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 Alternative Investment Management Association (AIMA) |
| Activity | Associations, professional bodies, industry representatives |
| Are you representing an association? |  |
| Country / Region | International |

# 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>

**AIMA COVER LETTER:**

The Alternative Investment Management Association (“AIMA”)[[1]](#footnote-2) appreciates the opportunity to submit comments to the European Securities and Markets Authority (“ESMA”) in response to its call for evidence on shortening the settlement cycle (the “Call for Evidence”)[[2]](#footnote-3).

AIMA welcomes ESMA’s commitment to evaluating a shortening of the securities settlement cycle in the EU. We support efforts to create an efficient, resilient and integrated post-trade environment and increase the competitiveness of EU financial markets. We believe that reducing the settlement cycle from T+2 to the first business day after trading takes place (“T+1”) can help to deliver this. It can reduce counterparty credit risk, market risk and liquidity risks associated with settlement failure while accelerating automation of the transaction lifecycle and standardisation in post-trade processes.

AIMA believes that any move to shorten the settlement cycle must be carried out in a way that neither damages the existing functioning of EU capital markets nor creates barriers to investing. For example, AIMA welcomes, in principle, the upcoming move to T+1 settlement in the US but has concerns about the timing of the transition. The US Securities and Exchange Commission announced on 15 February 2023 that the transition would take place on 28 May 2024, giving market participants only 15 months to make and test the necessary operational changes and technological upgrades required to settle trades in one day. In addition to subjecting firms to significant process and systems changes, the timing of the US transition introduces a misalignment of settlement cycles between the US and other jurisdictions. We believe that successful migration to T+1 in the EU, in particular, will require an appropriate timeframe given the complexities of the EU’s post-trade financial markets infrastructure and legal framework.

A direct move to T+0 (whether that is real-time “atomic” settlement, periodic intra-day settlement batches or end-of-day) would, in our view, exacerbate any (cross-border) challenges identified with moving to T+1 and require a fundamental transformation of the current trade lifecycle. As such, any consideration of shortening the settlement cycle to T+0 in the EU should not detract from the immediate challenge of transitioning to T+1.

We have provided comments on the questions included in the Call for Evidence in an annex to this letter.

In summary, AIMA believes that:

* the EU should move to T+1 and in an appropriate timeframe where market participants are ready to move;
* transition to T+1 in other jurisdictions, while the EU remains on a T+2 cycle, will create various challenges for firms with primary or significant exposures to markets that move to T+1;
* shortening the settlement cycle to T+1 and, in particular, T+0 will require firms to undertake a wholesale review of their operational processes and compel them to modernise their settlement processes;
* the impact of any transition on firms will not be equal - smaller firms, in general, would have to undertake greater levels of preparation and face larger costs; and
* shortening the settlement cycle will increase foreign exchange (FX) settlement risk.

**AIMA RESPONSE TO QUESTION 1:**

AIMA believes that compressing the intended settlement date to T+1 and T+0 will require firms to undertake a wholesale review of their operational processes and compel them to modernise their settlement processes. In time, we anticipate that the transition would lead to reduced operational overheads.

Shortening the settlement cycle would reduce the time available for market participants to carry out necessary post-trade processes for efficient settlement, such as sending written allocations and confirmations and matching the currency of payments on the currency market. Firms will face tighter deadlines for trade allocation and affirmation - they will need to ensure efficient and timely allocation of trades, confirmation with counterparties and submission of trade details to relevant systems and platforms. To ensure settlements are completed T+1, firms would require either extra operational staff or expensive settlement systems, leading to more delayed settlements or extra costs to firms. Since settlement issues tend to arise after hours, maintaining existing working hours in a T+1 environment may result in operations teams not identifying potential settlement breaks until the following morning, leaving only one working day and no overnight time to take remedial action. Therefore, as well as allocating extra staff to certain processes, firms may need to upgrade their technology and improve levels of automation across their settlement workflow.

Smaller firms, in general, would have to undertake greater levels of preparation and face larger costs as they find resources to upgrade their technology and settlement processes. For example, operational blotter errors tend to be corrected manually by smaller firms and most blotter errors are corrected T+1 - sometimes T+2. Moving from T+2 to T+1 settlement makes it more challenging and cost prohibitive for smaller firms. In the context of less liquid securities and size of trade, as a fund’s trade size becomes larger, partial settlements (sometimes over multiple days beyond T+2) tend to become more common. The additional costs imposed due to a shorter settlement cycle could ultimately be passed on to end investors in the form of more expensive execution costs.

We believe that the challenges associated with moving to a T+1 settlement cycle are exacerbated in the context of moving to a T+0 settlement cycle, which would reduce the time available for post-trade processes even further. Moving from T+2 to T+0 would require a fundamental transformation of pre-trade and post-trade processes and have a more material impact on trading and liquidity. Atomic settlement, for example, would require that various core post-trade processes (such as provision of allocations and exchange of settlement information, positioning of sufficient cash by a buyer, positioning of sufficient securities by a seller) take place before trading. This represents a fundamental transformation of the current trade lifecycle and may introduce friction to the trading process. End-of-day settlement, for example, would lead to issues for trades undertaken at or near EU market close – particularly for members in time zones ahead (as the new cut off times would occur later). End of day trading can be sizeable around such events as a portfolio rebalance and could be subject to same-day allocation, confirmation and affirmation requirements, despite a very short processing window. Such same-day requirements may make end-of-day trading operationally impossible.

<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>

For transactions with an FX component, AIMA believes that a move to a shorter settlement cycle would increase FX settlement risk if a trade were not matched and entered into the Continuous Linked Settlement (CLS) system in time to be included in a firm’s daily settlement process.

FX and coordination issues threaten asset managers’ ability to ensure funding is available in time to settle their trades at T+1. Uncertainty about collateral for settlement may mean foreign asset managers could need to redeem money market funds to meet their financing needs – or forego transacting in certain markets to comply with accelerated settlement requirements. Similarly, fund managers may be forced to reduce or curtail their foreign market participation due to the inability to align foreign trade settlement with their market funding needs. Ultimately, trade financing issues will lead to both significantly lower trading volume and lower overall liquidity, posing a risk to overall market health and stability.

Market participants would need to consider practices to ensure that funds are available to facilitate settlement of FX trades. Also, greater coordination of the timing and settlement for the security and FX trade is needed to ensure there is adequate time available for the settlement and payment of the FX trade for the T+1 security transaction. In addition, unilateral cancellation deadlines by currency need to be considered. Settlement of spot FX transactions generally occurs at two days post execution, although the period of irrevocability - between the unilateral cancellation deadline for the sold currency and actual receipt of the bought currency - can extend well beyond T+1). Service agreements between corresponding banks will need to agree and identify the cancellation cut-off time to manage risks effectively, within a window that affords T+1 settlement.

In the context of T+0, there would be a struggle to execute FX if trades were booked out late on T. There would be a need for shift work on the FX desks. On T+0, firms would not be able to use CLS to complete the exchange of cash as the cut-off would be too fierce. With CLS not an option, best execution would be called into question as FX flow would need to be placed with custodians only to ensure settlement of cash. If a third party was selected, firms would have the associated Herstatt Risk instead. In addition, US and Canada holidays would make funding for T+0 and some on T+1 impossible which would mean greater overdrafts unless cash balances are held in a variety of currencies. Unless the definition of a spot trade also changes in line with decreasing market timeframes, more forward points would need to be paid on trades.

<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>

TYPE YOUR TEXT HERE

<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>

AIMA’s member firms would require varying levels of systems and process changes to undertake the transition to T+1, from adjustments to systems that control trading, portfolio management and operations to the policies and procedures governing those areas, such as redrafting and renegotiating agreements with investors, counterparties and vendors that are affected by settlement timing and employing staff after EU hours for markets that continue after EU markets close.

Asset managers are almost entirely dependent on their counterparties to ensure they can meet the functional requirements of settlement. Therefore, much of the work that asset managers will need to undertake in moving to T+1 cannot happen until related counterparty changes are well underway. While these costs would be greater for smaller firms, even the most sophisticated fund managers may need significant changes.

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

AIMA believes that the transition to T+1 in other jurisdictions, assuming the EU remains on a T+2 cycle, will create various challenges for firms with primary or significant exposures to markets that move to T+1.

The misalignment in settlement cycles threatens asset managers’ ability to ensure funding is available in time to settle their trades at the shortened T+1. If a trade is executed in the EU for settlement on T+2 but the corresponding US trade settles on T+1, there is a one-day gap during which one party’s obligation may be fulfilled before the other’s is. This difference may introduce potential risks related to counterparty exposure, liquidity management and the market.

Market participants will need to adapt their operational processes and systems to accommodate the misalignment, managing differentiated processes across jurisdictions. Many market participants are not directly connected to market infrastructures (such as exchanges, central counterparties, CSDs) and therefore rely on the use of intermediaries. In this context, the need for additional operational adjustments and potential system complexities can increase costs and create operational challenges for participants involved in cross-border transactions between the EU and the US.

In addition, the difference in settlement cycles may impact trading efficiency and liquidity in cross-border markets. Investors and traders may face challenges in executing trades that involve both EU and US securities, especially when attempting to optimise trading strategies or manage positions across different settlement cycles. This could challenge best execution efforts driven by various regulations. Also, the misalignment could create variance in cross-border market prices and valuations between EU and US securities. This would require careful consideration and management to avoid any adverse impact to investors.

European market participants engaged in US securities lending and repo will have a narrower window to initiate and complete transactions, potentially affecting their ability to find suitable counterparties on appropriate terms, and complete settlement on time. With US securities settling on a T+1 cycle, EU firms may find that stock recalls are not completed in time to satisfy the shorter settlement cycle. This is most likely to be a problem for trades later in the day, in view of current standard industry practice for agency lenders to enforce a cut-off time two hours before markets close. The compressed settlement timeframe will require enhanced operational efficiency in securities lending activities. Lenders and borrowers would need to streamline their processes, improve communication channels and ensure seamless coordination to meet tighter settlement deadlines. A shorter settlement cycle can also impact collateral management. Borrowers would need to ensure the timely availability of acceptable collateral to secure borrowed securities, while lenders would need to manage collateral receipts and returns efficiently within the compressed timeframe.

<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>

AIMA sees benefits in the harmonisation of settlement cycles with other non-EU jurisdictions.

AIMA believes that the EU should move to T+1 and in an appropriate timeframe given the complexities of the EU’s post-trade ecosystem. Harmonisation of settlement cycles would, for example, make funding easier if selling to buy in other jurisdictions and make it easier to track cash being redeemed for a specific date.

The timing of the US transition to T+1 in May 2024 introduces a misalignment of settlement cycles between the US and other jurisdictions and does not provide market participants with sufficient time to prepare. While it is difficult to predict how liquidity flows will behave post-May 2024, the lack of harmonisation would make it more costly and complicated for global investors to trade US securities. Similarly, US funds that trade non-US stocks would find it difficult to trade fund units on T+1 but only settle security trades on T+2 for their non-US holdings. Such fund mismatches can fragment liquidity and reduce cross-border flows. For asset managers in particular, lack of harmonisation risks the ability to settle relevant FX trades on CLS where Payment-versus-Payment and net settlement are possible. Where these FX trades originating in the asset manager community (particularly Asia flows) can no longer settle in CLS, due to early cut-offs, this could introduce increased settlement risk if no mitigating operational changes (such as changing hours or locations) or risk management techniques (such as pre-funding or “on-us” settlement) are used.

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

1. AIMA is the global representative of the alternative investment industry, with more than 2,100 corporate members in over 60 countries. AIMA’s fund manager members collectively manage more than US$2.5 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage over US$1 trillion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst (CAIA) designation – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). [↑](#footnote-ref-2)
2. Available at [www.esma.europa.eu/sites/default/files/2023-10/ESMA74-2119945925-1616\_Call\_for\_evidence\_on\_the\_shortening\_of\_the\_settlement\_cycle.pdf](http://www.esma.europa.eu/sites/default/files/2023-10/ESMA74-2119945925-1616_Call_for_evidence_on_the_shortening_of_the_settlement_cycle.pdf). [↑](#footnote-ref-3)