5 October 2023
ESMA74-2119945925-1689

Reply form

on the call for evidence on shortening of the settlement cycle

Responding to this paper

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

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

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

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

Instructions

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

- Insert your responses to the questions in the Consultation Paper in this reply form.
- Please do not remove tags of the type < ESMA_QUESTION_SETT_0>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
- When you have drafted your responses, save the reply form according to the following convention: ESMA_CP1_SETT _nameofrespondent.

  For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA_CP1_SETT _ABCD.
- Upload the Word reply form containing your responses to ESMA's website (**pdf documents will not be considered except for annexes**). All contributions should be submitted online at *www.esma.europa.eu* under the heading *'Your input - Consultations'.*

Publication of responses

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

Data protection

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

Who should read this paper?

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

1 General information about respondent

Name of the company / organisation	Association of Global Custodians – European Focus Committee
Activity	Credit institutions, CSDs, investment firms, market operators, e-money institutions, UCITS management companies, AIFs
Are you representing an association?	☒
Country / Region	Europe

2 Questions

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

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

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

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

<ESMA_QUESTION_SETT_1>

a. **T+1**

A T+1 settlement cycle would in effect require settlement to start a few hours after markets close. In other words, there would be little or no time left for the pre-settlement process. Compression of the settlement cycle – and the capacity of processes and operations to adapt to this compression - would be complicated by the following overarching factors:

Complexity of and interdependencies within the post-trade ecosystem

It is important to address the implications of this on the entire post-trade "ecosystem" – not just on intermediaries in isolation – due to the many connections and interdependencies in the broader ecosystem. We attempt to depict – by way of example – the many kinds of players who are affected within this ecosystem:

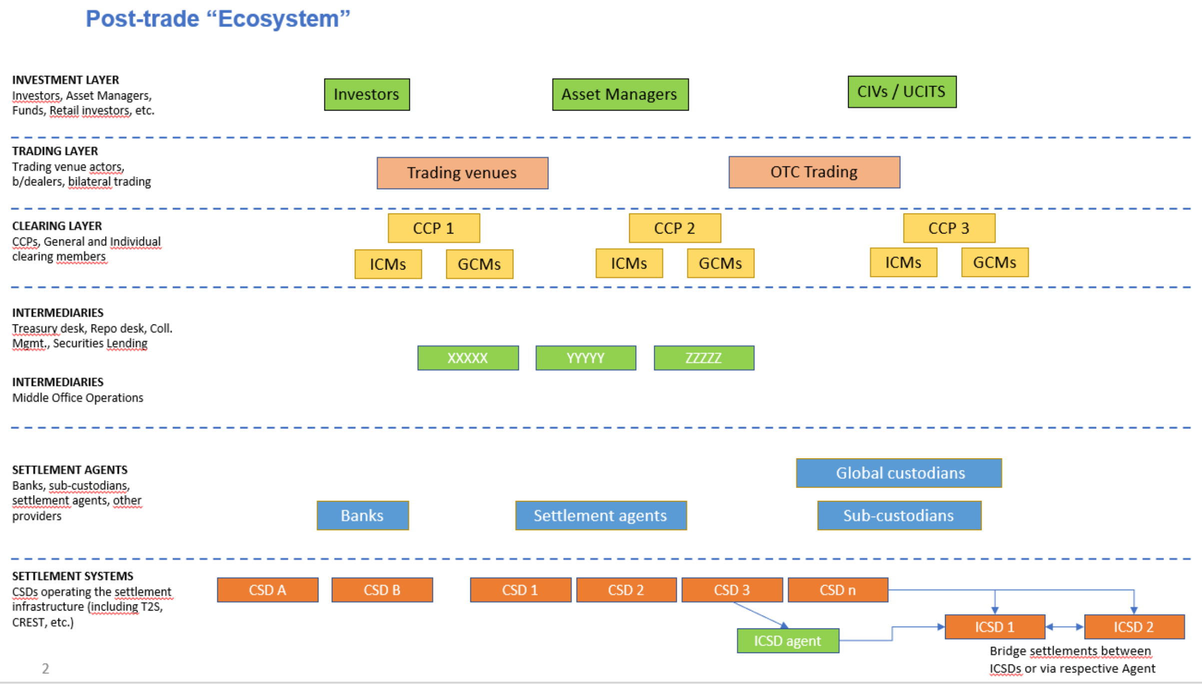


Diagram 1

The connections and interdependencies throughout the entire lifecycle – from trading through to settlement - have the potential to be bottlenecks inhibiting settlement acceleration: in some places the process isn't only slowed down by individual processing steps, but could require queries to and interventions by other actors "up the chain". It's important to recognize delays in this context, for example as a consequence of operational and credit risk controls, which can be compounded by a cascade effect where the chain of custody is attenuated. We attempt to depict this dynamic here:

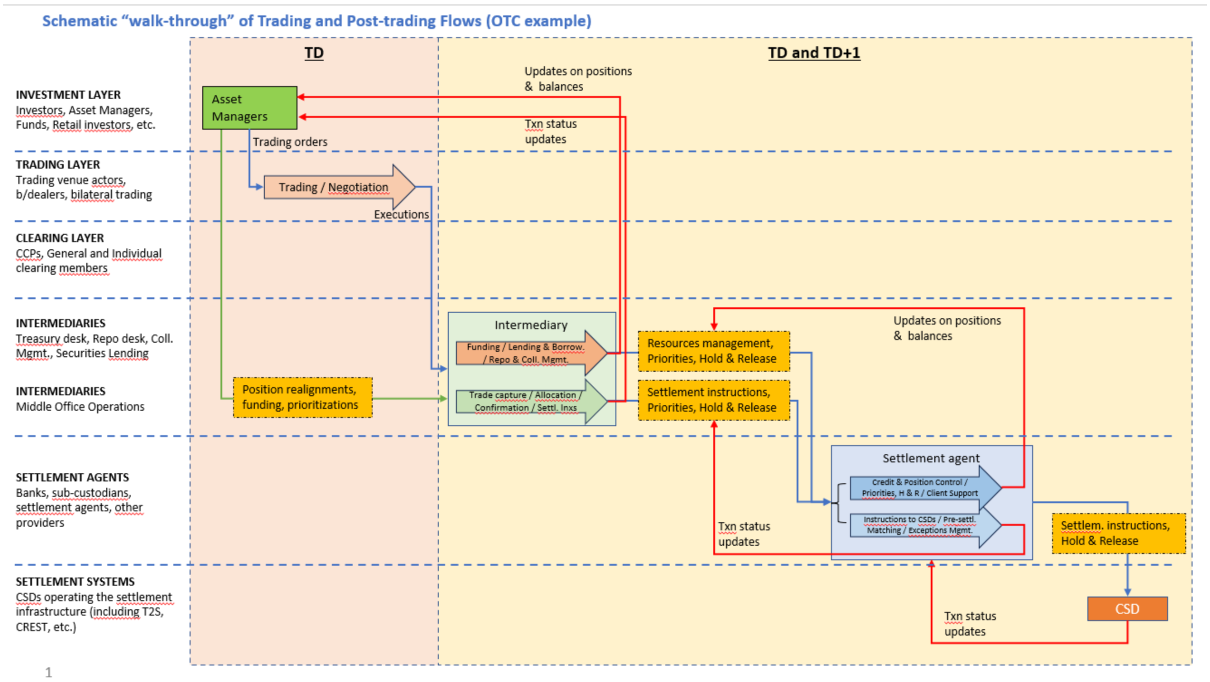


Diagram 2

This diagram shows the numerous processes that occur to facilitate settlement as well as ancillary activities (e.g., adequacy of funding, repo, collateral management, stock lending, forex, etc.) that bear directly on settlement and – together – determine whether a settlement instruction should be released onward to the next intermediary or CSD in the chain and eventually whether the settlement can be executed as intended by the original instructing parties.

A T+1 settlement cycle will impact the processes and operations of all stakeholders in the EU's securities markets, including trading counterparties, settlement agents / custodians, market infrastructure operators (such as the ECB) and investors. A holistic view must be taken in order to best accommodate compression of timeframes across all relevant processes: the difficulty is compounded where one process may need to complete its run before another can begin, and is further compounded if reconciliation breaks or other problems arise.

The most important point is that no one process or action may in itself be determinative: moreover, processes may operate in parallel and yet combine to yield a result that determines whether an instruction will be held or released, and a problem or shortfall that may be identified may be referred back to the previous intermediary or trading counterparty in the chain for query and resolution. The net effect is that custodians/settlement agents entirely depend on correct instructions being transmitted by all parties throughout the chain

– especially if there is an expectation of processing these instructions on an STP-basis. The possibility – and necessity – of intervention by intermediaries, including the need for addressing any inadequacies in resources or funding, will not go away – even if improvements are made in automation by all actors throughout the chain. Since the resolution of a problem may reside at a decision-making level further up the chain, including potentially a trading counterparty, STP processing cannot be seen as the only resolving factor.

We attempt to depict these various processes in parallel – for both guarantee and non-guaranteed markets – in the following diagrams attached in **Appendix 1**. We emphasise that these diagrams are intended to show processes that either overlap with others or can only begin after previous processes have completed, including showing timings leading into night-cycles.

Because T+1 would remove a full day to complete these processes before entering the night settlement window, a significant portion of settlements inevitably will be processed during the day of settlement with less optimization.

Unless action can be taken to substantially reduce the time needed for the post-trade / pre-settlement processes, such as allocations, trade matching and creation of settlement instructions, as well as improve inventory management, a move to T+1, will exacerbate challenges faced today in performing the processes that we have depicted.

For example, a large number of trades are executed in the run up to market close. The start of T2S's securities settlement overnight process is 20.00 CET for T2S. ICSDs and non-T2S markets begin night-time settlement processing at times that may be before or after T2S's. We understand that approximately 80% of cleared trades settle through the overnight batch, which suggests that there will be a need for CCPs and clearing members to revise timing schedules (including with respect to margin presumably). A move to T+1 obviously will create further challenges for trading counterparties operating outside the European time-zones. Putting pressure on the front-end, some exchanges offer extended trading hours on trade-date.

Assumptions and timings surrounding all of these and other processes will need to be revisited in order to asses not just whether they can be made more efficient but also to gauge how they interact with and affect the other processes depicted in our diagrams. By way of example, whether an exchange should permit extended trading hours, as some do today, should be validated in view of the loss of one day to process instructions necessary for settlement. At the other end of the chain, settlement engines, e.g., T2S, may need to move cut-offs to a later time of day.

Complexity and fragmentation of EEA markets

European markets are fragmented with a large number of FMIs operating across EU Member States and the EEA. Local requirements and rules (such as insolvency law and withholding tax) are not harmonised. This is compounded by a complex regulatory environment and different levels of implementations of EU legislation intended to harmonise practices.

Some instruments can be settled in multiple CSDs within the EU and internationally, resulting in a complex settlement process, where often several intermediate settlements need to take place to reach the final counterparty of a trade. Cross-border settlement is a challenge today: for example, for some multi-listed instruments CSD participants are required to realign securities between the “home” market and the “alternate” market so that settlement can take place. This process can be complex and can lead to delays.

Against this background, even a T+2 settlement can sometimes be a challenge: from time-to-time requests are made to settle on a T+3 basis, in order to avoid fails and related penalties.

EU markets are international

The global nature of investors means that investors transacting and operating in the EU’s securities markets will be doing so outside of the EU time-zone. In a move to T+1, U.S. investors in particular will have a limited window on trade date to allocate / confirm / instruct their trades in time to make the overnight settlement batch, which will be crucially important as they will have only a limited window on ISD to review and resolve any exceptions.

Manual and fragmented market practices

Due in part to the region’s complexity and fragmentation - but due to other causes as well - a large number of relevant processes are still manual or are fragmented, which must be addressed if the EU’s settlement cycle is shortened to T+1. For purposes of addressing and optimizing market practices, it is necessary to assess two streams of processes that, as described above in the simplified processing workflow, occur throughout the chain effectively in parallel: (1) settlement instruction processes and (2) resource management processes.

(1) Settlement instruction processing:

- **Allocation & Confirmation**: In a T+1 environment, the allocation and confirmation process will likely need to take place on trade date in order to allow sufficient time for settlement instructions to cascade through the custody chain and reach the CSD prior to its cut-off deadline. Because there would be very little time to discover and correct any errors/issues, which could lead to a potential failure (e.g., mismatched trade or settlement date, place of settlement etc.), consistently applied automation will be needed to facilitate straight-through processing. This automation must begin at the level of the trading parties (sell-side and buy-side) so that exceptions can be resolved quickly. In today's T+2 environment, allocation and confirmation processes are already challenged due to issues such as (i) manual processes, and (ii) counterparties located in a different time-zone, which can lead to allocations being completed on T+1. As a result, currently, not all processes complete on Trade Date, and not all breaks are identified and resolved on Trade Date, either, with the process rolling into T+1.

- **Settlement agent/custodian processes:** in addition to allocation and confirmation stage, which is decisive in triggering the settlement process in the first place, the transmission of settlement instructions to the settlement agents/custodians is an important 'first step' in the settlement process. Any latency or inaccuracy will put pressure on what are already today time-sensitive processes, that can lead to delays in matching and ultimately settlement. Settlement agents'/custodians' controls include performing various integrity checks such as sanction screening, cash/credit provision controls and validation of settlement instruction messaging formats before releasing the clients' instructions for matching at CSDs ahead of the CSDs' instruction cut-off times: all of this makes the timely and accurate transmission of the instructions for the trading parties fundamental. If the client or the client of the client is in a different time zone (e.g., US), the processing window in a T+1 settlement cycle will be very limited (e.g., just under an hour). If a mismatch occurs, there will be little or no time available for corrections. In today's T+2 environment around 54% of trades settle in the T2S overnight batch, which starts at 20.00 on S-1. If this level of efficiency cannot be maintained in a T+1 environment, more settlements will be processed during the daytime on ISD, with less optimization, which seems likely to pose a risk to settlement efficiency and impede the flow of liquidity. Taking clearing into account, as noted above, in today's T+2 environment, about 80% of cleared trades settle through the overnight batch, which *ceteris paribus* seems likely to drop significantly with compression to T+1. This also would impact overnight batch settlement efficiency and move more into real-time settlement, with optimisation only being done when possible and at a lower frequency.
- **CSD partial settlement practices:** among the 24 CSDs on T2S, auto-partial is only used by 14 CSDs and partial release by 11 CSDs, which means that firms are forced into manual processes to reduce settlement risk and optimize inventory. This adds latency to time sensitive processes and will threaten settlement efficiency.[1]

[1] See, Association for Financial Markets in Europe (AFME*), Improving the Settlement Efficiency Landscape in Europe,* (October 2023) (the "AFME White Paper"). Available at: https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME_SettlementEfficiency2023_07%20final.pdf

- **Continued use of batch processing:** In a T+1 environment it will be essential for matching to be performed by all CSDs in real-time rather than restricted to batches. The limited time available will require quickly exposing exceptions supported by real-time status update messages with reason-codes to identify cause of mismatches or settlement failures, so that resolution can be expedited sufficiently. Batches add latency in the matching and settlement process, reducing time available for remedial action and restricting the flow of inventory: this would be due to parties not being able to quickly turn around positions received in time. The end result would be reduced settlement efficiency. To maximise settlement efficiency, including with respect to the settlement of partials, matching and settlement should be optimised on a near-continuous basis throughout the settlement day, rather than in fixed batches.
- **Sanctions screening:** sanctions screening is a process that is undertaken by parties outside of securities settlement operations: this process tends to have significant manual elements, particularly with regard to assessment and decision making. An issue could be identified, causing a halt to processing, at any time.
- **Credit risk**: managing credit risk involves the same kinds of elements, operating outside of the usual settlement processing flow, as those described above for sanctions screening. Again, the decision-making process is not always possible to be automated as part of the settlement operational activities.

(2) Resource Management

- **Foreign exchange:** “Herstatt risk” occurs when a party may not be able to receive another party’s currency after delivering its own due to the delivery lag between the two currencies traded in the foreign exchange market. PVP (Payment versus Payment) reduces this risk by allowing for the simultaneous delivery of payments associated with both sides of the trade, meaning that one transacting party’s payment instruction in one currency is not “settled” unless the corresponding payment instruction in the counter currency is also settled. However, despite PVP, and despite the centralisation and credit risk absorption roles that CLS Bank play in neutralising FX settlement risk, challenges around FX Settlement Risk remain, which will be exacerbated in a T+1 environment:
    - Time zones: instruction deadlines come from different regions, with some coming very close to the CLS deadline even today: we believe the CLS deadline will need to be changed in order to continue to channel FX settlement through CLS, and to minimise any reduction in the role of CLS.
    - Fund pricing: cut-offs come at different points in the day depending on the currency/counterparty/custodian.
    - CLS Settlement does not support all currencies: according to CLS’s own estimates 60-100 billion of spot FX a day is taking place outside of CLS:

FX settlement taking place away from CLS will clearly need to be addressed as well.
    - Central Banks operational processes and cut-off times need to be analysed: for CLS Settlement to remain relevant in a securities T+1 environment globally, central banks will have to extend opening hours, which will have a knock-on impact to settlement agents'/custodian banks' own cut-off times – which would also need to be extended later in the day.
- **Stock loan recalls:** the process for recalls and the related movement of the securities from a CSD where they are held to where the lender requires them for an onward delivery settlement is broadly done manually. Even in a T+2 environment, there is a limited time window to recall securities so that they can be used to settle an open transaction. Should the broader market move to T+1, securities would need to be recalled on T+0, which, given current manual processes, would be a significant challenge.
- **Cash & Liquidity Management**: intermediaries providing securities services are heavily dependent on client behaviour and efficiency. If clients instruct settlement of trades and fund their accounts on a timely basis, then T+1 impact may be limited, however, even in this "best-case scenario", challenges will still exist. The reduced window for clients to fund and instruct their cash movements will mean Trade-Date processing will be required, which will present a more significant challenge for clients domiciled outside of Europe. In terms of liquidity management, treasury functions may face funding liquidity issues, impacting large positions on less liquid currencies such as CZK and HUF, which have earlier cut-offs on Value Date (VD) than more liquid currencies.
- **Repo, Collateral management:** repo and collateral management have significant impact to resource management – repo and collateral positions may need to be reallocated so as to provide sufficient resources to a delivery transaction, which is complicated if these positions are to be realigned across different CSDs.
- **Securities Finance Transactions (SFTs):** SFTs – which are facilitators of liquidity and settlement efficiency – also have significant impact on resource management: in order for the securities markets to move to T+1, the repo and securities lending markets would potentially need to operate on a T+0 basis: this is not currently realistic as a default assumption (although T+0 occurs today for same day recalls / loans).
- **Reconciliation practices:** Reconciliation is a fundamental process that underpins many stages in the post-trade process chain. It helps ensure integrity between trade capture and back-office systems in addition to reconciling trade executions vs CCP netted transactions. Securities reconciliation helps ensure position adequacy necessary to settle and informs inventory management processes such as depot realignment and stock borrow requirements.

- **Cross-border settlement**: Cross-border settlement, which may be necessary for position realignment, is often slower than standard settlement in a CSD, in part due to different batch processing times and market cutoffs: this may be difficult to compress in time.

In summary, there are multiple levels of interactions and dependencies across all these parallel and interconnected/interdependent processes for settlement instructions management and resource management. It is also important to note that many of these processes require human intervention and specific decision-making steps, and therefore they may be difficult / impossible to fully automate or to sufficiently compress in time.

b. T+0

We refer ESMA to the joint remarks by AGC-EFC and other industry associations ("*ESMA Call for Evidence on Shortening the Settlement Cycle: High-Level Remarks of the European T+1 Industry Task Force"*) (the "Joint Remarks") regarding T+0 concerns. We emphasise that it is premature to assess impact of T+0 to existing processes since fundamental market structure questions would first need to be resolved: if T+0 were implemented on the basis of atomic settlement, for example, the role of existing market infrastructure and intermediaries would need to be revisited in an entirely new paradigm. Obvious questions regarding settlement – when it would occur or even ***whether*** it would occur in the context of a Settlement Finality Directive similar to the one we know today – would need to be dealt with.

<ESMA_QUESTION_SETT_1>

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

<ESMA_QUESTION_SETT_2>

a. Hedging practices: the AGC-EFC defers to other industry associations on impact to hedging practices.
b. We have addressed FX impacts in our response to Question 1.

<ESMA_QUESTION_SETT_2>

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

<ESMA_QUESTION_SETT_3>

Which is your current rate of straight-through processing 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?

ANSWER: The AGC-EFC refers ESMA to the Joint Remarks regarding the provision of data in this respect; we expect some individual AGC members to provide responses as well, including data.

In addition, we emphasise that 'STP' will mean different things depending on where a party sits in the vertical (custody) and horizontal (trading) chain and depending on the role being performed. While each party's capabilities can only really be assessed at their own constituent / functional levels, every step of the "trade to post trade" value change has a dependency on the former, meaning that lack of STP in one link may challenge the next from a timing point of view – despite the fact that the transaction could still be processed 'STP' at the subsequent step / actor in the value chain. It should also be noted that a high percentage of trades will not result in any exceptions or hand-holding post trade / post allocation however may still fail due to lack of inventory.

In addition, with more processes and flows being handled in a tighter timeframe, the impact on IT capacity and resiliency – and the possibility of adding latency – cannot be ignored.

<ESMA_QUESTION_SETT_3>

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

<ESMA_QUESTION_SETT_4>

It is premature to indicate a cost on what has not, as yet, been defined, and prior to necessary assessments being conducted. Industry level changes or improvements which may incur development and implementation costs include, *inter alia*:

One-off costs:

- Changes to CSD processes, e.g., extended deadlines, revised functionality (mandated hold and release, partial settlement, etc.);
- Improved data quality and standardization, such as: use of SSI golden sources and review of settlement instruction templates across all EU markets; and
- Testing.

Ongoing costs:

- Adoption of industry matching and transparency tools / vendor platforms / data repositories such as SSIs.

<ESMA_QUESTION_SETT_4>

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

<ESMA_QUESTION_SETT_5>

The AGC-EFC refers ESMA to the Joint Remarks regarding the provision of data in this respect.

<ESMA_QUESTION_SETT_5>

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

<ESMA_QUESTION_SETT_6>

In our response to Question 1, we outline the various processes and practices that would be affected by and likely need to change due to a move to T+1, each of which inevitably bear on settlement efficiency. It is difficult to estimate individual or collective impacts except to say that some level of degradation seems likely. The more that is done to assess each of the processes and practices mentioned in our response, the more it is possible to pinpoint needed changes with a view to minimising negative impact to settlement efficiency. More specific assessment and prescription will in our view make it possible to estimate increased fail rates. In this connection, AGC-EFC refers ESMA to the Joint Remarks regarding the provision of data in this respect. We would add that the new paradigm that T+0 represents makes any estimates likely impossible unless and until the contours of and roles within a new market structure are defined.

<ESMA_QUESTION_SETT_6>

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

<ESMA_QUESTION_SETT_7>

The AGC-EFC believes that a key objective for any move to T+1 should be minimise degradation of settlement efficiency. Such a move will require extensive preparations involving all parties, including market infrastructure and the buy-side. Assuming such preparations are effected, and an appropriate time frame is chosen for implementation, then the AGC-EFC believes that it will be possible for any temporary reduction in settlement efficiency to be subsequently overcome.

It will be important to learn from the U.S. and Canadian markets whether fails increase, although in the U.S. there could be more stock dumps and "kick-backs" which will make it difficult to equate. Canada is a bilaterally matching market like EU so this may be a better comparison for European markets. The Indian market saw fails increase in the short-term and now has normalised to pre-T+1 levels, but the Indian market operates entirely differently compared to EU markets and is predominantly domestic.

<ESMA_QUESTION_SETT_7>

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

<ESMA_QUESTION_SETT_8>

This is a wider discussion beyond what the AGC-EFC is prepared to address: the AGC-EFC therefore defers to other industry associations on impacts beyond post-trade, however, we note that if liquidity in the market is negatively impacted by the inability of liquidity providers to source inventory, and if lenders become reluctant to lend securities due to having to recall much faster to avoid fails on their own deliveries, higher costs are likely to be the result for investors and issuers - especially in less liquid markets and/or where it is difficult to find counterparties in stressed market conditions.

<ESMA_QUESTION_SETT_8>

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

<ESMA_QUESTION_SETT_9>

The AGC-EFC sees a fundamental benefit of shortening the settlement cycle as being the greater alignment of traded positions and settled positions. For the relationship between buyers and sellers, this translates into a reduction of counterparty risk. For the relationship between issuers and investors, this creates the possibility for improvements in the processes of shareholder identification, and of the exercise of shareholder rights (notably, voting at general meetings), since there would be greater alignment between the entities that have an economic interest in securities and the entities that have the practical ability to exercise shareholder rights.

The AGC-EFC will leave to others to advise as to whether collateral requirements would be reduced and liquidity improved (we remain concerned about challenges to liquidity management by clients posed by T+1, as mentioned in previous answers).

As ESMA suggests, the international context cannot be ignored. We believe that a lack of harmonisation of settlement cycles between the European Union and such major jurisdictions as the UK and the US would create significant problems and risks for market participants.

Accordingly, any move by the European Union that delivers increased harmonisation, or that avoids a lack of harmonisation, will deliver significant benefits.

The benefits of harmonisation would be spread widely among all market participants that have cross-border activity, and among all activities that have a cross-border aspect. There will, for example, be benefits for fund managers that have to manage fund with assets in different jurisdictions. From a specific custodian perspective, we would like to highlight the issues and risks relating to corporate action processing that would arise when securities that are traded on different exchanges with different standard settlement cycles. Further harmonisation of market practices induced by the shortening of settlement cycles will be beneficial to the streamlining and the efficiency of custody processes (i.e., reducing complexities and eliminating the need for multiplicity of operational processes for different market specificities, thus leading to cost saving and operational risk reduction.

However, to be considered a success, a move to T+1 must demonstrably benefit the region's securities markets, investors and other relevant stakeholders. All parties must have confidence in their ability to execute and operate in a reduced cycle with limited processing time, recognising this may require heavy investment.

Notwithstanding the perceived benefits of reduced settlement risk, counterparty risk and reduction of the cost of collateral, these benefits would be offset in the event that settlement fails increase and transactions continue to settle T+2 (albeit in a T+1 environment). Such unsettled positions would still be subject to margins called by CCPs, continue to increase credit and counterparty risk. Incurring cash penalties would also increase financial risk.

<ESMA_QUESTION_SETT_9>

Q10 :Please quantify the expected savings from an eventual reduction of collateral requirements derived from T+1 and T+0 (for cleared transactions as well as for non-cleared transactions subject to margin requirements).

<ESMA_QUESTION_SETT_10>

The AGC-EFC refers ESMA to the Joint Remarks regarding the provision of data and, in any case, defers to other industry associations more suited to respond to this question. <ESMA_QUESTION_SETT_10>

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

<ESMA_QUESTION_SETT_11>

One of the advantages of moving to T+1 would be a potential reduction in counterparty risk and a reduction in margin requirements (subject to how the CCPs would react and the current margin levels for securities activity over derivatives). This potential reduction of margin would in our view help free-up regulatory capital.

It is difficult to answer further without a clear scope and without defined solutions that will likely incur a multi-year payback vs. investment. As detailed in our response to question 1, there are mutual dependencies throughout the broader industry, i.e., on who parties trade with / settle with / the FMIs they connect to, etc. This means that any "payback" will also be dependent on external parties' own readiness and technical and operational capabilities.

The readiness and smooth operation of the EU ecosystem as a whole will also be decisive – if the structural barriers in the region have not been resolved, then automation by trading parties and custodians could be undermined if challenges at an EU infrastructure level persist (e.g., convoluted cross-border settlement processes, misaligned market cut-offs, lack of RTS, partial settlement, etc). This could add to operating costs.

<ESMA_QUESTION_SETT_11>

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

<ESMA_QUESTION_SETT_12>

The AGC-EFC refers ESMA to the Joint Remarks regarding the provision of data and, in any case, defers to other industry associations more suited to respond to this question. <ESMA_QUESTION_SETT_12>

Q13 : What would be the benefits for retail clients?

<ESMA_QUESTION_SETT_13>

The AGC-EFC refers ESMA to the Joint Remarks regarding the provision of data and, in any case, defers to other industry associations more suited to respond to this question.

<ESMA_QUESTION_SETT_13>

Q14 : How would you weigh the benefits against the costs of moving to a shorter settlement cycle? Please differentiate between a potential move to T+1 and to T+0.

<ESMA_QUESTION_SETT_14>

As noted in our response to Question 11, one of the potential benefits of moving to T+1 would be a potential reduction in counterparty risk and a reduction in margin requirements (subject to how the CCPs react and the current margin levels for securities activity over derivatives). This potential reduction of margin would help to free-up regulatory capital.

A move to T+1 would likely see firms incur significant one-off implementation costs, and additional longer-term / ongoing costs due to changes to operating models / platforms / vendors. This will require significant investment across the industry and therefore a thorough cost-benefit analysis should be undertaken once a scope is proposed whereby all factors can be taken into careful consideration. We would expect smaller market participants to be affected more than larger international players who will likely be in the process of making changes to operating models and platforms as a result of the US moving to T+1 and would have larger reserves to withstand such an investment but it will still be impactful and will divert money away from innovation and other competing priorities which may also include other aspects of regulatory / legal compliance – it is advisable that any move to T+1 in the EU should be considered against the broader regulatory and market change horizon.

<ESMA_QUESTION_SETT_14>

Q15 : Please describe the main steps that you would envisage to achieve an eventual shorter securities settlement cycle. In particular, specify: (i) the regulatory and industry milestones; and (ii) the time needed for each milestone and the proposed ultimate deadline.

<ESMA_QUESTION_SETT_15>

Our answer relates just to a move to T+1, as we do not view a move to T+0 as realistic at this stage.

The main steps that we foresee are the following:

1. A statement by European public authorities that there is the intention to introduce legislative change (amending CSDR Article 5) shortening the standard settlement cycle in Europe for transactions executed on trading venues. Such a statement would be important to generate momentum and to encourage all actors to conduct reviews of the possible changes, in internal systems and processes, and in market practices and standards, that would be necessary to make a move to T+1 a success. Such a statement would also be important for other jurisdictions, including notably the UK, so that plans for moves to T+1 could be aligned to the greatest possible extent, thereby minimising disruption.
2. The introduction by the European Commission of a legislative proposal to amend CSDR Article 5. This proposal could also grant powers to ESMA to introduce a temporary suspension, linked to the migration to T+1, of the CSDR settlement discipline regime.
3. The establishment of a broad industry steering group, for example under the aegis of the European Central Bank's Advisory Group for Market Infrastructures and Collateral (AMI-SeCo), that would discuss and coordinate the detailed modalities and the specific timetable for the migration of individual exchanges and market infrastructures, within the constraints of the deadline set by the amendment to Article 5 of CSDR.

These main steps will need to be complemented by extensive work both by individual institutions and by bodies responsible for establishing market practices and standards. We believe that this work can already start but will be given additional urgency and momentum by the announcement under point 1. above. We would see the current Joint Industry Association Steering Committee on T+1, of which the AGC is a member, as playing a key role in coordinating this work.

We can suggest a sequence of events, however at this stage it's not possible to assign timelines except to say that sufficient time would be needed for each:

1) Public consultation (i.e., this ESMA call for evidence)
2) ESMA's report of findings (expected Q2 / Q3 2024)
3) Decision by EU public authorities on the start of an implementation preparatory phase (with strong governance and broad industry coverage) aimed at detailed analysis and identification of working recommendations for the T+1 migration planning (including discussion about the most suitable migration date)
4) Simultaneous approach:
   - Preparation of delegated regulations – the regulatory technical standards (RTS) (assuming that the CSDR regulation itself will not require an amendment based on the current requirement to settle no later than T+2) including public consultations;

- FMI and vendor discussion / assessment on what technical changes are required for T+1;
- Industry Steerco / Industry playbook drafting to commence

5) FMIs and vendors to publish changes to their systems, processes and T&Cs including a timeframe to implement and test
6) Publication of RTS and ITS, **including the definition of a broadly-supported migration date** (which takes into account the FMI changes / testing schedule)
7) Publication of a comprehensive industry playbook
8) Any legal repapering
9) Any client outreach on the above and other operational process changes
10) FMI technical changes to be implemented and tested and signed off by the relevant NCAs (to avoid a spectacle like the Cash Penalty implementation)
11) E2E industry testing in accordance with a governance schedule
12) Go-live

<ESMA_QUESTION_SETT_15>

Q16 : Assuming that the EU institutions would decide to shorten the securities settlement cycle in the EU, how long would you need to adapt to the new settlement cycle? And in the case of a move to T+0?

<ESMA_QUESTION_SETT_16>

the challenges – as described above - in ensuring sufficient time for full consultation, assessment, development of workable recommendations leading to legislation and regulatory and industry guidance are very significant and, as also described above, very difficult to reduce to an implementation timeframe. Consultation, assessment and development of recommendations will each require extensive input from a very diverse array of stakeholders – from trading counterparties, settlement agents/custodians, FMIs and others. Comparison for this purpose to other jurisdictions, such as the U.S., is inappropriate because the market structure, complexity and other aspects (all as described above) are not comparable, either.

We recommend establishing - as a first priority - a timeline and governance for identifying and addressing all of the dependencies mentioned above in consultation with all relevant EU stakeholders (including international investors into the EU) and through public consultations.

Regarding T+0, we refer to the above-referenced Joint Remarks.

<ESMA_QUESTION_SETT_16>

Q17 : Do you think that the CSDR scope of financial instruments is adequate for a shorter settlement cycle? If not, what would be in your views a more adequate scope?

<ESMA_QUESTION_SETT_17>

The AGC-EFC is of the view that the current scope is appropriate. In particular, transactions that are negotiated privately need to allow parties to establish the ISD as a commercial matter and with full flexibility. There is no reason for this to change.

<ESMA_QUESTION_SETT_17>

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

<ESMA_QUESTION_SETT_18>

It would not be advisable to have different settlement cycles across different instruments where those instruments are executed over regulated venues: the common thread that requires harmonisation is execution over regulated venues.

<ESMA_QUESTION_SETT_18>

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

<ESMA_QUESTION_SETT_19>

Please refer to our answer to Question 18.

<ESMA_QUESTION_SETT_19>

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

<ESMA_QUESTION_SETT_20>

The members of the AGC-EFC are of the view that Article 5 should be amended in level-1 legislation when appropriate in order to specify a settlement cycle of T+1. We acknowledge the Level-1 text can be read to permit a shorter settlement cycle, with the possibility of specifying T+1 in possibly Level 3 regulation, however, given the utmost need to ensure harmonisation and clear binding effect on all relevant stakeholders, we believe it would be best to provide for maximum clarity in Level 1 text.

<ESMA_QUESTION_SETT_20>

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

<ESMA_QUESTION_SETT_21>

The AGC-EFC refers ESMA to the Joint Remarks in this respect. In addition, we make the following points:

- **Securities processing related impact:** For market participants active in securities markets in different parts of the world or across different markets, the time difference in settlement cycles between Europe (T+2) and the US (T+1) can lead to increased settlement risk. The time differences can introduce potential risks related to counterparty exposure and liquidity management and tighter deadlines in trade capture, allocations and confirmations, matching, instruction and reconciliation.

ETFs: In general, where ETFs use global baskets – and where there would be time differences among investors - more pressure will be put on participants. This will present a dilemma for

EMEA based ETFs with global baskets who will need to decide whether they remain on T+2 or move to T+1. The end result could be wider spreads for the investors and potential cash breaches for ETFs operating as UCITS funds.

US focus: since the U.S. will move before any EU decision, the misalignment will exist as of May 2024, so firms will need to develop processes to manage the mismatch without waiting for an EU potential move to T+1. In addition, we note that EU has experienced a difference with the U.S. between 2014 and 2017 (until the US moved to T+2) and also differences within the EU pre-CSDR with the German market already on T+2 when other markets were on T+3.

However, whilst it is very difficult to gauge, there will be impact. Likely areas of impact include:

- Multi-listed instruments: It is still yet to be determined whether U.S. assets settling in a European (I)CSD will be subject to a T+1 or T+2 settlement cycle – realistically this will be a recurring, but resolvable, issue if the EU remains on T+2 and other markets adopt T+1.
- EU / U.S. misalignment: For market participants active in EU and US (or UK) markets, we might expect to see an increase of non-standard settlements requested (i.e., where clients wish to align settlement in EU CSDs with the US on T+1 or conversely to request T+2 in the US to align with the EU CSDs: this will become clearer after May 2024).
- Corporate actions: questions arise as to how to manage the EX date on corporate events (T+2 (EX=RD-1) vs. T+1 EX=RD), i.e. as a principle, Record Date should be the same across markets.

<ESMA_QUESTION_SETT_21>

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

<ESMA_QUESTION_SETT_22>

We would welcome guidance on the settlement convention to be used for multi-listed instruments, e.g., US (or UK) listed instruments that settle in EU (I)CSDs. We also would suggest regulatory coordination is required between the EU and UK to prevent fragmented processes and to avoid duplicative costs to market participants.

<ESMA_QUESTION_SETT_22>

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

<ESMA_QUESTION_SETT_23>

Please refer to our response to Question 9. We believe it will be important to focus on an alignment between the EU and the UK to ensure that any change to the settlement cycle is co-ordinated. It will be very important to have the ICSDs on the same settlement cycle as U.S. (and UK) to prevent matching issues due to ambiguity of settlement cycles. Coordination should also address concerns of liquidity shifting to UK should the UK move ahead of the EU. Coordination should also be undertaken with a goal of preventing participants in both jurisdictions from funding and managing two operationally and technically impactful market implementation programmes in potentially close succession – which would be likely to negatively impact investors in addition to settlement agents/custodians.

<ESMA_QUESTION_SETT_23>

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

<ESMA_QUESTION_SETT_24>

We believe that the principal consideration is harmonisation of settlement cycles. If the EU is out of step with other major jurisdictions who successfully implement shorter settlement cycles, then the EU’s efforts to project itself as integrated with and important in global capital markets will be impacted.

<ESMA_QUESTION_SETT_24>

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

<ESMA_QUESTION_SETT_25>

Yes, but only in part, and only for some categories of market participant. For example, many of the necessary changes at the level of EU market infrastructure will not be affected by the adoption of T+1 in other jurisdictions.

<ESMA_QUESTION_SETT_25>

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

<ESMA_QUESTION_SETT_26>

As in the past, stakeholders will find a way to adapt where there are difficulties and challenges, but this may come with increased complexity, costs and operational risks.

In the short-term, as we experienced between 2014 and 2017, there is no other option, viable or not. However, global products such as ETFs and DRs have grown in popularity in recent years, carrying the possibility that misalignment with the U.S. (possibly UK should it move ahead) will be less viable in the longer term.

Moreover, cross-border transactions with different settlement periods could result in differences in pricing across the same product in different markets, which could increase funding costs and widen spreads.
<ESMA_QUESTION_SETT_26>

Q27 : Please elaborate about any other issue in relation to the shortening of the securities settlement cycle in the EU or in third-country jurisdictions not previously addressed in the Call for Evidence.

<ESMA_QUESTION_SETT_27>

The EU will need to take time upfront ahead of a move to T+1 to understand and address the root cause of settlement inefficiency, improve data methodology to monitor and analyse settlement fails and for operational solutions to be implemented to improve settlement efficiency across each all sectors of the industry.[2]

In addition, the barriers to post-trade integration need to be identified and a clear path to resolve them should be devised (for example, under the ECB AMI-SeCo's oversight), including improvements to cross border settlement, which may require FMI (and even regulatory) changes.

From an implementation point of view, the complexity of EU capital markets, in particular the post-trade environment, should not be underestimated. Twenty-seven markets with varying levels of efficiency and technical capabilities, compounded by different insolvency and securities laws and different tax regimes, will require careful assessment, scoping, planning and execution. In addition, the market cut-offs and batch times across the regions CSDs and T2S will need to be aligned and where appropriate extended, which would increase the technical complexity and testing footprint requirements – all of which will need to be factored into the timeline.

APPENDICES ATTACHED:

- Non-guaranteed trading: T+2 (current) vs. T+1 (future)
- Non-guaranteed trading vs. Guaranteed trading

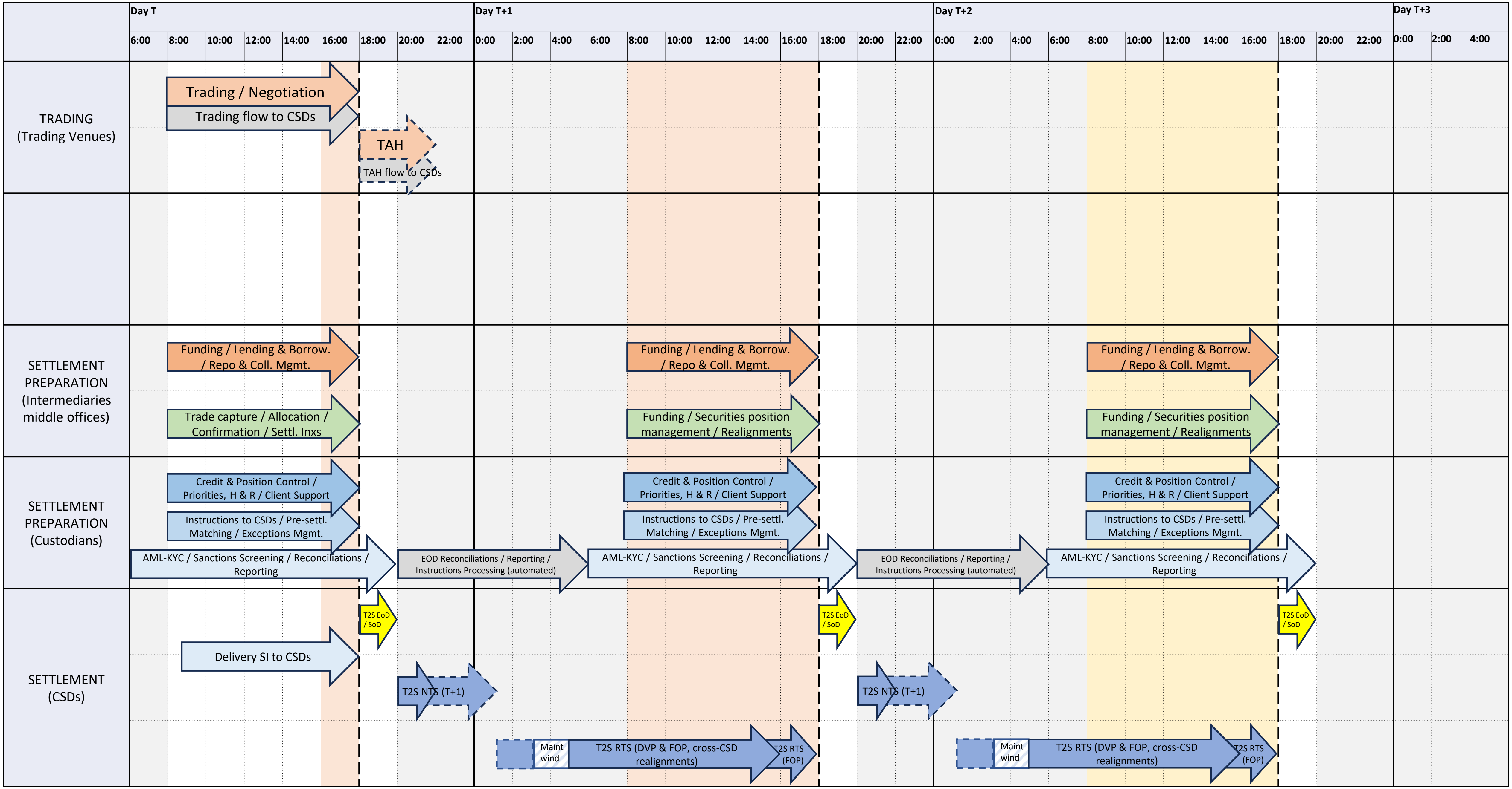
<ESMA_QUESTION_SETT_27>

[2] We refer ESMA to AFME's settlement efficiency recommendations contained in the AFME White Paper as well as recommendations by ICMA.

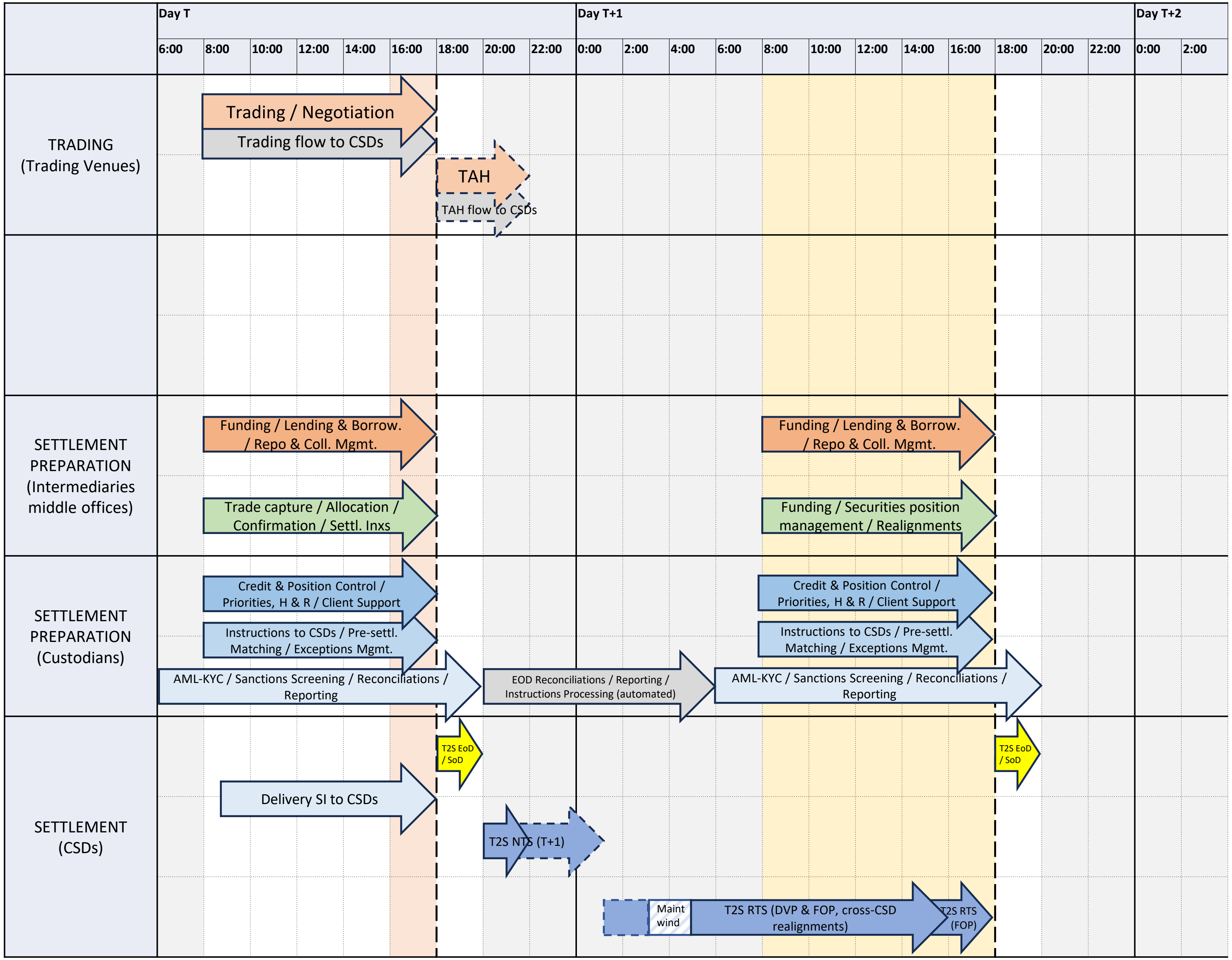
Appendix to AGC submission to ESMA Call for Evidence

- Non-guaranteed trading: T+2 (current) *vs* T+1 (future)
- Non-guaranteed trading *vs* Guaranteed trading

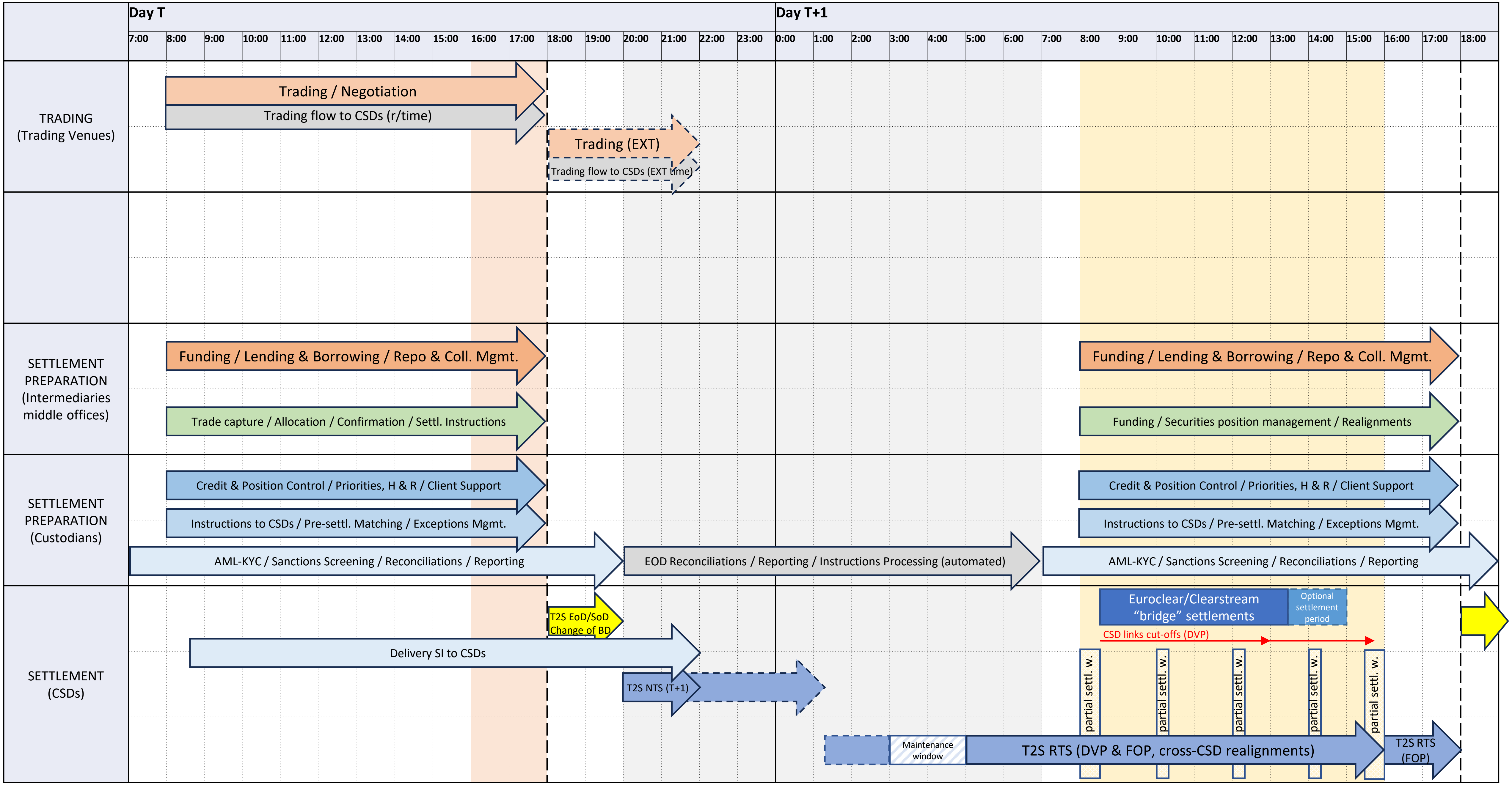
Non-Guaranteed Trading – T+2 settlement cycle



Non-Guaranteed Trading – T+1 settlement cycle



Non-Guaranteed Trading



Guaranteed Trading