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 | ISITC Europe CIC |
| Activity | Trade Association |
| Are you representing an association? |  |
| Country / Region | EU and UK with global input |

# 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>

This issue is covered extensively in the ISITC Europe CIC research report published May 30th, 2023. The report was commissioned by SWIFT Research and is available here: <https://swiftinstitute.org/research/industry-preparedness-for-accelerated-settlement/>

In general terms to achieve an efficient T+1 settlement model the whole market has to operate a same-day processing model. This encompasses:

* Extended CSD operating hours.
* Operation of a same-day processing model with completion of all trade confirmation processes on trade date: covering,
  + Delivery of allocation instructions (e.g. within 1 hour of trade execution, or within 1 hour of confirmation of the block trade by the client)
  + Full agreement (either via affirmation or matching) of all trade and settlement details
  + instruction to the settlement entity on trade date (i.e. within the overnight cycle to enable T+1 settlement)
  + Fully electronic exchange of SSI’s
    - all the above to be done in a properly automated format (i.e. no fax, no email, no CSV files)
  + Standard automated processes for creating a new account (at a broker, custodian & CSD)

See sections 4-6 on pages 5-7 of the SWIFT Institute/ISITC Europe report.

<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>

The near universal current usage of the T+2 settlement cycle facilitates efficient hedging and is also compatible with the standard FX settlement cycle. Disharmonised settlement cycles (EU, UK, US) will make hedging more complex and, inevitably, more expensive. There is no current, or future, plan for a reduction in FX settlement cycles and therefore capital market transactions which require an FX component will face a funding gap in a T+1 environment.

Where an investor, retail or institutional, sells a holding in a T+2 environment and invests instead in a T+1 market there will be a 1-day funding gap. The entity (broker, bank etc) that provides the credit to ensure T+1 settlement will incur a cost that will ultimately be paid by the underlying client. This may lead to an increased Total Expense Ratio and therefore have a negative impact on performance.

More detail on the hedging & FX issues can be found in section 7.1 and 7.2 of the of the SWIFT Institute/ISITC Europe report.

<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>

ISITC is not a direct market participant so it is not able to address this question. However the content of the SWIFT Institute/ISITC Europe report are based on interviews with 45 firms active in the market.

<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>

We are concerned that securities-lending, an important component of market liquidity, may be curtailed or limited to the most liquid stocks due to operational costs related to call backs. In the research SWIFT Institute/ISITC Europe found concerns that lenders of mid-cap stocks may withdraw from the market. That would negatively impact market liquidity in mid-cap stocks and reduce the benefits for listed companies. A further concern expressed was that to encourage lenders to continue lending would require stock lending borrowers to pay higher fees.

<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>

Prior to the 2017 US transition Boston Consulting produced research concerning the cost of T+1 changes when the market moved from T+3 to T+2. This estimated that a decade ago a small to medium sized firm would have to budget $5m to make the changes and a large firm $20m. The costs will have increased. New technology has developed since to improve all areas of trade processing operations will require selection, implementation testing and would need to be tested on an industrial scale.

Resources will need to be found on an industry scale to move the EU markets collectively to real-time processing . It is likely there will be ongoing costs and ongoing development to resolve unintended consequences. Small firms will need to find budget that may be more  
challenging than for large firms. The systems will be mainly provided by third party vendors, but large firms may develop their own. Investors are likely to have to pay higher charges to cover the firm's financial IT development.

<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>

There is no available data to measure existing fails, why they fail and who is responsible. More transparency from firms on the reasons for fails would benefit the industry by focussing on the causes of failed trades.

There is also no industry consensus on this issue. It is widely anticipated that settlement fails would increase in the short term. However, if the market, as a whole, adopts the required operational procedures and associated IT the settlement failure rate could stabilise or improve in the medium/long term.

<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>

Failed settlement penalties need to adhere to an industry wide standard and be transparent. Some firms will be tempted to cover the cost to protect the client relationship and in effect allow settlement failings to persist. Regulatory scrutiny of failed settlement penalties would helpresolve the problem.

If the cash penalties are set at a punitive level and, crucially, are passed on as a cost of doing business to the underlying client settlement efficiency should improve over time.

See also section 9.4 of the SWIFT Institute/ISITC Europe report.

<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>

No response.

<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>

* Reduction of counterparty risk; Agreed.
* Encouraging additional automation and STP. Agreed.
* Lower collateral requirements. Direct participants in CCP’s will benefit from lower collateral costs. However it is unclear if these benefits will be distributed to other market participants.
* Promoting international harmonisation and increasing the attractiveness of EU markets. Agreed.
* The T+0 question is addressed in response to Q27

<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>

Not applicable for a direct ISITC Europe answer. See sections 7.2, 9.2-5 and 10 of the SWIFT Institute/ISITC Europe report for a discussion of possible wider market benefits.

<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>

ISITC Europe is not in a position to answer this question, but would offer the following commentary:

* Previous, and ongoing, projects to reduce settlement cycles have always focussed on the direct, quantifiable benefits of reduced clearing costs. These benefits accrue to CCP’s and their direct members. It is not proven that these benefits trickle-down to the wider market community.
* It is widely accepted that the associated improvements in risk, IT capabaility and operational capacity are real but nearly impossible to quantify.
* One cost/risk issue that is not sufficiently analysed is operational resilience. CCP’s, CSD’s and other market infrastructures have very high levels of resilience – but this capability may not extend across the whole market. Clearing and settlement are both systemic functions – the market will not operate if they are disabled. Reducing the settlement cycle means that IT and operational failures must be fixed very quickly therefore increasing the importance of operational resilience.
* See response to Q.10

<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>

No response.

<ESMA\_QUESTION\_SETT\_12>

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

<ESMA\_QUESTION\_SETT\_13>

The research performed by ISITC Europe for the SWIFT Institute report did not identify any specific benefits for retail clients. There is no demand for T+1 settlement in this segment.

This question relates to trading where the expectation is that faster settlement will increase trading. Investing for the medium/long-term does not happen on the same time scale where investing individuals and funds tend to act over a far longer time scale. For investing the shorter settlement holds no benefit in cost reduction nor risk. In fact, they may incur greater  
costs and risks. In ETFs and other collective funds, the investors may have further funding requirements due to FX transactions. We also are concerned that reduction of lending of midcap securities would make listing less attractive. The need is to increase investing in markets by deepening the investing pool and T+1 or T+0 does not.

<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>

The overall costs of a move to T+1 have not been quantified. It is therefore not possible to properly answer this question.

The US market has not published a clear cost benefit analysis of shorter settlement cycles for the wider market. ISITC Europe calls for EU markets to clarify exactly what the cost benefits are, where the risks are and who benefits. An obvious benefit to Issuers and investors must be made. We do not see the market change to shorter settlement as beneficial unless the benefits are clear to Investors and Issuers,

The T+0 issue is addressed in response to Q27

<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>

Elsewhere in this response ISITC Europe has set out its recommended approach i.e creation of a same-day processing environment and universal adoption of real-time processing. These improvements can be made with, or without a T+1 regulatory mandate. However, the past 25 years history of this subject shows that a regulatory push is essential. The timetable should, preferably, be set according to the readiness level of the market. The imposition of a random “big-bang” implementation date can be made to work but is not the optimum model.

<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>

ISITC Europe recommends that an eventual implementation date is defined when the industry has completed the essential building blocks:

* Near universal adoption of a Same-Day Processing Model i.e.
  + Full end-to-end automation of confirmation, allocation and instruction processing (no fax, no email, no spreadsheets/CSV files etc)
  + Elimination of batch processing (particularly overnight batch)

See also answers to Q1.

<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>

The CSDR scope is appropriate.

<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>

Yes, it is feasible. Government bonds are often settled on T+1 (US Treasuries, Japanese Government Bonds) and co-exist with other instruments settling on a T+2 cycle. This feature is a long-standing market convention which does not demonstrate any overt benefits.

<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>

The market practices and associated technology needed for T+1 settlement do not differ between types of financial instruments, transaction types or asset classes. However, there are segments of the market, such as ETF’s where, due to the complexity of the instrument, implementation is more difficult than for simpler instruments.

It is technically feasible but not advisable to have different migration times for different products/markets/assets. This would lead to implementation complexity and increased operational risk.

<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 is appropriate to continue the current CSDR Article 5 exclusion provisions.

<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>

See section 9.2 (page 12) of the ISITC Europe/SWIFT Institute report for detailed coverage of this issue.

<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>

ISITC Europe cannot 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. EU market participants would benefit most from a harmonised T+1 implementation with markets outside the EU.

<ESMA\_QUESTION\_SETT\_22>

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

<ESMA\_QUESTION\_SETT\_23>

There are considerable benefits to some segments of harmonisation of settlement cycles. In particular buyside firms/investment managers that invest globally are able to divest from a market and invest in a new market on the same timescale. This prevents funding issues. Since 2017 most capital markets have converged on a T+2 settlement cycle and this benefit has largely been overlooked and taken for granted.

For EU based investment managers, the re-introduction of disharmonised settlement cycles will introduce new operational complexities and costs. If, as seems possible, the markets in North America and UK adopt a T+1 settlement cycle several years in advance of EU markets this additional complexity and cost will persist for many years. Investment managers will be able to manage the situation but the rea impact is that underlying customers will pay higher costs than before.

<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>

The main benefit for the markets is to improve efficiencies reducing costs and risks. However, this should be for the overall cost and risk benefits for Issuers and Investors to attract new listing and broaden and deepen the investor base. If it increases the cost and risks, it is hardly worth undertaking.

<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. The implementation of a T+1 cycle outside the EU in advance of the EU markets will help prepare for an implementation 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>

Yes. It is a viable, but not desirable, scenario. (This situation has existed before when, prior to 2014, Germany operated a T+2 cycle and the rest of Europe was at T+3.)

<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>

The issue of T+1 settlement frequently raises the possibility of T+0 settlement. The ISITC Europe viewpoint is:

* T+0 settlement is neither achievable or desirable at this time
* It is frequently asserted that Blockchain/DLT is a way of achieving T+0. This is not correct. The technology prerequisite of reduced settlement cycles is true real-time processing, which can be achieved using legacy IT. Most CSD’s can facilitate T+1 or T+0 today – without Blockchain/DLT.
* What is meant by T+0 settlement is also ill defined. There are two forms:
  + End of day, netted, settlement on T.
  + Instantaneous (so-called “atomic”) real-time trade by trade settlement. This model, whilst being operationally efficient (see section 4.6 of the SWIFT Institute/ISITC Europe research report) removes the netting function from the process. Netting has many substantial benefits and the likely impact on liquidity, trading volumes and price formation would all be negative.
  + Both end-of-day and atomic models require real-time operational performance, across the whole market, which is way beyond the capabilities of many market participants today. It essentially requires 24-hour, global real-time processing capability across the whole market.

<ESMA\_QUESTION\_SETT\_27>