

DECEMBER 2023

**AFG'S RESPONSE TO ESMA'S CALL FOR
EVIDENCE**

Shortening the settlement cycle



AFG



The AFG federates the asset management industry for 60 years, serving investors and the economy. It is the collective voice of its members, the asset management companies, whether they are entrepreneurs or subsidiaries of banking or insurance groups, French or foreigners. In France, the asset management industry comprises 700 management companies, with €4600 billion under management and 102,000 jobs, including 27,000 jobs in management companies.

The AFG commits to the growth of the asset management industry, brings out solutions that benefit all players in its ecosystem and makes the industry shine and develop in France, Europe and beyond, in the interests of all. The AFG is fully invested to the future.

SHORTENING THE SETTLEMENT CYCLE

AFG welcomes the opportunity given by ESMA to answer its call for evidence on shortening the settlement cycle.

The AFG has been working for several months on how the French industry, and more globally, Europe, has to prepare for the new settlement cycle (one working day after the transaction date : “T+1”) that has been decided by the United States (US) and Canada in February 2023 and that will enter into force in May 2024 (c.f. AFG’s [note on the impact in Europe of the US move to T+1](#)). These works are still ongoing, and it is still not obvious at this stage that it will have the benefits intended by the US i.e : reduction of risks failures of settlement/delivery instructions and of risk exposure and margins.

Therefore, and considering that CSDR Refit has just been published, AFG feels that the ESMA call for evidence on shortening the settlement cycle from two working days after the transaction date (T+2) to T+1 or transaction date (T0 = atomic settlement or T+0,5 = end of day settlement) in Europe is premature.

That being said, and as we already identify many challenges to overcome a move to a T+1 settlement cycle, we decided to put aside the question of T+0.5 or T0. All of the points that we raise on T+1 would in fact be exacerbated in a move to T0 and would require an even bigger transformation of our current processes and a complete shift of paradigm (envisage DLT for instance) that is impossible at present and that would result in the creation of new risks.

Here below are some general considerations that AFG would like to raise as a preliminary remark.

I – General comments

We understand that European authorities are considering the possibility for Europe to move to a shorter settlement cycle notably to avoid having misaligned settlement cycles between different jurisdictions. However, it is important to stress the need, when introducing new settlement frameworks/regimes, to be sure that they won’t have a damaging effect on exiting efficiency and on the access to and the functioning of EU capital markets and on its competitiveness. However, at this stage, we find many undesired aspects in the compression of time to complete post-trade processes that would drastically impact our financial markets and its competitiveness.

In fact, we’d like to stress that Europe has a different market structure than the US. It is much more complex, much more fragmented with a high number of market infrastructures:

- 26 CSDs in Europe versus two in the United States, 18 CCPs in Europe versus one in the US,
- different securities settlement systems and infrastructures process (affirmation in the US versus matching in the EU) ;
- different currencies (14 in the EU) ;
- market liquidity in Europe can vary from one EU country to another and from one stock market to another ;
- trading hours are not aligned and there are many disparities in terms of member states’ respective legal and regulatory frameworks (the US securities law allow) ;
- Different matching systems (in the EU, once a transaction is entered into the settlement system and is matched, it becomes irrevocable whereas the US system allows for a transaction to be unmatched i.e: settlement revocability) ;
- the common settlement platform (T2S) does not support all currency denominations of the instruments traded and settled in the EU and not all EU CSDs participate in that platform.

Furthermore, Europe has a framework in place regarding the improvement of securities settlement and central securities depositories, and which provides measures (preventive and disciplinary



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measures) to enhance the safety and efficiency of settlement processes and avoid failures ([Regulation \(EU\) No 909/2014](#) “CSDR” and [Directive 98/26/EC](#) “Settlement Finality”). Such a regime finds no equivalent in the US (except for US treasury bonds). It being specified that CSDR has just been revised and that any further change in market settlement structure should be consistent with the changes made and that will soon come into force.

Moreover, such drastic change of moving to T+1 will require considerable investment and resources that would be better spent on other ambitious projects such as the achievement of the Capital Market Union (CMU), addressing environmental issues, investing in financial education, financing the European economy... If we don't put the necessary effort into these projects to the detriment of other, less urgent projects, we run the risk of damaging the EU's competitiveness and attractiveness.

Bearing in mind that the shortening of the settlement-delivery cycle was not envisaged in either ESMA's or the EC's plans before the US announced its decision to move, it seems all the more important that a thorough cost/benefit analysis should be made in order to assess:

- If a reduction of settlement cycle would be fit for European market. Meaning, would reduce risks failures, risk of settlement, risk of counterparty etc. ;
- If it wouldn't damage EU's competitiveness and attractiveness;
- Its consequences on the industry as a whole and notably on the end investor. Knowing that at this stage we see no benefits for the buy-side, particular danger for small asset managers who might not be able to follow the move and for retail investors on whom the costs would be ultimately passed on to ;
- How it would be managed. A move to a shorter settlement cycle needs to be considered in a coordinated way by all actors of the chain (from the emission to the delivery) to set an appropriate timeframe for them to make the proper operational and technical changes required ;
- If it would require regulatory changes;

In fact, at this stage we find it extremely difficult on our side to assess the costs/benefits as we don't have sufficient background on the scope, the technical and operational changes that would be necessary, the timeline etc. We have an overview with the migration from T+3 to T+2, which was a demanding effort, and evaluate that a shorter move would be even more demanding as it requires a redesign of infrastructures environment (post trading and trading hours, different cut-offs, CCP processes etc.). In any case, in order for the European industry to get some data and make a proper cost/benefit analysis, authorities shouldn't expect Europe to move at the same pace as the US. We should be able to draw all the consequences that will come with the switch from T+2 to T+1 in the US on liquidity, on investors behaviours, on cash management etc.

One impact that is already identifiable and that will affect all markets from 27 May 2024, is the misalignment between jurisdictions (US vs. Europe, Asia etc.). If ever authorities were to agree on a move for Europe, we stress the importance of doing it in a coordinated way with other jurisdictions and notably the UK and Switzerland.

II - AFG's answer to ESMA's questions

Impact of the reduction of the securities settlement cycle in the operations of market players

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



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- (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.

As already pointed out, European authorities should bear in mind the differences between EU and US markets while envisaging a move to T+1 :

- European markets are much more fragmented with 26 CSDs in Europe vs. one in the US, many currencies vs. one currency in the US and 16 CCPs vs. one etc.
- They follow a different organisation. From a legal/regulatory framework point of view, the US has no cash penalty regime such as in France, where market participants must comply with that regime on a daily basis no matter how big or small is the size and the impact of the fail. In the US the only risk is to be sanctioned by the SEC ex-post and probably only for major fails (not for minor impacts).

From our viewpoint, the one-day timespan cannot structurally fit the European market structure. It is essential to keep the existing settlement deadline at T+2 which allows in practice the feasibility of such securities settlement. Trying to reduce the settlement cycle to T+1 would first require solving those above organizational features of the EU securities market and ensure that settlement efficiency is at its highest (no fails).

However, if a move to T+1 was to be decided by EU authorities, we identify several operational and technical impacts notably:

- **Impacts on the matching process and time constraints:**

As a first step of the settlement process, trades need to be allocated and confirmed. To meet a T+1 deadline while benefiting from the night settlement batches that T2S offers (which is a much better tool than waiting for the T+1 morning batch), it implies having securities and cash ready to be exchanged on trade date impacting liquidity and cash management processes that will also need to be compressed (we'll come back to these issues further down our response). However, today T2S night batches starts at 20:00 am CET, leaving only a few hours to allocate, confirm and send the settlement instruction. It goes without saying that its completely impossible to meet in case of an error. This leaves absolutely no room for manual processes and requires automation which will be particularly impactful and will require enormous investment for smaller asset managers.

These deadlines will also be harder to meet for securities traded on close. This is particularly true for equities and ETFs portfolios where actors will have less than 2/3 hours to affirm, allocate, pre-match the trades. A move to T+1 would necessarily mean the need to rethink these processes with an impact on liquidity, on the asset managers strategy and therefore an impact on the market and on the performances of the end investor who will bear higher costs.



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- **Impact for fund settlement, ETFs & FX:**

Today most funds are still on T+3/T+4 basis for subscriptions and redemptions. Reducing the settlement deadline will only exacerbate the misalignment between the settlement cycle of underlying securities and the funds' subscription/redemption settlement and create breaches of UCTIS thresholds (cash and borrowing limits).

ETFs are subject to the same negative impacts as other traditional funds (FX, asset/liability misalignment, securities lending, etc.). However, as they are sold on the stock exchange (secondary market), they are also affected by the irreconcilable difference between settlement of the underlying (T+1) and settlement of exchange-traded units (T+2). This settlement gap generates both a need for funding and, in some circumstances, an additional risk for participants in the chain. There is a cost to these two elements, which will be passed on to the end client (via a wider spread and therefore a less competitive price on the secondary market).

The T+1 move will also be very problematic for FX (cross-currency) transactions. Today, under the current T+2 framework, members enter into FX transactions once the security purchased is confirmed so to have certainty on the execution of the trade. As such the FX trade is executed on T+1. The only central market infrastructure for FX trades is CLS which permits multicurrency cash settlement (Payment versus payment system) and netting, helping mitigate counterparty risks. CLS deadline for a T+1 settlement is set at midnight CET. This implies a total change of operational and technological processes to manage the compression of deadlines. Parties could therefore end up settling their FX transactions bilaterally, reintroducing counterparty risk, higher costs, liquidity and funding issues.

- **Impact on inventory management functions:**

Securities lending can be an important tool :

- to provide additional revenue to investors (they get revenues from lending their stocks)
- to provide liquidity to the market and therefore avoid settlement.

However, a move to T+1 will shorten the timeline to identify and cover short positions and return the securities in time. All the more so given the multiple actors involved across different time-zone. This might lead to an increase in settlement fails and cash penalties (even buy-ins). Auto-borrowing could become mandatory and de facto evicting some actors out of the market because of the high costs it implies.

- **Impact on corporate actions:**

Reducing the settlement cycle will have an impact on corporate actions that follow well defined procedures and dates. As such ex-date would need to be brought forward, falling on the same date as the record date. This could have consequences on claims and fails.

- **Human resources issues:**

We identify that many entities will have to consider human organisational changes such as having night teams to process late instructions, manage errors and fails, which raises questions regarding legislation on nighttime work. We want to stress that it's the first time our industry needs to question the interest of having nighttime shifts. Others may also be forced to relocate teams.

All the above impacts being multiplied in the case of mixed funds.



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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?

Moving to a shorter settlement cycle will have high impact on hedging as most trades are happening at the closing and end-of-day custodian cut-off leaves very little time to get everything done. It recreates a bilateral risk.

It will have consequences on securities lending practices as explained above.

For transactions with an FX component, trading desks will have to be much more attentive regarding settlement processes to ensure that funding is in place to allow same day settled trades (high need for prefunding). Matching, confirmation, and payment will need to be completed within local currency cut-off times so market participant will need to be aware of those cut-offs, of local holidays etc.

Q3. What 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?

The settlement chain is very complex and involves a wide range of players (from the trading to the settlement phase) which makes it extremely difficult to get a clear estimation of the overall rate of STP transactions.

From what we've gathered from a few of our members, the STP rate for equities is on average 93.43% of transactions matched on T0, 92,43% for fixed-income and 98% for Forex.

Even if STP rate could be improved, it doesn't mean all delays or risk of failures will be eliminated. In fact, straight-through processing means processing operations as they occur, i.e. without interruption or delay. However, it doesn't prevent from human interventions/verifications. Moreover, it doesn't prevent from receiving late confirmations and instructions. In short, STP does not guarantee transaction efficiency and can't be solely considered as a sufficient condition for a smooth transition to T+1.

Q4. Do you expect the shortening of the securities settlement cycle to have any other impacts on the functioning of markets (trading, liquidity formation) and on the access of retail investors to financial markets? If you identify any negative impact with a legislative or regulatory root cause, please identify the piece of legislation affected (MiFID II, MiFIR, Short Selling Regulation, etc.) and elaborate on possible avenues to address it.

As already mentioned above, we foresee a high decrease in securities lending market and therefore impacts on liquidity.

On end investors: Reducing the settlement cycle could also affect retail performance because of the inability to have transactions at the closing and of the loan shrinkage. Decorrelation between the fund liabilities and its assets' settlement cycles with the need for an extra day of funding and therefore more costs & lesser performance for the investor (cash for funding does not provide any remuneration while invested money does). With impact on UCITS cash ratios – with different treatment of the bridge depending on the jurisdiction. It must be reminded that retail clients do not base their investment decisions on the settlement aspect of operations.



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CSDR measures to address settlement fails and buy-in procedures in a T+1 environment could be an obstacle for the negotiation of certain type of instruments/transactions.

Impacts on other regions such as Asia Pacific. Today the T+2 settlement cycle compensates the fact that Europe and Asia have different time-zone, meaning that Asia trades once the European markets are closed therefore allowing enough time for allocation, confirmation, instructions, matching and Net Asset Value calculation. A reduced settlement cycle will have effects on all these processes, which might result in Asia Pacific entities trading elsewhere.

Costs and benefits of a shorter securities settlement cycle

Cost related to operational changes

It is very premature at this stage to have a clear view of all the cost a migration to T+1 would have on market participants and give estimates. A first step would be to clarify the changes that would have to occur for that reduction to be effective. Therefore, we are going to concentrate on the major cost drivers that we expect (operational, technological, implementation).

Q5. What costs would you have to incur in order to implement the technological 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.

It is impossible at this stage to assess the costs a reduction of settlement cycle would incur as we do not know the changes that will be made and features that will be decided (scope, timeline, operational and technical changes etc.). However, based on the above, we reiterate that we see no benefit in such a reduction and anticipate, considering the first issues we assessed, that it will have a high one-off cost for implementation and probably on-going costs. Here below are the categories of costs we identify for a shorter settlement cycle :

- **Human costs:** need for additional staff, night shifts, relocation ... ;
- **Technological costs:** need to have faster tools, automated processes, systems that operate at night ;
- **Operational costs and of implementation:** For example, a decorrelation in the settlement cycle of fund's assets and liabilities will require more funding and therefore more costs;
- **Costs related to fails:** given the level of existing fails despite settlement cycle set at T+2, we can easily guess that there will be an increase of settlement fails and cash penalties considering;
- **Costs due to a lack of liquidity** i.e. a reduction in the securities lending market will necessarily have an impact on market volatility, uncertainty and costs;
- **Cost due to repapering** i.e. prospectuses, agreements with depositories, legal and commercial documentation ...
- **Risk management** costs.

The cost of monitoring fails, the effect on securities lending and all the above costs will outweigh the benefits of automated processes.

It should also be stressed out that these costs will have a much greater impact on smaller players, who will have a much higher hurdle to clear in order to comply with this new deadline, particularly in terms of investment in automation.

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Costs linked to cash penalties

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

Although it's hard at this stage to provide clear estimates, it is inevitable that due to how the European market is organised in terms of infrastructure and to today's level of fails, a move to T+1 will increase settlement fails and potential cash penalties with a probable spike at the beginning of the implementation.

Currently fund managers at Back-Office and Middle-Office levels make use of night batches to ensure settlements overnight between T+1 and T+2. This will be much harder under T+1. It will require changing operational and organisational practices incurring high costs for a poor benefit. It would of course impact settlement efficiency with more fails. The additional one-day safety net would disappear and would require back-offices to make their operations on trade date.

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.

Our European infrastructure organisation and our lack of knowledge on how a move would be set makes it very difficult to assess if the impact on settlement fails and probable cash penalties would decrease over time in a T+1 world. However, as demonstrated by the recent review of CSDR, we see that settlement rate could further be improved. It is however obvious that a reduction of settlement cycle would have an impact on the number of fails exacerbated by the lack of securities lending (also impacted by T+1) which goes counter to CSDR objectives.

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.

- High costs to change our infrastructures (T2S change of cut off);
- Increased cost for securities due to a lack of liquidity;
- Impact on market making activity which will incur some costs ...

More generally, on the question of costs, whether we're talking about permanent or one-off costs, these costs will ultimately be passed on to the end investor.

Benefits

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?

Although we can agree that a reduction of settlement cycle can have a positive impact on the improvement of post-trade systems/processes, since actors will be forced to invest in those systems to respond to their obligations and meet the need for automation, we see no benefits and on the contrary, huge losses, for the buy-side and for the end retail investors who'll have to pay higher costs to support these investments. Furthermore, these automation improvements will have no material effect on the improvement of settlement efficiency which has been dealt with through CSDR.



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We believe the benefits mentioned by ESMA are purely theoretical. And we disagree with the fact that shortening the settlement cycle would reduce counterparty risk as we predict higher fails. We believe it would stress it for all the above arguments and notably the reduction in securities lending.

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 noncleared transactions subject to margin requirements).

We see no possible savings for the buy side. Asset managers are not concerned by the eventual benefits expected from a reduction of collateral. Besides, it seems that the high level of fails that will occur if ever we move to T+1, will in fine be passed on through margin calls.

Q11: If possible, please provide estimates of the benefits that you would expect from T+1 and from T+0, for example the ongoing savings of potentially more automated processes.

See response to question 10. At least in a short term, it will cost much more that what it could save.

Q12: How do you assess the impact that a shorter settlement cycle could have on the liquidity of EU markets (from your perspective and for the market in general)? Please differentiate between T+1 and T+0 where possible.

A move to T+1 will have a high negative impact on the securities lending market and therefore could impact the liquidity in general. Repo and securities lending are key functions of inventory management. They are essential for funding and for dealers/market makers in the way they manage their positions. If settlement of the cash market is shortened, it will put high constraints on securities financing transactions which usually settles on a shorter settlement cycle. And without securities financing transactions we'll see more failures, probably less trades, a reduction in the number of market actors and at the end, impacts on liquidity.

Q13: What would be the benefits for retail clients?

We believe that at the end it will cost retail investors much more for something they do not even consider today.

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.

In first analysis, we see no benefit for the buy-side but very high costs. However, it is impossible as of today to give precise estimates of the balance between costs and benefits for numerous reasons:

- We need to have a clear view on how the market will be set/structured in a T+1 world to be able to make clear estimates;
- As it is a global project that impacts all actors of the trading and settlement chain, we need more time to have a global view of the changes to be made;
- We need to see how the US market has transitioned to this new settlement cycle to have precise knowledge of the consequences on liquidity, on investors, on infrastructures before being able to make an impact assessment for our market.

How and when to move to a shorter securities settlement cycle

No move should be made until we have a clear understanding of all the consequences such a move had on the US market. Furthermore, a chain analysis is required, which we cannot be carried out in



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a short timeframe. A move to T+1 needs to be assessed jointly with all the actors throughout the chain of settlement without rushing the steps.

Q15: Please describe the main steps that you would envisage to achieve a 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.

We believe that it's too soon to talk about the legislative calendar that would be fit for the implementation of a shorter settlement cycle as all the operational and costs issues has not sufficiently been assessed at this stage and as it has not yet been decided if a move would be beneficial. In fact, if we decide to move to a shorter settlement cycle, we first need to estimate how we should adapt our market, see how much it will cost, see if the benefits outweigh the costs and then, in a very last phase, envisage a calendar. On our side, and as previously stated, we see no benefit for our industry and high costs and therefore asks authorities to take time to assess the impact such a move will have compared to its potential benefits.

Q16: If the EU institutions were 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?

See our answer to question 15.

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 view a more adequate scope?

As previously mentioned, we do not favor a shorter settlement cycle no matter what type of instruments concerned.

However, if a move is decided, we believe the scope should be restricted to article 5.2 of CSDR. Furthermore, a one-time approach should be favoured. A progressive approach would complexify it all. The difficulty will be for all countries to be ready on the same time.

Q18: Is it feasible to have different settlement cycles across different instruments? Yes/No, please elaborate.

It is already the case today for some instrument like some funds. However we would push to stick to CSDR scope and have a "big bang" approach.

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? Would it be feasible/advisable to have different migration times for different products/markets/assets? If yes, please elaborate.

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?

No, transactions excluded from CSDR shall still be excluded in case of a move to T+1. However, further analysis on this point should be made if and when we'll have sufficient knowledge of the structural changes.



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International developments on settlement cycles and their impact on the Union's capital markets

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.

As the US hasn't moved to T+1 yet, it is very difficult to anticipate with certainty the impacts it will have but we can provide some thoughts:

- Impact on **the settlement process** because of the mismatch in settlement cycle and the one-day lag where the obligation of one party to the trade may be met before the other party's obligation is met: risk of counterparties' exposure, liquidity management.
- **Operational challenges:** allocation/confirmation. Increase of costs and difference between US and EU in the setting of markets prices and valuations. Overlapping working hours between US and EU.
- **ETFs** : Rules on fund liquidity in the UCITS regulation may be breached due to liquidity inflows caused by the misalignment (US securities of a US fund based in the EU has been redeemed but the fund settles on a T+2 basis...). Difference between the settlement of the underlying and the settlement of the unit. This gap will generate a need for funding and additional risk meaning higher costs that will finally impact the end client via a wider spread and less competitive prices.
- For **fund units**, need to validate the asset value early on T+1 or execute the settlement at T+1 based on estimated value that will be adjusted later. Both solutions having an impact on end investors. These issues may be higher for mixed funds (US + Europe + Asia).
- Impact on **FX transactions:** risk that the transaction is not funded in time.
- **Securities lending:** fund will need to be returned on a shorter timescale. It will probably provoke an increase in suspense and, worst case scenario, in systematic buy-ins. This will probably lead to a reduction of securities lending transactions or an increase in collateral.
- Impacts on **securities transactions and dividends:** for events like rights issues where the deadline for giving instructions is one the registration date of the shareholder's right. For dividends the record date will need to be brought forward by one day to correspond to the registration date. This could increase the number of claims and breaches which could have an impact on compliance with payment dates and withholding tax.

Anyway, we suggest waiting and see the consequences the US move will have before considering it for our own markets and bearing in mind that EU markets are extremely fragmented compared to the US.

As for other markets and notably UK and Switzerland, who are also considering a T+1 move, the impact assessment hasn't been made yet in view of how quick the ESMA CfE was released and given that the interest of moving to T+1 has only recently come to the fore given the US move. However, and that is particularly true for EU and UK, they have significant interdependencies between each other with, for example, up to 20% of UK equity funds invested in European equities. It is fair to say that, even though there's no timeline impacts because of these jurisdictions being on the same time zone, any misalignment between them will have huge consequences. That is why, if we decide to embrace the T+1 settlement cycle, we need the transition to be harmonised between these jurisdictions. If failing to do so, any competitive advantage (if any) would be outweighed by the costs of managing yet another settlement misalignment.

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



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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.

Here below are the legislative or regulatory action that could be taken in order to reduce the impact T+1 in the US will have in the EU:

- EU authorities and the ECB in particular, should request CLS supervisors, or CLS members to react to the industry's request for later cut-offs. In fact, current deadline on CLS platform will mean that a significant portion of FX trades will settle bilaterally outside CLS, meaning loss of netting benefits and more worryingly loss of the PVP mechanism reducing settlement risk.
- CSDR cash penalties regime and the buy-in regime shall be amended, both to provide relief when the US migrates to T+1 and to smooth a potential transition for the EU to T+1 (ex: fails on ETF transactions, because of the misalignment). As the CSDR review is at its end, maybe amendments could be brought through a level 2/level 3 text.
- Under CSDR Revue's provisional agreement, ESMA is mandated to draft regulatory technical standards 18 months after the entry into force of the text to precise notably 1) measures to be taken by investment firms in order to limit the number of settlement fails, 2) the details of the measures to encourage and incentivise the timely settlement of transactions. The drafting of these RTS could be an opportunity for the industry to raise the T+1 issue and for ESMA to take it into account notably by granting an easing in terms of penalties. Furthermore, after the entry into force of the amending regulation, we urge the Commission to consider the impact of the move to T+1 (either by the US, the EU or any other regulation) when considering the adoption of a delegated act regarding buy-in procedures.
- Authorities should precise how cash breaches resulting from trading T+1 shares will be managed (From an operational standpoint, ETF issuers will prefer to be long cash when trading US securities, even if that means breaching cash limits). Measures should be taken to give relief on cash breaches and borrowing limits.

If a move to T+1 is agreed, we want to stress how important it is that the UK and the EU move together to avoid a second misalignment.

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

We believe that harmonization of settlement cycles between different jurisdictions is indeed a good thing to achieve if it's done in coordination between those same jurisdictions. Unfortunately, the US decided to move without considering other jurisdictions. Now that they formalised their move, the EU shouldn't rush into a shortened settlement cycle just to align itself with the US and without thoroughly considering the impact. If we ever consider changing our settlement cycle, it is vital for the EU, the UK and other jurisdictions to consider these changes jointly. Moreover, this move would only be successful if all actors of the chain are being involved in defining the project (i.e. Intermediaries, FMs, investment companies, EU and non-EU investors) along with the various authorities who must play an important role notably in coordinating their efforts.

However, before considering a move to T+1 and a global harmonisation, we would suggest trying to harmonise the European market as a first step (operationally with CSDs, currencies, CCPs and then on a regulatory standpoint).

We believe it would have been useful and beneficial for other jurisdiction to postpone their move to T+1 in order to let others prepare themselves and have a coordinated move.



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

First, on a short term we believe that the US move will certainly weaken the EU's position internationally. Moreover, the EU's market fragmentation is also an obstacle. A first step, as already mentioned, should be to rationalise capital markets in the EU meaning rationalise the number of market players in order for the project to be viable: one CSD and one currency.

In the long run it will force actors to invest in new tools and enhance their performance. However, the EU finds itself in a position where the choice has practically been made for her and will have no choice than to invest in its tools, not to strengthen its position internationally but to remain competitive and not be left behind.

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.

As mentioned above, the EU market has nothing to do with the US market in terms of infrastructures. It is much more fragmented, with 26 CSDs compared to two in the US, 16 CCPs versus one, different securities settlement systems and market currency non-aligned trading hours and disparities in terms of legal and regulatory frameworks. As such, EU's adaptation to the US shorter settlement cycle will not be sufficiently facilitated. It should also be noted that many actors have no activity in the US and will therefore need to prepare from scratch. This is particularly true for smaller actors for whom the transition could be hugely detrimental.

Q26. Would different settlement cycles in the EU and other non-EU jurisdictions be a viable option?

The question of the viability of having different settlement cycles between EU and non-EU jurisdictions is irrelevant regarding the US in the sense that the EU has no choice but to live with it. The US and Canada will move to a t+1 settlement cycle in May 2024, leaving the EU no time to prepare for a potential move to T+1 within these deadlines. A harmonised reflexion on the subject would have been positive.

However, we do not believe that a misalignment between jurisdictions would be so detrimental that Europe would have to rush to T+1. Even though having different settlement cycles between jurisdiction is not ideal we need to find more reasons to consider T+1 than just the need for alignment considering the efforts such a move would require from the whole industry. Benefits must outweigh the operational constraints if we want the move to be a success which, at this stage, is not the case. It is also essential we draw the benefits and consequences this move will have on the US before considering it in Europe.

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.

Today, particular attention is paid to preparing for the transition to T+1 in the US. As such it is extremely difficult for actors to make a complete cost/benefit analysis and give estimates of a potential move in Europe. We suggest to wait and see how the US will succeed in changing its settlement cycle before deciding if, when and how EU should transition to T+1. This will allow us to get sufficient figures, a clear view on the impact the shift has on trading behaviours, liquidity and so on.



SHORTENING THE SETTLEMENT CYCLE

Finally, European authorities should keep in mind that EU legislative process is extremely complicated and that once a legislative/regulatory choice has been made, it is all the more complicated to go backwards.



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