Reduced settlement cycle for securities (T+1)
AFG position paper

In 2021 the US decided to move to a reduced settlement cycle from T+2 (two business day after trade date) to T+1. It was influenced by the GameStop market event in 2021 and the COVID-19 pandemic which highlighted the vulnerabilities associated with longer settlement cycles during periods of high volatility. Indeed, one of the rationales behind this move was that longer settlement cycles can create liquidity stress for brokers and clearinghouses, especially when they have to post large amounts of collateral (margin). Whereas the shorter the time between trade execution and settlement, the lower the risk that one party will default before the transaction is completed. This change took effect in May 2024, with Mexico, Argentina and Canada following the move.

Not long after, the United Kingdom (UK) and Switzerland expressed a clear interest in moving towards a T+1 settlement cycle. In December 2022, the UK launched an Accelerated Settlement Taskforce (AST), to assess the feasibility of moving to T+1. It published its final report in March 2024, recommending that the UK target a transition by end of 2027 at the latest. The technical group of this AST published last February its implementation plan/rulebook.

On 18 November 2024, the European Securities and Markets Authority (ESMA) published a final report recommending moving to T+1 by 11 October 2027. This date was supported by the UK and Switzerland. This timeline allows about a year for developing standards and processes, a year for implementation, and a year for testing to ensure a smooth transition. In order to help the industry coordinate the shift ESMA, the European Commission (EC), and the European Central Bank (ECB) have set up a governance framework with several dedicated workstreams involving industry participants.

On February 12, 2025, the EC published a legislative proposal introducing an amendment to Regulation (EU) No 909/2014 (CSDR)[1] to act the new reduced T+1 settlement cycle to be implemented by 11 October 2027. This text is currently being negotiated at EU level.

Since the beginning of the US project, the AFG has been very active on the subject, with a view to identifying the impacts on asset management companies and prepare for the move.

Despite the realignment between the US and the EU's settlement cycle, this shift will be a challenging task for EU players/asset managers and especially for smaller ones or those in non-eurozone countries. Indeed, EU faces operational, regulatory, and infrastructural hurdles due to its fragmented market structure, diverse regulatory environments, and complex cross-border coordination needs.

As such, the purpose of this paper is to present the impact of the project on asset management companies and to outline our positions with the aim of moving to T+1 by the scheduled date of October 2027, avoiding any adverse consequences for the market.

[1] Proposed article 5(2) of CSDR "*2. As regards transactions in transferable securities referred to in paragraph 1 which are executed on trading venues, the intended settlement date shall be no later than on the ~~second~~first business day after the trading takes place. That requirement shall not apply to transactions which are negotiated privately but executed on a trading venue, to transactions which are executed bilaterally but reported to a trading venue or to the first transaction where the transferable securities concerned are subject to initial recording in book-entry form pursuant to Article 3(2).*"

I.Fund settlement cycle & specificities (UCITS and AIF)

From October 11th 2027, all securities traded on a trading venue, will have to be settled on T+1[2]. However, this will not necessarily be the case for fund units who are not in scope of CSDR and are therefore not covered by the obligation under article 5(2) to settle on a T+1 basis.

Therefore, after October 11th, there will probably be a misalignment between the fund's units and their invested securities/assets.

Indeed, asset managers can either choose to keep a misaligned settlement cycle between their funds' assets and liabilities or can choose to reduce their funds liabilities settlement cycles (To T+2/T+1 for funds that may remain with cycles beyond T+2, or to T+1 for funds with current settlement cycles at T+2).

The choice to follow either one option, will depend of various considerations/impacts that's we've outlined below.

A. Misaligned settlement cycles

In the case of subscriptions, the manager will need cash to buy securities in time to settle its trade earlier (T+1), cash which will not be available in time because of his subscription remaining on T+2. It will require pre-funding or the use of credit lines with the associated costs (interest) and risks. Furthermore, it might cause a breach of UCITS borrowing limits (*UCITS, art. 83(2)*).

In the case of redemptions, the manager will need to sell earlier to meet with the selling of the underlying securities on T+1, he will receive the cash from the sales on T+1 and pay for the redemptions on T+2. In that case, the manager will be long cash for a day and might be in breach of UCITS cash ratios (*UCITS, art. 52(1)*). Holding an excess of cash might impact the fund's performance.

B. Aligning the fund unit settlement cycle with its underlying assets

Although aligning fund units with their underlying securities will reduce the liquidity mismatch, it is not without consequences. All actors (manager, custodians, fund administrators, transfer agents, distributors) will need to be ready to process subscriptions and redemptions in a shortened timeframe.

This will impact the timing for the calculation of the net asset value (NAV) to support next-day settlement (move from 28 hours to 4 hours). This can be more challenging when talking about a global fund with assets across different time zones.

Prior to the dissemination of the NAV, the entity responsible for calculating the NAV (the delegated fund administrator) must provide the portfolio manager representing the asset management company, with a comprehensive set of data necessary for conducting appropriate checks and ensuring the accuracy and consistency of the NAV before final validation. This includes, but is not limited to, the portfolio's valued inventory, management fees, corporate actions etc. NAV calculation takes place upon receipt of market closing prices (T midnight). Once the NAV is calculated and reviewed and approved by the portfolio manager, the fund administrator may then officially transmit it to the centralizing agent and the custodian, among others. In a T+1 environment, this requires that the NAV be disseminated no later than 12:00 p.m. on T+1. It will impact some communication processes, particularly

[2] Proposed article 5(2) of CSDR (see footnote 1)

those concerning late trades, manually overridden prices, transactions at unknown prices, and operations involving atypical funds that are not processed via SWIFT.

Distributors will need to adapt their platforms and operational workflows to match the faster deadlines for settlement.

Both scenarios could potentially lead to higher settlement fails with their associated cash penalties. At least for a short time during the T+1 move. Indeed, managing misaligned settlement cycles at a higher scale could potentially lead to some errors, delays and fails while aligned settlement cycle in a reduced timeline to complete the various steps for settlement could here again, cause some fails.

To date, no solution appears to be the most suitable. At the end, the choice of whether or not to shorten the settlement cycle of their fund units should be left to the fund managers, depending on its type of funds (with or without numerous subscriptions/redemptions - when JPY underlying) and their own cost/benefit analysis (on the one hand, the impact on distribution, fund administrators, prospectus changes, etc., and on the other, potential breaches of UCTIS ratios, the cost of funding etc.). This choice might also have consequences in terms of human resources, for example, which needs to be analysed by the asset management company.

The decision to reduce or not the fund unit's settlement cycle must remain a choice of the asset manager.

II.ETF settlement cycle & specificities

Unlike traditional funds, ETFs are listed on a regulated market. Therefore, the impacts of the EU move to T+1 are slightly different. Indeed, the settlement of these products requires an additional step. Before the fund can be traded on exchange on the secondary market, the ETF share needs to be created on the primary market (creation/redemption). The authorised participant (AP) delivers cash (or in some cases, a basket of underlying securities) to the ETF issuer/provider (the asset manager) and receives the ETF shares (creation units). Noting that the ETF value (the NAV) must remain aligned with the benchmark it tracks. The AP can then sell the shares to investors on the secondary market.

Primary market transactions are excluded from the scope of CSDR[2].

However, in a T+1 world, for ETF shares to be created on time to be settled on T+1 on the secondary market, they will have to be created upstream on the primary market. For global ETFs operating across multiple time zones and markets, it will create mismatched of settlement cycles leading to funding needs, more borrowing and operational challenges e.g. an EU listed global ETF that includes securities from T+2 or T+3 markets (mainly Asia Pacific).

In addition to having different settlement cycles (mainly T+2), Asian markets are in different timezones that close before European ones. As such, creation/redemptions orders will need to be sent much earlier (in the night or in the previous evening).

As for traditional funds, there will be some risks in terms of cash breaches. Furthermore, today ETFs are subject to higher settlement fails and therefore cash penalties. With these new constraints, settlement fail rates might even get higher. In addition, with global ETFs, there is often the additional operational constraint of carrying out foreign exchange transactions (FX) which will need to be dealt with.

Asset managers will need to figure out how to resolve these timing issues. At this stage different options are being considered within the EU T+1 AM technical workstream. One of which we believe could be implemented i.e. Orders placed Tminus1, every securities (EU/US/APAC) is traded on T with the settlement on an indicative NAV T+0 and a true up[3] of any slippage once all trades have been executed. This solution would allow APs to meet T+1 settlement obligations for secondary market trades.

However, each AM must retain some flexibility on the model they want to implement.

Asset managers must keep some flexibility in the choices they will make regarding the settlement of global ETF's primary market transactions.

III.UCITS ratios

Directive 2009/65/EC (UCITS Directive) sets strict rules on cash holdings and borrowing to ensure investor protection and maintain liquidity. Cash ratios and borrowing limits are dealt with in both article 52 and 83.

A UCITS shall not invest more than 20% of its assets in deposits made with the same body (*UCTIS, art. 52(1)*) and may borrow up to 10% of its net assets, but only on a temporary basis (*UCTIS, art. 83(2)*). However, regarding cash limits, the directive also sets in article 49(2) that a UCITS may hold ancillary liquid assets. The directive does not impose any specific limits, leaving it to the discretion of each Member State to decide whether or not to establish them[4].

According to national competent authorities (NCA), any "active" breach of one of the regulatory ratios must be reported/notified to the NCA. However, it's important to note that the distinction between "active" and "passive" breaches is not defined in European legislation and is not uniformly applied across the EU. Temporary infringements may be tolerated under certain market conditions, but this varies from one regulator to another.

It is important that any breach due to a misaligned settlement cycle be considered as a "passive breach" i.e. a breach from an external / unintentional cause without needing to report on that beach. Indeed, it's easy to imagine that this breach will be temporary, just long enough to obtain the securities/cash to settle the transaction. It can be particularly useful in case of a large subscription.

[3] A true-up is a financial/accounting adjustment to reconcile previously estimated amounts with actual final values. In that case, the true-up will adjust the probable mismatch between the value of the NAV and the value of the securities delivered.
[4] See. DOC AMF 2011-25 for French funds.

Any breach due to misaligned settlement cycles should be qualified as a passive breach.

On that point, in a letter dated from June 2nd 2025, the AMF acknowledges that the shift to T+1 may cause temporary and unintentional breaches of cash and borrowing ratios due to misaligned settlement cycles. These specific breaches, if they are resolved automatically and are beyond the portfolio manager's control, do not need to be reported to the AMF in the quarterly reporting.

IV.Treatment of fails and associated cash penalties

Settlement fails are described in article 2(15) of CSDR as "*the non-occurrence of settlement, or partial settlement of a securities transaction on the intended settlement date, due to a lack of securities or cash and regardless of the underlying cause*". Considering article 5(2) of CSDR will soon be modified so that transactions in transferable securities executed on trading venues will no longer have to be settled T+2 but T+1, a transaction will be considered as failing if it has not been settled by T+1.

Article 7 of the CSDR outlines several measures to address settlement fails, one of which is a cash penalty mechanism. Under this regime, participants who fail to settle transactions on the intended settlement date incur a daily cash penalty (applied on each business day the transaction remains unsettled) until the transaction is either settled or cancelled.

As the transition to T+1 will require significant effort and coordination across the entire settlement chain, including increased automation, IT system upgrades, changes to operational processes, investment, and workflow optimisation, we believe that a temporary suspension of cash penalties during the initial phase of the T+1 migration is necessary. This would help ease the operational burden on firms and enable them to focus on the most critical elements of the project.

Experiences from the US shift to T+1 highlight that additional resources were required to ensure a smooth transition, with some teams still actively finalising automation processes. In a T+1 environment, a likely increase in settlement fails would result in higher workloads related to incident qualification, client communication, resolution follow-up, market claims, and penalty processing, all of which translate into added operational pressure and increased costs.

Some EU market participants have estimated the current running cost of automatic cash penalty process to 0,5 million euros per participant per year. Across the EU, this adds up to hundreds of millions of euros (costs that UK and US firms are not subject to under their respective local frameworks). At least on a temporary basis, that extra burden and cost for EU participants should be avoided.

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V.Scope of T+1 : exclusion of Securities Financing Transactions (SFTs)

Securities Financing Transactions (SFTs), as defined in Article 3(11) of Regulation (EU) 2015/2365 (SFTR), are flexible, non-standardised instruments essential for liquidity provision, inventory management, and short-term funding needs. Unlike outright securities transactions, SFTs do not follow a fixed settlement cycle and often require start (settlement) and end dates beyond T+1, driven by market demand / tailored to the funding and liquidity needs of counterparties. For example, forward repos are agreed today but their "start" date is set in the future, beyond the usual settlement cycle date (usually two business days after). While only SFTs' end legs are explicitly excluded from Article 5(2) of CSDR (*see Recital 13*), there remains ambiguity about the broader application of CSDR.

The upcoming move to T+1 offers a timely opportunity to clarify this and fully exempt SFTs, as imposing a fixed cycle would undermine their core function and create operational inefficiencies. A targeted exemption for "forward repos" would be insufficient, as the term lacks a clear legal definition and would introduce unnecessary complexity. In practice, most SFTs already settle on T+0 or T+1[5], and this trend will only accelerate under a T+1 regime, making a full exemption both practical and consistent with market behaviour, without leading to any risks or downsides.

Considering the above, AFG supports the steps taken by the Legal & regulatory EU T+1 workstream to achieve a total exemption for SFTs from the scope of article 5(2) of CSDR.

Exempt SFTs, as defined in article 3(11) of SFTR, from article 5(2) of CSDR

[5] See. ESMA's Report stating that the vast majority of SFTs already settle on T+0 or T+1, irrespective of the current T+2 rule.