sourcing true STP data. For example, for a transaction that has been booked with incorrect SSIs gets re-booked with the correct SSIs, the new trade will flow through looking as if it’s been processed as STP, but in reality has involved manual intervention.

Whilst we see the value in firms providing individual STP data, we believe that CSDs are best placed to provide the data on matching rates ahead of settlement and on settlement rates. We note existing resources such as the [ECB T2S report](https://www.ecb.europa.eu/paym/intro/publications/pdf/ecb.t2sar2022.en.pdf).

<ESMA\_QUESTION\_SETT\_3>

1. : 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>

Under misaligned settlement cycles, the access to funding becomes more and more important, with firms relying on credit to settle trades until the later cashflows are received (e.g. sale of an EU asset on T+2 and purchase of a US asset on T+1).

Should there be a market shock and a resulting tightening of credit in the market, there is a concern that this could have a significant impact on a misaligned settlement cycle market, which may be more reliant on temporary funding than it is today.

We encourage national and central banks to consider this aspect and potential contingencies in the event of a market shock.

**On FX transaction reporting in particular:**

FX spot transactions have not been considered a financial instrument thus out of scope of EU regulatory rules and reporting regimes such as MAR, MiFIR, EMIR etc. FX spots are usually defined by its settlement period of T+2 or below. With the move to financial instruments settling T+1, FX spots will inadvertently be caught by a host of EU regulatory rules and reporting regimes. We would appreciate additional clarity from ESMA on how it intends to treat FX spots.

<ESMA\_QUESTION\_SETT\_4>

1. : 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>

Costs are difficult to quantify.

Some of the trade matching and FX solutions that the buy-side have put in place for the North America transition should aid in any EU transition.

The biggest costs that buy-side firms are likely to incur are changes to any fund vehicles (e.g. changing a mutual find from T+3 settlement to T+2). This is likely to involve updates to documentation, engagement with regulators, engagement with service providers (e.g. transfer agents, retail platforms, etc). Some local jurisdictions may struggle to have the infrastructure for a move to T+2 or T+1 for mutual funds.

There are also processes which an investment manager may not need to prepare for but may be indirectly impacted by. This may include securities lending or collateral recalls.

<ESMA\_QUESTION\_SETT\_5>

1. : 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>

From a buy-side perspective from looking at CSDR cash penalties, our members are able to get a broad view of where settlement fault lies for trades that they engage in.

From a survey of 17 asset managers, on average they saw that around 83% of cash penalties were attributable to the broker, and of this, the vast proportion were because the brokers were short of stock, with the buy-side account receiving a credit cash penalty. Of the remaining 17%, our members saw around 10% due to the custodian or client, the largest cause of this was security lending recall fails. Of the remainder, the asset management community have been looking to resolve for the challenges. This includes a greater leverage of SSI vendors, a more robust onboarding process and a better reconciliation of where stock is (e.g. whether it’s at an ICSD like Euroclear or sits with the primary market CSD).

Of the fail types:

Counterparty/broker fails – This makes up the biggest component of current fails. Potentially one of the reasons that counterparty/broker fails make-up the majority of fails the buy-side see, are that many brokers will manage their inventory (clearing position) to near 0 as the most cost-efficient funding process for holding stock and brokering transactions through their clearing account. Accordingly, on any given day, tens or hundreds of deliveries through a brokers’ clearing account for a particular security may be reliant on tens or hundreds of receipt trades, with the end of day position expected to be near 0 in the account should all trades settle. Should one big receipt trade fail, this will impact a large number of deliver trades (which may then impact onward trades for those counterparts). We don’t believe that moving to T+1 will change this problem, though increased fails into brokers would then exacerbate settlement fails onto onward counterparts.

Asset manager fails – These are likely to increase following a move to T+1 settlement but we wouldn’t expect this to be significant. Some of the steps taken for US T+1 will also help prepare asset managers for the EU transition.

Custodian/sec lending fails – Securities lending recalls remain a challenge as outlined in our response to question 1. Where there’s a sale on a loaned security, it will be very difficult to recall the stock in time to settle the onward leg. Whilst some steps will have been improved with regards to T+1 in the US, the European securities lending flow works a little differently. Depending on process improvements between now and the transition date, settlement fails relating to securities lending could spike. The onward challenge of this is that CSDR cash penalties for securities lending is complex, and often involves a time consuming process of determining who of the counterpart, agent lender, asset manager and client is at fault and claiming the difference.

New fails arising from a shortened settlement cycle – These are difficult to quantify but it is expected that there will be a rise in fails as a result of a transition to T+1. Any processes undertaken on T+1 of today’s T+2 settlement cycle will now have to be resolved on T. An example might include where SSIs are incorrect following an onboarding process and insufficient time is available after pre-matching to resolve for this. Significant automation would have to be achieved in other flows to lessen this impact.

General – More generally, it is likely that there would be a rise in settlement fails but we don’t envisage that the current highest reason of fails the buy-side see (CLAC – Counterparty lack of securities), will be materially impacted.

It's impossible to quantify what impact a move to T+0 against current metrics of settlement fails would be, as it would likely require a significant overhaul in systems and processes.

<ESMA\_QUESTION\_SETT\_6>

1. : 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>

We would expect settlement fails and cash penalties to come back with time as firms acclimatise to the change and are incentivised by CSDR cash penalties to improve their processes.

<ESMA\_QUESTION\_SETT\_7>

1. : 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>

Alignment and misalignment should be considered by ESMA and the EU as both a benefit and a cost, taking into account the number of markets that are at T+1 or committed to T+1 prior to a possible EU transition.

For this question, extended misalignment with the US should be considered a potential cost given it will cause frictions that may incur costs on the end investor.

<ESMA\_QUESTION\_SETT\_8>

1. : 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>

We believe that ESMA should also consider the asymmetry of the costs and benefits on the market.

The lower collateral requirements cited in paragraph 31 only impacts the direct clearing members. Whilst the SEC final rule document speculates that these benefits may be passed onwards, it’s unclear how and whether this will happen.

Whilst the theory of a reduction of counterparty risk is valid, in practice it’s not seen as a major issue given that most trades settle DvP or RvP (delivery or receipt vs payment) or are transactions that are protected through collateral.

The biggest benefit for the buy-side is in looking to re-attain global alignment in settlement rates. This reduces friction in global baskets and cross-asset trades, which in theory means lower costs for the end investor, given there would be less pressure on funding costs, managing failing trades and managing difficult misaligned cashflows. We have attempted to show these costs through a worked example below:

An example case study of how misaligned cash flows might lead to additional costs.

- Fund (EUR 1 billion) that’s fully invested (0% cash) with 70% invested in North America assets on T+1 and 30% on EMEA assets on T+2.

- Subscription comes in for 10% of the value of the fund (EUR 100 million) to settle on T+2, the UCITs fund subscription and redemption settlement cycle.

- The onward security buys fail for one day in North America (T+1 assets) but settles on time for the EU assets (T+2) in line with cash flows.

- Assuming 5% interest rates which equates to a (0.05/365 = 0.0137%) day rate

- In theory this creates an interest claim for the failing transactions (100m x 70% X 0.000137) = EUR 9,590 interest claim.

In this case the interest claim costs might instead be replaced by interest costs incurred in asking for extended settlement on the US assets (e.g. asking the broker to settle T+2), or in leveraging a custodian overdraft.

Whilst the above represents an extreme example (e.g. funds are likely to hold some cash to alleviate mistimed settlement cycles and generally subscription and redemption flows can be offset), it hopefully illustrates how misaligned settlement cycles can cause additional cost.

Whilst buy-side firms will look to protect the end investor, these frictions to trade may manifest in higher costs, be it in product spreads (ETFs) or additional costs or performance drags.

The preference for a move to T+1 would have been for it to be globally co-ordinated. Given the US has already looked to transition imminently, it’s of benefit for EMEA (as a whole) to look to transition to match.

<ESMA\_QUESTION\_SETT\_9>

1. :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>

Buy-side participants do not see a material benefit from this reduction. If it’s seen as a large reduction for clearing members, it would be beneficial for ESMA and European legislators to consider whether and how this would feed down to the end investor.

<ESMA\_QUESTION\_SETT\_10>

1. : 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>

As a firm it’s very difficult to quantify and even more difficult as a trade body for this sensitive information.

It will also be very different across firms of different sizes and locations in terms of proportion and value.

<ESMA\_QUESTION\_SETT\_11>

1. : 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>

The IA does not propose to comment

<ESMA\_QUESTION\_SETT\_12>

1. : What would be the benefits for retail clients?

<ESMA\_QUESTION\_SETT\_13>

**For T+1 Settlement**

Retail investors would be able to swap between US and EU assets on the same day without failing or funding costs.

The main benefit for retail clients would largely reside in the re-attainment of alignment across global settlement cycles.

**ETFs**

ETFs are a popular retail client investment, offering exposure to a broad range of assets at a relatively low cost.

The US move to T+1 settlement will create a misalignment across global baskets. For example, ~65% of the MSCI world index is US securities at T+1, whereas ~35% of the remaining securities would be T+2 settlement). For the authorised participant, market maker or ETF issuer, these misaligned flows represent complexities, either forcing them to hold a greater amount of cash to manage the misaligned cash flows, potentially making the fund overdrawn or in funding the creation/redemption processes for additional days.

Should the investor purchase a European ETF with global exposure on a T+2 settlement cycle, the cash would not be available to settle the underlying US security purchases on T+1. Similarly, should the fund redeem, cash would be received on T+1 on the US securities and need to be held a day before being delivered to the investor on the standard T+2 cycle.

These issues are likely to result in a higher cost borne by the end investor, as the various parties to the ETF will need additional resource or funding to manage the added complexities, resulting in a wider spread to the end investor. The UK and Europe moving to T+1 in line with North America would make EMEA ETF products more efficient and narrow spreads back down.

**Mutual funds**

Whilst not impacted to the same degree, mutual funds benefit from aligned cash flows, allowing for asset swaps between jurisdictions without cashflow misalignment reduces friction, and therefore reduces performance drag (where the fund may suffer from being out of the market or holding excessive cash), or results in a reduction in the costs of doing business.

**Retail client transactions** – There is some benefit to retail investors receiving redemption or sell proceeds faster, either on securities or in a potential shortening of a mutual fund settlement cycle. For retail investors, buys and subscriptions often have to be pre-funded. It is very difficult to quantify what kind of numbers this represents.HERE

<ESMA\_QUESTION\_SETT\_13>

1. : 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>

For any major jurisdiction moving in isolation away from a global standard (T+2), the costs outweigh the benefits given that they’ll be breaking alignment in cashflows across jurisdictions, creating costs and frictions for products representing global baskets (many funds), to the ultimate detriment of the end investor.

It becomes more difficult to quantify for an EU transition. Much of the work done to prepare for a US T+1 go-live for the EMEA buy-side (and many firms will have had to prepare given how many global participants are invested in North American capital markets), will also set them in good stead for an EU transition, reducing many of the costs.

An EU transition will also reduce some of the costs of the US transition, in that it will bring more of the world’s major capital markets jurisdictions back in alignment of the same settlement cycle. There is an ongoing cost to the end investor of remaining misaligned

We will likely be able to better assess post the US transition. Currently we see that the costs outweighed the benefits of the US transition, but that it’s a bit more unclear with an EU transition.

<ESMA\_QUESTION\_SETT\_14>

1. : 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>

We believe that alongside a move to T+1 securities, the EU should also look to adopt:

- That allocation and confirmation be mandated by end of day on T. It should be explored whether this means 23:59 CET or something like 04:59 CET next day, which would give greater time for global entities to complete the matching process.

- Given the fragmented nature of European capital markets, it should be mandatory for all custodian’s statements of holdings (commonly communicated via an MT535 SWIFT message) to disclose exactly where securities are held within (CSD or ICSD) such that they can be instructed to the correct location.

<ESMA\_QUESTION\_SETT\_15>

1. : 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>

**For T+1 Settlement**

We note that per the consultation, paragraph 18 many CSDs and CCPs consider shortening the settlement cycle would have no major impact for them.

In the asset management industry, many firms will have prepared for US T+1 settlement, and in doing so have prepared for T+1 settlement globally. Many of the practices outlined in question 1 (around trade matching, FX, cash-flow management), that asset managers will have had to adapt for should mean that the industry is in place for a relatively quick go-live in those areas.

It has been difficult to set a proposed ultimate deadline with buy-side member firms, with differing views across firms and differing views across representatives within the same firm. Some representatives claim the buy-side are largely ready and can transition within 12 months, others claim that due to the nature of capital markets it will need much longer and a timeframe can not yet be assessed.

Further outreach should be done with small entities (buy or sell-side) to better understand the impact. These small entities are unlikely to have access to some of the automated infrastructure that bigger firms will use such as trade matching platforms. They will likely be more reliant on middle office service providers.

Whilst we understand the caution in paragraph 18 of this consultation citing the ETF difficulties, we believe the intent was to relay the challenges of the US move, many of which asset managers will have prepared for by now. ETF issuers and authorised participants have contingencies in place for the US transition until the EU and UK decide to move (e.g. ETF creates on T+1 and redeems on T+2, with further concerns around cash breaches). An EMEA move to T+1 will resolve some of these challenges and reduce friction to the benefit of the end investor.

We understand that other market participants, often facing the individual markets directly, will take longer than the buy-side, CCPs and CSDs to prepare. They may not be able to leverage solutions from the US transition for an EU move to T+1 and may have a bigger build to be ready.

**For T+0 settlement**

A change to market infrastructure would be required to move to T+0 settlement, we do not think the industry is ready to transition to T+0 any time soon.

<ESMA\_QUESTION\_SETT\_16>

1. : 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>

Article 1, laying out the scope and article 5, laying out the intended settlement date is an adequate scope assuming that the EU moves at the same time as other jurisdictions within EMEA and the EEA. If the EU moves faster, then further clarity is needed.

For example, in the event that Europe moves faster than the UK and Switzerland, there will be certain products where there will be a degree of uncertainty, given that they may trade on a UK or Swiss venue, but settle within and ICSD or within an EU CSD. According to CSDR, this would settle on T+2, whereas the rest of the market would be on T+1. An example of this is ETFs, which may commonly list in the UK, Germany, Italy, Switzerland and more for the same product. In such a case, further clarity would need to be made on what would happen to those products and potentially an exemption would have to be sought.

Similarly, if those jurisdictions were to move ahead of the EU, exemptions would be sought from those authorities for the cross-listed products.

It is to the benefit of European investors if jurisdictions based within Europe are able to co-ordinate transition at the same time.

By extension, it’s also crucial that all member states within the EU transition at the same time.

The EU should ensure, however, that if a transition to T+1 settlement is for the benefit of the end investor, that a collective move should minimise any delay to a transition.

<ESMA\_QUESTION\_SETT\_17>

1. : 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>

Different settlement cycles across different settlement instruments exists today. For example, some Government bonds trade T+0 or T+1, versus the default T+2 settlement cycle. Some processes can also happen T+0. For example, some securities lending trades can settle same day as long as collateralised.

Firms have developed methods to handle these misalignments, though they cause frictions which can increase costs to the end investor. For example a fund switching from a T+2 asset to a T+1 asset will have a failing trade for a day due to a lack of cash, causing a CSDR cash penalty. Alternately it may sit uninvested for a day, leading to performance drag.

Baskets of securities such as a variety focus mutual fund suffer the most from a range of settlement cycles, and are often incentivized to retain a long subscription and redemption cycle to manage the misaligned flows

It’s feasible for securities to be at differing settlement cycles, but is not recommended as it increases trade friction for investors and adds costs. Ideally global instruments and jurisdictions are aligned.

<ESMA\_QUESTION\_SETT\_18>

1. : 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>

From the buy-side perspective, it should be relatively straightforward to manage a transition for single stock products like equities and bonds, and that work done in preparation for US T+1 settlement should serve well for these instruments.

More challenging are products that have ancillary processes underpinning them, which makes the reduction of processing time a larger challenge. Most notably this includes ETFs, which have a creation/redemption process to aid in price discovery.

It is not advisable to have different migration times for different products, markets or assets. Given misalignment is cited as a key cost and alignment as a key benefit, investors would not be served well by transitioning in a piecemeal way to T+1 Settlement. Instead it would cause confusion and inefficiency in the transition process.

<ESMA\_QUESTION\_SETT\_19>

1. : 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>

It would be detrimental to enforce that settlement cycles for transactions exempted under article 5 of CSDR are regulated within the EU. Once T+1 becomes the default there will be a natural funding and STP cost to trading non-T+1 that means most market participants will default to the new settlement cycle when they can, as is the case with T+2 settlement today.

A key lever for investors and fund managers when investing is to lengthen or shorten settlement cycles, should they need to manage cashflows. For example, should a large subscription be made into a T+3 subscription/redemption cycle UCITs fund, the asset manager may need to also settle the capital markets transactions on a T+3 basis to avoid CSDR cash penalties (if instructed using a new standard T+1, the fund would suffer two days of penalties due to insufficient cash, or be overdrawn). These trades may come with extra funding costs imposed by the broker but may be the most cost-efficient way to manage cashflows for the end investor.

Uncertainty around whether extended settlement trades are permitted in the US has hampered preparedness for the T+1 settlement transition. It’s imperative that the EU makes clear no rules are changing around permitted extended settlement within the EU.

<ESMA\_QUESTION\_SETT\_20>

1. : 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>

These have all been outlined in response to question 1.

<ESMA\_QUESTION\_SETT\_21>

1. : 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>

We note that EFAMA, who the Investment Association are members of, have carried out existing work on the likely result of increased cash breaches and have asked for forbearances. The IA supports their work in this area.

**EU/UK - MoU**

We also encourage the EU to leverage the signed Memorandum of Understanding with the UK in looking to align settlement cycle transitions.

**ECB oversight of CLS Settlement**

The European Central Bank are among a Committee of overseeing central banks of CLSSettlement. We encourage the ECB and European legislators to assist in any transition of CLSSettlement timelines (e.g. a shift from 12AM CET to 2AM CET as requested), which should allow more buy-side firms to leverage PvP netting for USD currency pairs. EURUSD is the most traded pair.

We also encourage the ECB and European legislators to review what sort of netting and counterparty risk toolings might be available for same-day FX settlement. The FX global code recommends the use of PvP netting as a counterparty risk mitigation technique, but a global shift to T+1 and possibly T+0 can make it very difficult to leverage existing solutions.

<ESMA\_QUESTION\_SETT\_22>

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

<ESMA\_QUESTION\_SETT\_23>

Yes - We also encourage the EU to leverage the signed Memorandum of Understanding with the UK in looking to align settlement cycle transitions.

We would encourage that all EMEA jurisdictions to continually assess the impact of the US move on EMEA investors, with a view to aligning to T+1 together, and at pace, if it’s to the benefit of the end investor.

<ESMA\_QUESTION\_SETT\_23>

1. : 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>

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<ESMA\_QUESTION\_SETT\_24>

1. : 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>

Yes, though the adaptation of EU market participants to other jurisdictions (such as North America) is asymmetric across the market. The majority of medium to large size EMEA buy-side firms will have some degree of investment in the US market so will have had to update processes, systems and operating models for changes to those markets. This includes updates to the trade matching process, FX models, cashflow and funding practices as outlined in our response to question 1.

There will be additional process and system updates to be considered for an EU move for investment managers, such as a potential shortening of the fund subscription and redemption settlement cycle and management of cross CSD/ICSD listings which is more prevalent across EMEA than in the Americas.

We understand other participants may not see the same fungibility in adaptation to US processes in facilitating adoption in the EU.

<ESMA\_QUESTION\_SETT\_25>

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

<ESMA\_QUESTION\_SETT\_26>

This will be the case anyway from May 2024 with the North America, so the market will have to make it viable. Many global portfolios will have a large North America weighting on T+1, with the remaining portfolio likely split across T+2 (e.g. Europe and UK).

This, however, does not mean that different settlement cycles is optimal and as previously discussed in our response the added friction globally causes additional costs.

We encourage all major jurisdiction to consider co-ordinating future moves (such as a potential move to T+0). This could be facilitated using global forums such as through IOSCO. An example where this has worked well is in the global application of uncleared margin requirement under EMIR (or equivalent).

<ESMA\_QUESTION\_SETT\_26>

1. : 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>

**Funding**

We reiterate the potential funding challenges.

Under misaligned settlement cycles, the access to funding becomes more and more important, with firms potentially relying on credit to settle trades until later cashflows come in.

Should there be a market shock and a resulting tightening of credit in the market, there is a concern that this could have a significant impact on a misaligned settlement cycle market, which may be more reliant on temporary funding than it is today.

We encourage national and central banks to consider this aspect and potential contingencies in the event of a market shock.

**Daylight savings**

We understand that there’s still pending discussions over daylight savings in Europe, with some jurisdictions still considering whether to unilaterally abolish daylight savings.

When clocks change there is generally a small spike across different areas of the sector, be it settlements, transaction reporting etc.

T+1 will put additional timing pressures on the market and inconsistent application of daylight savings transitions will make things considerably harder.

Similar to T+1, we encourage policy makers across EMEA to co-ordinate on daylight savings to lessen the impact on settlement.

<ESMA\_QUESTION\_SETT\_27>