France Post-Marché

15/12/2023

ESMA
CALL FOR EVIDENCE:
On shortening the settlement cycle

FRANCE POST MARCHE PRESENTATION

FRANCE POST-MARCHE (previously named AFTI) was created in 1990, with the goal of gathering members of organizations in the Banking and Financial Services industry involved in activities with financial instruments and specifically post trade activities.

FRANCE POST-MARCHE is an integral part of the French, European and international financial ecosystem, supporting the increasingly interdependent players in the French financial marketplace.

FRANCE POST-MARCHE (FPM) is the leading association representing the post-trade business in France and Europe.

FPM represents through its 82 members a wide range of activities: market infrastructures, custodians, account-keepers and depositaries, issuer services, reporting, and data management services, with a total staff of 28,000 in Europe of which 16,000 in France.

Our members acting as financial intermediaries account for 26% of the European market.

CONTEXT

ESMA has launched a call for evidence on the Shortening of settlement cycle in Europe. This call for evidence seeks the opinion of the industry on a settlement at T+1 and T+0. This call for evidence was launched on the 05th of October 2023 for an answer on the 15th of December 2023.

In this context France Post Marche has collaborated with the French associations (AFG[1] and AMAFI[2] notably) and has gathered the opinion of its participants to elaborate a comprehensive answer to the question asked by ESMA. France Post Marché however submit this answer on its own, and both AFG and AMAFI are providing their own answer to ESMA.

Before presenting our findings, we would like to thank ESMA for this consultation and for the opportunity to share France Post Marché views on the main questions of an accelerated settlement in Europe.

[1] Association Française de la Gestion financière (AFG) federates the asset management industry for 60 years, serving investors and the economy.
[2] Association Française des Marchés Financiers (AMAFI) is a trade association representing French financial markets participants of the sell-side industry which operates in all market segments, such as equities, bonds and derivatives, on primary and secondary markets

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Following the project of the US industry to adopt an accelerated settlement, the subject has been at the forefront of the post trade industry across the world. Mexico as well as Canada have decided to follow the US project.

Due to the US decision to start a project aiming at shortening the settlement cycle, both United Kingdom and EU have decided to each launch studies to consider a potential shortening of settlement cycle under the benefits and challenges angles for their financial community.

United Kingdom has created a dedicated task force whereas ESMA first issued a public consultation to get some evidence of the impacts of the shortening.

It should be noted that the move to T+1 in the US has been an industry led initiative in particular by DTCC. The move to T+1 was not initiated by the SEC, and it should be noted that the final decision was not taken unanimously, and that member expressed significant concerns[1]. This move has been also colored by political driven reasons, the industry feeling threated by the emergence and challenges related to retail-oriented trading platforms.

Main reasons to move to T+1 were to reduce settlement risk and improve post trade processes inefficiencies. In particular, the volatility of markets following Covid and retail stocks phenomenon had shown the relative instability of settlement industry in stress periods. **As such T+1 initiative in US should improve market efficiency by pushing market participants to improve their processes toward more automated and robust systems.** Ultimately the expected effect is a reduction of settlement risk and as such margin deposits requirements.

We believe the project of T+1 in Europe would not present the same benefits and challenges because US and Europe market structure is fundamentally different:

- The US follow a relatively simple market infrastructure model: **1 CCP, 1 CSD, 1 currency. Europe has currently 18 CCPs, 31 CSDs and 14 currencies. US and Europe also bear differences in their securities law (settlement revocability) and different infrastructure process (affirmation (US) vs matching (EU) ; cash collateral (US) vs asset collateral(EU)).** As such this project in Europe is much more ambitious than in any other jurisdiction
- **ESMA has already worked very intensely toward improving Securities market and settlement efficiency** through different regulations, the latest being CSDR, having improved considerably the settlement efficiency over the years. Thus, this has enabled EU market to smoothly face recent crisis (ex. Covid, Ukraine…)

MAIN VIEWS & CONCLUSIONS

We believe that these fundamentally different market organizations should be taken into close consideration. As such, you will find below our main positions:

[1] Decision was taken with 3 in favors and 2 against, with Hester Pierce believing this move “could pose a risk to the market” and that the SEC “cannot afford a cavalier approach” (link to article)

1. Even though we believe that on a theoretical basis it is sensible to open the discussion on both T+1 and T+0 settlement, our view is that they are not really comparable and should not be assessed on an equal basis. Indeed, their nature is fundamentally different and a one day less scenario would require critical changes whereas 2 days less scenario would require drastic transformations**. A move to T+0 is not achievable for the moment and would not help address any of the challenges a move to T+1 would create**. On the other side, a move to T+1 cannot be considered as a first step to a move to T+0. **For all these reasons, we prefer to limit our answers to the Call for Evidence to a "T+1" scenario.**

2. T+1 settlement is already achievable if agreed upon between parties; the **real challenge however is on the ability to shift all transactions on specified instruments towards T+1** and in particular the intermediated transactions. As such a careful analysis of processes is necessary to correctly address T+1 considerations. **You will find our detailed analysis both in our answer and in our presentation in appendix.**

3. From our point of view, there is **no clear interest so far for European actors of the market to go to T+1**. However, we understand European authorities opened the question due to the US decision (indeed it did not appear to be in the work plan of the EC or ESMA for the next years). The European market as a whole has made numerous investments these past years on the path to a unified and secured market through important efforts despite the diversity of infrastructures, countries, and actors. Although the European market is more complex than others, these **achievements are the foundation of the strength, attractiveness, and competitiveness of the market**. A move to T+1 would certainly weaken the market for some time, due to the diversity and the amount of work and expenses necessary to achieve this transformation. We believe that such a move, if it should be pursued, must be **extremely well thought out, planned, and executed** with a robust project planning and coordination, to avoid losing the benefits achieved over the past years. Without doing so, the EU carry a significant risk on its liquidity resulting from the operational risks associated with this transformation. Therefore, **we urge ESMA to not rush any recommendation to move to T+1** and take the time to evaluate in detail the ratio of benefits versus costs in particular in terms of attractiveness and competitiveness both for the market participants and the European Union itself, while **scrutinizing the consequences of the project in the US market.**

4. Should a decision to move to T+1 be taken, it is mandatory that EU authorities work towards further harmonizing the underlying regulations for processes related to CSDs, CCPs and trading venues within Europe to ensure a seamless and successful transition.

5. The prerequisite to this move to T+1 is to **completely redesign the infrastructure environment** (Trading Hours, Post Trading hours, CCP processes, ECB processes etc.) which supports the European Market. We are convinced that **under the current infrastructure conditions a move to T+1 could not be achieved**. The definition of this new infrastructure conditions would be the first step toward achieving T+1. Assessments and costs/benefits analysis can only be performed once these new conditions are clearly laid out. This analysis must also take into consideration the operational risks increase associated with such a move, and eventually the impact it could have on the market liquidity.

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6. The success of such a critical change would require **full adhesion of the financial community** across Europe. Strong coordination of actors within as well as outside Europe is a mandatory prerequisite to achieve an orderly move to T+1. Ensuring that an **evolution is made jointly, at the same time, in accordance with UK and Switzerland markets and authorities, would also be essential to the success of this project**. Furthermore, ensuring that all actors (FMIs, Intermediaries, investment companies and investors both domestic and foreign ones) can be informed and contribute to the definition of this project would be required for its success.

7. More fundamentally, we believe that a **move to T+1 would bring more costs than benefits**, taking into consideration that these benefits would take much more time to appear compared to substantial costs before and during the transition. We also believe that these costs would be **unevenly shared between market participants**. Moreover, the costs of this transition would impact **European actors, and hamper their capacity to invest into innovative projects and affect their competitivity** at the international level. We believe that the competitiveness of the ecosystem is a key criterion for a market to be attractive for investors. Therefore, our concern is that such a move to T+1 would result in a massive misallocation of EU resources and workforce even if both US and UK market were on T+1. Furthermore, we fear a move to T+1 may force EU market participants to consider a potential workforce relocation or outsourcing out of the EU to cope with the new timeline.

8. Therefore, we would like to suggest to the EU authorities to consider carefully **whether T+1 should constitute a priority for EU capital markets** as alternative projects requiring less resources may foster more innovation and benefits for Europe. Also, it should be kept in mind that there are **multiple "T+1"s per different regions** where it is being considered or implemented in the world. Some countries have chosen to apply different settlement cycles for diverse investors (domestic/foreign) or for diverse asset classes and with different local market rules (pre-funding, account segregation, etc.) making "T+1" very different across jurisdictions.

9. **T+2 settlement cycle might also present some advantages** for domestic investors (working hours, FX market, Sec Lending, UCITS management, ….) and foreign investors (notably for Asian ones) for which a move to T+1 could negatively affect their propensity to invest in European markets. Taiwan for instance, which adopted a T+1 settlement cycle in the past moved back to a T+2 cycle because of the difficulties it created for foreign investors. The **interest to move to T+1 is therefore strongly correlated to local or regional market organizations** and should follow an independent cost/benefit assessment in each jurisdiction.

10. Finally, we would like to remind that the **US decision** which is the starting point of this analysis conducted for Europe was:
    - meant to reduce the counterparty and liquidity risks and to increase the confidence of investors in the financial markets, following some impactful cases (Market volatility, Gamestop, AMC Entertainment etc.)
    - led by the industry and not the regulators. Indeed, the project was brought up by DTCC and then agreed upon by the SEC. It is also worth reminding that this decision came after

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the fact that the industry felt compelled to improve its processes following the challenges faced due to the emergence of retail trading and DLT platforms.

- **made without assessing the impacts on non-US actors**
- **expecting benefits that may not replicate in the EU**

11. Meanwhile it should be considered that Europe addressed these issues by implementing more restrictive regulations such as CSDR and the settlement discipline. Therefore, **the benefits that the US perceive by implementing T+1 would not necessarily translate into the European market environment**. It should also be noted that the US market is not monitoring its settlement efficiency and is not applying penalties in case of settlement fails, on which we would expect a substantial increase if Europe adopts T+1. **The European market has already achieved important milestones towards making its market infrastructure more efficient and stable through rigorous regulations**. Therefore, a move to **T+1 should only be considered for the right reasons, in the interest of EU markets and investors, justified by a documented cost/benefits analysis and not be based on a "follower stance".**

We hope that the elements that we brought through this response to the Call for Evidence are substantial and will help ESMA analyzing more precisely the benefits and the challenges of such a move. **Our goal is to allow ESMA to perform a comprehensive analysis and to be able to make documented and rational recommendations.** We remain committed to help ESMA in this work and will be happy to discuss our document further if needed.

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