5 October 2023
ESMA74-2119945925-1689

Reply form

on the call for evidence on shortening of the settlement cycle

Responding to this paper

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

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

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

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

Instructions

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

- Insert your responses to the questions in the Consultation Paper in this reply form.
- Please do not remove tags of the type < ESMA_QUESTION_SETT_0>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
- When you have drafted your responses, save the reply form according to the following convention: ESMA_CP1_SETT _nameofrespondent.
  For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA_CP1_SETT _ABCD.
- Upload the Word reply form containing your responses to ESMA's website (**pdf documents will not be considered except for annexes**). All contributions should be submitted online at *www.esma.europa.eu* under the heading *'Your input - Consultations'*.

Publication of responses

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

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Data protection'.

Who should read this paper?

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

1 General information about respondent

Name of the company / organisation	ABBL
Activity	Finance association
Are you representing an association?	☒
Country / Region	Luxembourg

2 Questions

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

(i) provide as much detail as possible on what issues would emerge in both cases and how they could be addressed with special attention to critical processes (matching, allocation, affirmation and confirmation) and interdependencies. Where relevant please explain if these are general or asset class/instrument/ trade specific.

(ii) Identify processes, operations or types of transaction or financial instrument class that would be severely impacted or no longer doable in a T+1 and in a T+0 environment.

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

<ESMA_QUESTION_SETT_1>

The members of the ABBL (The Luxembourg Bankers Associations) have identified several process and operations impacts in case of accelerated settlement.

Failed settlement: By shortening the settlement cycle to T+1 or T+0, this may increase failed settlements rather than reducing counterparty credit risk. This highlights the importance of maintaining an appropriate settlement timeframe, as shorter settlement cycle leaves less time for parties to resolve any discrepancies or issues that may arise during the settlement process

Rushed processes: Furthermore, a shorter settlement cycle may also put pressure on market participants to make quick decisions, increasing the likelihood of overlooking important details or rushing through due diligence. This can further amplify the potential for errors and mistakes, jeopardizing the overall efficiency and integrity of the settlement process.

Impacts linked to transactions with third parties: However, when trading participants rely on third-party intermediaries or multiple trading venues, achieving full STP (Straight Through Processing) becomes more challenging. In such cases, it is important for trading participants to establish strong communication channels and implement robust reconciliation processes to minimize the risk of errors or delays in settlement.

Additionally, the confirmation of the final net settlement amount and settlement date can create uncertainty and potential discrepancies in the overall transaction process. If a trading participant, , deals for external clients and has to settle against other counterparties, T+0 seems impossible to respect, and even T+1 will be difficult to cope with; Execution prices may be confirmed without delay to the counterparties throughout the day, but most brokers still confirm the final net settlement amount (including their brokerage fees) on the final settlement date. It was reported to us that even in the T+2 environments some exceptions remain such as ETFs or bonds that may be traded either at T+2 or T+3.

Impacts on resources: Implementing T+0 settlement for international business transactions will require longer working hours and the organization of back-office teams in shiftst to handle the changes in settlement process with the aim on resolving issues within the same day.

Technological impacts: It will be necessary to invest in technology and infrastructure upgrades to support real-time transaction processing and settlement. As example, implementing a system of intraday cash funding will require careful coordination and communication between front-office and back-office teams.

Impacts on cash coverage and cash funding: Adjustment of cash coverage will no longer be possible for eventually failed trades at T. Thus, intraday cash funding will be necessary instead of cash funding on a provisional basis for overnight coverage, as handled mostly from a T+2 perspective.

In the context of cash funding, our members reported to already face problems due several aspects:

- the differences in cut-off times between the end of business of a different stock exchanges
- the security settlement cut-off of the CSDs and custodian banks for bilateral trades,
- the cash settlement at their correspondent banks for cash funding.

These challenges in coordinating cut-off times can lead to delays in trade settlements and hinder the efficiency of financial transactions, which from our perspective, will make it impossible to cope with T+0 and very difficult to cope with T+1. Additionally, the complexity of navigating multiple intermediaries further exacerbates the difficulties faced by smaller market participants.

Impacts on asset management: Asset managers verify executions the next working day, assign them to their customers, and confirm to their custodian banks. Custodian banks are then only authorised to make arrangements for settlement against the executing brokers as of T+1, at the latest. This process ensures that asset managers have the opportunity to review and verify the executions before finalizing settlement instructions. It also helps to mitigate any potential errors or discrepancies that may have occurred during the transaction process.

Impacts on cross-border settlement: Cross-border settlement—that is, settlement between two or more CSDs or even ICSDs—remains complex and requires time for both counterparties to determine which route to use. There was an opportunity to simplify this with Target to Securities, but regrettably, things are becoming more complicated and frequently result in the transfer of shares without payment before a matching against payment can be arranged with the counterparty.

Also, specific fiscal and regulatory constraints when working with foreign clients, are time consuming and making the process more cumbersome; as there is no unique settlement safekeeping rule. A financial institution who deals with foreign clients is required to have multiple custodians for each given security and, for each sub-custodian, multiple accounts (such as tax pools, individual client segregation, etc.) from which security instructions are settled. Hence, in addition to reviewing the deal details, counterparties must validate the right SSI, and stock must be realigned between custodians and/or accounts through free of payment transfers. These steps frequently result in a prolonged final settlement period.

<ESMA_QUESTION_SETT_1>

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

<ESMA_QUESTION_SETT_2>
Pre-hedging is not a common practice is the financial institution we are representing.
With regards to FX trades traded in the US, we see an issue on how they will be handled from the first day of T+1 application, trades will need to be pre-funded and not all involved parties will have the necessary liquidities to cope. This will add trading costs and operational risks, especially if the settlement takes place outside trading time.
<ESMA_QUESTION_SETT_2>

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

<ESMA_QUESTION_SETT_3>
As per members testimonies, we can observe the following:
Back-office execution processing of market transactions initiated by dealing room achieves an STP booking rate of 93% (transaction volume).
Currently, for pre-matching purposes, equity settlement instructions (80% of volume) are sent to sub-custodians only after a cross-check with broker confirmation, as this allows to achieve a good pre-matching rate thereafter and is achievable in a T+2 architecture.

This pre-matching check is a process that requires human intervention and, for European markets, is carried out in the morning at T+1. With the US move to T+1 the current affirmation process is subject to internal review and will probably need to be adjusted. Settlement instructions would then be sent directly after the execution has been recorded, without prior checking. A post-trade control would have to be added instead to detect discrepancies and adjust them, at T+1 in the morning. Currently pre-matching platform are considered as solution to cope with that situation, nevertheless it remains difficult to obtain the correct SSI for settlement with our counterparties.
For the transactions settled for custodian clients who use third-party brokers for the execution part, a 67% STP rate (transaction volume) for the process of receiving incoming instructions, processing them internally and sending them to our sub-custodians.
Also to be noted is a high dependency on third parties in the process detailed above, as instruction details and notifications are given by asset managers or clients.
<ESMA_QUESTION_SETT_3>

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

<ESMA_QUESTION_SETT_4>
The drawback might be that as more participants search for brokerage-to-custody options, the market's best execution (MiFID II) would not be the primary factor in decision-making about execution; rather, it would be a provider of brokerage-to-custody.
The lack of pre-matching time to arrange settlement instructions and cash funding may also provide a challenge for financial institutions acting as custodian as they are covering global custody or multinational operations.
<ESMA_QUESTION_SETT_4>

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

<ESMA_QUESTION_SETT_5>
Financial institutions are currently analysing the possible impacts and coping strategies in relation to an acceleration the settlement cycle. The accompanying costs have not yet been computed yet. <ESMA_QUESTION_SETT_5>

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

<ESMA_QUESTION_SETT_6>
In the absence of data, it is difficult to estimate the actual rate of settlement failure. Nevertheless, we believe that if settlement failures hovers around 5% in a T+2 configuration, settlement failures will climb to around 30% in a T+1 configuration, and to around 60% or more in a T+0 configuration.
<ESMA_QUESTION_SETT_6>

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

<ESMA_QUESTION_SETT_7>
Over the course of two years, our members have reported a minor drop in the number of unsuccessful transactions following the implementation of the CSDR Penalty, but nothing particularly noteworthy. Therefore, it seems highly unlikely that settlement efficiency will improve in the absence of other significant market changes in Europe.
A proposal would be the creation of a single, universally applicable CSD, acting as a single clearing platform that would replace the cumbersome and time-consuming cross-border settlement processes. Coupled with a mandatory pre-matching architecture that would match each SSI trade in a preformatted structure, T+1 or 0 for all processes involving Forex, ETFs, and other financial instruments, improved cash funding cut-offs.
<ESMA_QUESTION_SETT_7>

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

<ESMA_QUESTION_SETT_8>
Financial institutions are currently analysing the possible impacts and coping strategies in relation to an acceleration the settlement cycle. The accompanying costs have not yet been computed yet. <ESMA_QUESTION_SETT_8>

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

<ESMA_QUESTION_SETT_9>
In theory, we concur that a shorter settlement cycle lowers counterparty credit risk and the corresponding need for collateral, but only under favourable settlement efficiency conditions. Nevertheless, in practise, the anticipated benefits of a shorter settlement cycle will be offset if settlement efficiency is not provided. Our members view the shortening of the settlement under T+1 as complicated and critical under T+0.

Settlement efficiency under these conditions can only be reached if different components are met, (i)Investment in more personnel in the settlement back offices to deal with settlement issues such as claims of fund users and market participants, (ii) adding cash funding. The above will increase fix costs and consequently products cost in the end.
<ESMA_QUESTION_SETT_9>

Q10 :Please quantify the expected savings from an eventual reduction of collateral requirements derived from T+1 and T+0 (for cleared transactions as well as for non-cleared transactions subject to margin requirements).
<ESMA_QUESTION_SETT_10>
At this stage of the impact analysis, there is no information that can be shared from the financial institutions in our membership. Participants are focusing on clients and counterparties in the first instance, followed by in-house platforms and processes, and then evaluating staffing and location strategies.
<ESMA_QUESTION_SETT_10>

Q11 : If possible, please provide estimates of the benefits that you would expect from T+1 and from T+0, for example the on-going savings of potentially more automated processes.
<ESMA_QUESTION_SETT_11>
At this stage of the impact analysis, there is no information that can be shared from the financial institutions in our membership. Participants are focusing on clients and counterparties in the first instance, followed by in-house platforms and processes, and then evaluating staffing and location strategies.
<ESMA_QUESTION_SETT_11>

Q12 : How do you assess the impact that a shorter settlement cycle could have on the liquidity for EU markets (from your perspective and for the market in general)? Please differentiate between T+1 and T+0 where possible.
<ESMA_QUESTION_SETT_12>
At this stage of the impact analysis, there is no information that can be shared from the financial institutions in our membership. Participants are focusing on clients and counterparties in the first instance, followed by in-house platforms and processes, and then evaluating staffing and location strategies.
<ESMA_QUESTION_SETT_12>

Q13 : What would be the benefits for retail clients?
<ESMA_QUESTION_SETT_13>

Retail clients in in the context of wealth management business, would have the benefit of earlier cash availability for their sales, but on the other hand would also have to provide coverage of funds earlier for purchases.
<ESMA_QUESTION_SETT_13>

Q14 : How would you weigh the benefits against the costs of moving to a shorter settlement cycle? Please differentiate between a potential move to T+1 and to T+0.
<ESMA_QUESTION_SETT_14>
Please confer to response to Q1 ad Q9
<ESMA_QUESTION_SETT_14>

Q15 : Please describe the main steps that you would envisage to achieve an eventual shorter securities settlement cycle. In particular, specify: (i) the regulatory and industry milestones; and (ii) the time needed for each milestone and the proposed ultimate deadline.
<ESMA_QUESTION_SETT_15>
We would like to see the authorities NCAs and regulatory bodies proposing and assistance /project plan to follow to cope with the changes. Our members would like to see an active support and clear guidance for implementation between the various market participants.
The transition to T+1 will be specially challenging for European and Asian counterparts as it the treasury implications will be higher for them.
<ESMA_QUESTION_SETT_15>

Q16 : Assuming that the EU institutions would decide to shorten the securities settlement cycle in the EU, how long would you need to adapt to the new settlement cycle? And in the case of a move to T+0?
<ESMA_QUESTION_SETT_16>
At this stage, the estimation is not possible. The transition to a shorter settlement cycle, such as T+1, is expected to yield major risk benefits and expedite operational and cost synergies, but it could also put strain on certain processes, such as FX management and trade settlement fails. Therefore, the adaptation period to a new settlement cycle, especially to T+0, would likely involve a comprehensive overhaul of post-trade procedures and a significant investment in technology and automation to ensure seamless functioning within the condensed time-frame.
<ESMA_QUESTION_SETT_16>

Q17 : Do you think that the CSDR scope of financial instruments is adequate for a shorter settlement cycle? If not, what would be in your views a more adequate scope?
<ESMA_QUESTION_SETT_17>
Any shorter settlement cycle should be aligned with all financial instruments traded on a specific market or for OTC transactions settled in the EU area (CSD and ICSD), which would be clearer for all participants than the scope of the CSDR. For example, whether or not an asset's main trading venue is located in a third country should not result in a longer or shorter

settlement cycle if the asset is traded on an EU market but should follow the rule of the EU market or, for OTC transactions, the settlement zone.
<ESMA_QUESTION_SETT_17>

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

<ESMA_QUESTION_SETT_18>
We don't see the point of differentiating settlement cycles by instrument according to a given initial regulation. For collateral purposes, specific T+1 or T+0 agreements are already negotiable between two counterparties, for the US Treasury in particular. This alternative should also be allowed in the context of a shorter settlement cycle, but timely settlement often depends on agreements made throughout the sale and repurchase chain of a transaction.
<ESMA_QUESTION_SETT_18>

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

<ESMA_QUESTION_SETT_19>
We are in favour of a general application to all products/assets by market or group of markets, so that internal processes and tools can be adapted accordingly.
<ESMA_QUESTION_SETT_19>

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

<ESMA_QUESTION_SETT_20>
The T+2 settlement cycle should apply to all type of transactions. In the case of bilateral trades, T+2 should also be the rule, with the possibility of specifically negotiating a longer or shorter cycle if both counterparties agree.<ESMA_QUESTION_SETT_20>

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

<ESMA_QUESTION_SETT_21>
Please confer to our previous answers. The first issues will be linked to liquidity to be provide in the right time i.e. T+1, settlement efficiency failing and an increase in CSDR penalties.

Additionally, we see the fact of not moving to T+1 settlement as harmful to the European business as it will damage the European competitiveness.
<ESMA_QUESTION_SETT_21>

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

<ESMA_QUESTION_SETT_22>
We would like to emphasize our answer given on Q15.
Additionally, we would also like the following measures to be considered as regulatory actions that could be taken.

- Implement measures to harmonise settlement cycles across jurisdictions, thereby reducing the risk of misalignment and facilitating cross-border transactions.
- Alignment of securities lending procedures with the T+1 settlement cycle, including the timing of identification and recall of securities to avoid potential disruptions and settlement errors.
- Amend existing regulations, such as the Central Securities Depositories Regulation (CSDR), to take account of the shorter settlement cycle and avoid potential settlement errors and fines.

<ESMA_QUESTION_SETT_22>

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

<ESMA_QUESTION_SETT_23>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_SETT_23>

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

<ESMA_QUESTION_SETT_24>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_SETT_24>

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

<ESMA_QUESTION_SETT_25>

TYPE YOUR TEXT HERE
<ESMA_QUESTION_SETT_25>

Q26 : Would different settlement cycles in the EU and other non-EU jurisdictions be a viable option?
<ESMA_QUESTION_SETT_26>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_SETT_26>

Q27 : Please elaborate about any other issue in relation to the shortening of the securities settlement cycle in the EU or in third-country jurisdictions not previously addressed in the Call for Evidence.
<ESMA_QUESTION_SETT_27>
There will be pressure on Europe to adopt T+1 in line with other mature capital markets. However, over the last ten years, we have witnessed a similar pattern wherein markets with disparate settlement cycles in different regions of the world came together around T+2.
For Europe to keep its competitive edge and attractiveness, a switch to T1+ settlement need to be orchestrated at European level and applicated in the same manner by all European market participants with the help of regulators and industry participants.
From our perspective the biggest hurdle does not lay in the settlement itself, but rather in the upstream procedures that need to be streamlined and automated throughout markets prior to settlement. It will need coordinated industry-wide cooperation including all parties involved in the transaction chain, from investors and intermediaries to custodians and market infrastructures, to deliver the required post-trade efficiency and harmonisation.
<ESMA_QUESTION_SETT_27>