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 | European Association of Public Banks |
| Activity | Associations, professional bodies, industry representatives |
| Are you representing an association? |  |
| Country / Region | Belgium |

# 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>

* Matching/Confirmation processes will have a very compressed timeframe with no margin for error. And the allocation / confirmation is only the first step in the post-trade process; then comes the matching of instructions that can not be undertaken before the pre-settlement matching.
* Some market participants continue to rely on email/voice for communicating allocations / confirmations. Workflows with manual interventions, dealer-to-custodian activity, and behaviour of specific firms are the main drivers behind pre-settlement-matching issues. The use of an allocation/confirmation platform may be too costly for small buy-sides (both in terms of implementation and running costs).
* Delays in the allocation / confirmation process can arise from manual processes.
* Furthermore, not all breaks identified in the allocation/confirmation process are resolved on T+0, sometimes being left until the next business day. Some matching issues are not identified until the instructions reach the CSD. Hence, a very robust pre-settlement matching process would have to be set up.
* Industry tools re SSI accuracy and completeness are available, but not widely used and accuracy varies; sell side firms have to maintain their own records of all clients’ SSIs within their own systems.
* Possible increase in Late Matching Penalties (CSDR) and additional costs and complexities of missing overnight settlement batch, if there is no major improvement in processes. A worse settlement rate could lead to further punitive CSDR measures from EU authorities (such as increased penalties or the introduction of mandatory buy-ins).
* Onboarding of new clients will have less time to remediate initial teething issues.
* We should expect that some settlement matching will inevitably move to settlement date. This can have implications for the timely settlement of back-to-back transactions relying on the positions of instructions that match late on settlement date.
* The market may need to accommodate to increasingly longer working days that would be required for clients to finalise the matching process on trade date.
* As regards allocation/confirmation, small buy-sides (maybe specialised on SME values) will have to either spend money to pursue their activity or use of third party platforms. Intermediated transactions often lead to two different types of settlement: those between the custodian and a clearing member (client legs) and those between the clearing member and the CCP (market legs). For an ideal settlement, all these settlements should be processed at the same time (ie during the night settlement – NTS). This is achieved (more or less) today in a T+2 model. In a T+1 model, should the allocation / confirmation not be completed early enough to allow the custodian to instruct against the clearing member then the NTS will only process the already matched instructions sent by the CCP.
* These already existing issues would be made worse if there are no significant changes to current operating environment. The business day in between trading and settlement to allow for processing of any manual or late bookings, or resolution of any mismatches will be lost, since the settlement window actually starts a few hours after the closing of the markets.
* Liquidity: A move to T1 does mean a shorter window in which to access liquidity. This is especially an issue for trades that come late in the day, near market close.
* Operations: The current architecture is not optimised to perform instruction, allocation, and confirmation under a reduced timeframe.

<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>

As regards FX funding, one of the main innovations brought to FX markets in the last 20 years, has been the growth of PvP (Payment versus Payment) settlement through the increased use of the CLS platform (*Continuous Linked Settlement*, is a specialized financial infrastructure group who operates a global multicurrency cash settlement system, known as the CLS System, which plays a critical role in the FX market. Despite this positive development, challenges around FX settlement risk remain:

* Time zone related challenges: instructions come from different regions, with some coming very close to the CLS deadline.
* CLS Settlement does not support all currencies.

<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>

TYPE YOUR TEXT HERE

<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>

In contrast to the US, where there is only one CSD and CCP, European markets are fragmented with a large number of CSDs and CCPs acting across the different EU Member States. There is also very little harmonisation in terms of local rules (such as for example insolvency law, withholding tax etc.). Some instruments are settled on multiple CSDs, resulting in a complex settlement process, where often several settlements need to take place to reach the final counterparty of a trade in one single instrument.

Due to its complexity and fragmentation, a large number of procedures in EU markets are still manual, such as for example the stock loan recall process, and there is a limited window of opportunity to recall securities to enable their usage for an open transaction. Should the broader market move to T+1, this would mean that the stocks would need to be recalled already on T+0, which, given the manual process, would be a significant challenge.

Another challenge pointed out is the already late market close in Europe which is 5.30pm, with a large number of trades being executed late into the close. As a result, a move to T+1 would make it very challenging to receive and process late incoming trades for example from the US on/after US closing hours.

<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>

TYPE YOUR TEXT HERE

<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>

We would assume that also in the long term not every market participant will implement STP. Hence, also in the long term, settlement fails due to inefficiencies in the processes will remain.

<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>

They would remain permanent. Also, in the long term not every market participant will implement STP. Hence, settlement fails due to inefficiencies in the processes will remain.

<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>

TYPE YOUR TEXT HERE

<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>

No, we do not fully agree with the mentioned benefit. Possibly lower collateral requirements may be outweighed by higher FX funding costs. Also being aligned with other jurisdictions is not a benefit for all market participants but rather only for the internationally active ones.

<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>

The EU market can be characterised as a non-cash collateral market, which means that banks and other institutions are providing collateral in asset form, which results in multiple settlements related to the same transaction. A move to T+1 would put further stress to this multi-settlement approach. A large part of borrowing activity is collateralised via tri-party agents. A move to T+1 would mean that those parties would be unable to move collateral without friction on a same day basis and will, therefore, likely resort to placing excess collateral at the tri-party agent. This will increase funding costs and potentially drain liquidity from other areas, disrupting the market for securities financing as a whole. Hence, we do not fully support the assumption that collateral requirements will be reduced and collateralisation itself will be even more challenging.

<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>

TYPE YOUR TEXT HERE

<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>

In terms of liquidity, as an example, since there are no real-time information flows between trading and funding desk and the repo desk, secured funding desks usually rely on overnight maturity transactions. In case of any operational disruption, there is a liquidity trap which might force a higher cash buffer maintenance, and which will hence increase the cost of business for banks and hence clients. If it came to T+1, banks would need to hold a larger amount of intraday liquidity as pre-funding needs will grow substantially due to faster settlement (ie from a trader’s perspective, one cannot simply wait until a trade “comes in” and instruct to settle at a later point; in a T+1 world the liquidity would need to be held already in anticipation of new trades).

In terms of trading activity, there are reasons to believe that there will be a decreased trading activity/ provision of liquidity from market makers in those instruments which would be hard to find in the repo market. Possible transactions to think about here would be the offering of an illiquid corporate or High Yield bond for example, or, on the Equity side, arbitrage option strategies again involving shorting cash instruments such as shares. Whereas T+2 allowed the trading side 1 day to source the relevant instrument(s), a move to T+1 would mean those had to be sourced on T+0. As a result, higher bid-offer spreads in, or even the non-offering of those instruments, could be expected, and/or a decreased activity or a general forced change in option trading strategies.

<ESMA\_QUESTION\_SETT\_12>

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

<ESMA\_QUESTION\_SETT\_13>

TYPE YOUR TEXT 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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

There will be additional challenges for loans and repos for which more information must be included on allocations / confirmations (e.g. rate, maturity,…).

Challenges are also expected for EMTN, USTN, etc., and other debt instruments for which ISIN code is not available at time of execution.

Also instruments on which the final price is dependent on overnight price feeds – e.g. ETF creation and redemptions or listed derivatives – will be strongly affected by the migration to a shorter settlement cycle.

Furthermore, trading in certain derivative instruments might become more difficult, such as for example in the case of options. At this point in time, the software containing pricing models for stock option trading allows for T+2 settlement in most products. Such software would need to be adjusted or would result in different manual adjustments of valuations by traders, which would affect their pricing of the product. Software providers should be able to accommodate for the change, but this will come at a cost.

<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>

TYPE YOUR TEXT HERE

<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>

From an affirmation/confirmation & matching perspective, two separate workflows are required for differing settlement cycles. This may lead to confusion, namely for multi-listed securities, ADR and baskets with securities underlying coming from both geographies.

<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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_SETT\_22>

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

<ESMA\_QUESTION\_SETT\_23>

For market participants acting on a global level, being synchronised with those markets helps to enable standardisation and coverage models. For smaller market participants not acting on a global level there is no merit in harmonising settlement cycles with other non-EU jurisdictions.

<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>

TYPE YOUR TEXT HERE

<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>

Not in all circumstances. There are many EU market participants who do not have any settlement outside of the EU. For them, a move to T+1 in the EU will be something completely new to implement.

<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>

It is difficult to foresee, whether probably reduced collateral requirements are actually a factor for increasing the attractiveness of the relevant market. In particular, since this reduction on the one hand might be outweighed by FX funding issues.

Furthermore, remaining on T+2 would mean that the amount of settlement fails would not negatively impacted, since the current available settlement window is much more amenable to reducing errors, resolving mismatches and avoiding fails. Greater penalties are therefore avoided. There would also be cost savings as market participants would not be required to update systems and change processes.

While it is best not to be reactive but proactive, and be prepared to adequately roll out any new framework the EU intends to implement, we recommend to take the time to learn from US lessons once their T+1 system is in place. We are of the view that this will make it easier to identify any necessary changes to legislation.

<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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_SETT\_27>