Reflections on a EU move to T+1 settlement cycle
High level considerations to have in mind

October 2024 -

Since the United States (US), Canada and Mexico announced their intention to move from a two-business day settlement after trade date ("T+2") for securities, to a one day settlement cycle ("T+1")[1], the T+1 subject has been in the forefront of the whole trading and post trading eco-system both in the EU, the UK and Switzerland.

Indeed, following the Geffen report in March 2024[2], recommending an effective move to T+1 in the **UK** for December 2027, a **technical Group of industry experts** was set to determine the technical and operational changes necessary for the transition to T+1 in the UK. The taskforce published its Draft Recommendations Report & Consultation[3] on the 27th of September 2024. The final version of these recommendations should be published by the end of 2024 and will give certainty on the final implementation date with a schedule of work covering tasks to be completed between 2025 until the 2027 deadline.

On the **EU**'s side, ESMA launched a call for evidence end of 2023[4] which is to be followed by the publication of its public report Q4 2024. Pending this report, the industry has already set up **working groups**[5] within an EU T+1 Industry Taskforce (EUT1-ITF) which, in the same vein of the UK taskforce, are **reflecting on the operational and technical changes that are needed** for a smooth move to an EU T+1 settlement cycle **as well as on the costs it might entail, with the final aim of formulating a high-level roadmap, including potential timeline, and have a first clear picture of all the prerequisites** before the publication of ESMA's report. All market participants are also actively engaging in numerous exchanges with regulators and with other jurisdictions.

It is therefore safe to say that Commissioner McGuiness' speech during the European Commission's T+1 conference in January 2024 was heard and that actors have adopted a proactive approach. We have also noted ESMA's similar message during its July 2024th public hearing.

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[1] The US announced it in 2021 and Securities and Exchange Commission adopted its rule amendment on 15 February 2023.

[2] Accelerated Settlement Taskforce Report - March 2024

[3] Accelerated Settlement Taskforce, Technical Group – Draft Recommendations Report & Consultation – 27th September 2024.

[4] ESMA call for evidence - on the potential impact of shortening the standard settlement cycle - October 5th, 2023

[5] AFME working groups that are divided in the different following sub-groups managed by various trade association.

- A – Trading [ICMA]
- B – Matching/Confirmation [AFME]
- C – Clearing [EACH]
- D – Settlement [ECSDA/AGC]
- E – Corporate Actions [CEJWG]
- F – Funding/FX [EFAMA/AGC]
- G – Securities Financing [ISLA/ICMA]
- H – Funds (inc ETFs) [BVI/EFAMA]

However, it should clearly be noted that the **US move to T+1 was an industry led project** that was not initiated by the US Securities and Exchange Commission (SEC) and that was **pushed due to specific US market events**[6] which underlined the necessity to reduce settlement risk and improve post trade processes inefficiencies in the US[7]. The **absence of a CSDR regime** being an additional factor that led to such a reform. It took the US a huge amount of preparation, training, documentation, communication, and a 9-month industry testing[8].

We believe an EU T+1 would not present the same benefits and challenges than the US (nor the UK) and **call for authorities to make a thorough impact assessment** having in mind the following points.

I. Market fragmentation : the complexity of EU market infrastructures

It is important to consider the significant structural complexities of the European market when reflecting on such a move. It is extremely **fragmented** with 29 central securities depositories (CSDs), 16 central counterparties (CCPs), 14 currencies.

On the contrary, **countries that already moved to a T+1 settlement cycle** (India, China, Canada, the US, Perou, Argentina etc.) **follow a much simpler market infrastructure model**, most of them having one CCP one CSD and one currency. They are not all as internationalised as the EU and some act on a pre-funding model which is not desirable in terms of liquidity impact. Therefore, they cannot be entirely relied upon when predicting how long and how complex it will be for the EU to move to T+1, nor to what extent it will be beneficial.

Above market infrastructures, they bare differences in their tax regime, disparities in terms of their respective legal and regulatory frameworks (with the US possibility for revocability and the EU's CSDR regime), they've got different trading hours and different processes (affirmation for the US against matching in the EU). As such, liquidity can easily vary from one European country to the next and from one stock market to the next and the EU T+1 project will be much more ambitious than in other jurisdictions.

Considering **alignment with UK and Switzerland**, although it may be seen as preferable for simplicity and coordination, it **must not be at the expense of the time needed for the EU to prepare smoothly**. At this stage, we can't say with certainty that a misalignment with the UK will have negative impact on the EU, first as we don't know the exact precisions governing a UK move to T+1 (list of all prerequisites), second, as the subject has not been properly assessed yet, third, UK is highly exposed to EU markets while proportionally, the EU is exposed to a lesser extend to the UK. From a study produced by the IA

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[6] DTCC proposal following the Gamestop market event.

[7] One of the main benefits advanced by the US was the reduction of liquidity needs on the CCP margin costs. On the reduction of liquidity needs for margin calls, the European Association of CCP clearing houses itself estimated a reduction of margins for clearing members at EU CCPs of 0.5% of the current total margin levels for cash equities.

[8] In its recent ex-post report analysing the USA T+1 move : "Securities Services *Evolution 2024* -Disruption and transformation in financial market infrastructures", Citi indicates its "*smooth sailing but harder than expected*".

in October 2023[9], European equities (ex.UK) represent 19,5% of UK equity assets under management whereas UK equities account for 5% of the equity allocation of EU funds.

Therefore, while coordination with other jurisdictions is important, it may take the form of an alignment on the EU's date, which date should pragmatically reflect the 27 multipartite realities. In addition, it should be noted that in its Draft Recommendations Report & Consultation, the UK taskforce considers both a transition to T+1 with EU alignment on the same date and a transition with a different date. In the latter case, the UK taskforce considers exempting some products such as exchange trade products (ETPs) and Eurobond until an EU move happens.

The US move to T+1 last May will also give some elements of reflexion. The question is not only to see how it went but rather to reflect on how EU intermediaries would face a long-term misalignment and notably if it induces different behaviours which would require the EU to move rapidly to a T+1 settlement cycle.

II. Technological cost and implication of moving to T+1

As seen above, the extreme complexity and heterogeneity of settlement processes in the EU will require a **great number of efforts to standardize** them to a greater extent so that an EU T+1 doesn't exacerbate the problems already identified. Such streamlining will take time and resources affecting not only the post-market but the entire transaction chain (all related **processes being accelerated, loans, cash financing, currency exchange** etc.). Accelerating the settlement cycle for EU securities to T+1 increases the risk that securities transactions are not funded in time, recalls will be very complicated to manage in operational terms which may cause a reduction in securities lending transactions and the shorter timeframe will stress allocation and confirmation processes.

T2S and all the CSDs will have to adapt their night-time cycle so that they can process transactions concluded during the day which is not a simple development. This implies that the current governance of T2S should be reviewed to make it more reactive. More generally it will have to be accompanied by **optimization** to make it more attractive and efficient.

Although a move to T+1 may be seen as a catalyst for increasing levels of automation and standardisation in post-trade processes, it will have a cost, cutting back on other important projects, and which will certainly impact small actors who may not be able to follow, reinforcing the dominance of large players to the detriment of smaller ones. Moreover, although it is tempting to have more harmonised and straight through processing (STP) systems, we need to be cautious not to create oligopolistic systems/infrastructures that we'll end up regretting a few years from now (see our experience on data).

[9] The Investment Association Annual Survey "*investment management in the UK 2022-2023*" - October 2023

We see that automation of manual processes, leveraging on alternative tools and technologies, innovation, interoperability, will be key for every sector of the securities industry to meet these reduced timelines while avoiding errors. Developing such tools and proposing alternatives is not a few months process and should not push European actors to turn to existing non-EU solutions, to the detriment of the Union's competitiveness. Noting that in its recent report reflecting on the USA's move, Citi shows that "*the industry is still only two-thirds of its way through its North America T+1 project agenda. With 33% of project work still to be undertaken (mainly in 2025) in the form of further automation as well as additional hiring, the effort and focus on T+1 extends well beyond the transition date.* »

III. Considerations regarding human ressources aspects

One important aspect that is often omitted regards human resources. To remain attractive to investors (Asian investors for instance) and have sufficient time to complete all post-trade processes, the EU will have to reflect on various options such as but not limited to:

- Offshoring;
- introduce night/late shifts with teams in the EU working extended hours (up to 11pm/ midnight) to be able to lengthen the European day;
- have continuous assistance across time zones.

These considerations totally call into question the current HR model in the EU and most be assessed regarding employment law and the impact on EU's attractiveness for foreign investors.

IV. Competitivity and attractivity of EU markets

With the relaunch of the Capital Markets Union (CMU) and the urgent need for massive financing, **Europe has the ambition to boost its competitiveness for savers and attract more capital**[10]. An attractive market for investor is linked to its economic prospects/economic gain, its ease of access and notably in terms of costs and security and in terms of its robustness and certainty of settlement processes. Having **one day less in the settlement cycle does not seem to be a decisive factor** to improve the EU's attractiveness towards investors.

Moreover, the numerous costs and impacts that stakeholders have identified at this stage i.e. an increase in settlement fails which can lead to reputational risk, the reduction of liquidity and the deterioration of prices because of the impact of T+1 on securities lending, the cost of automation, seem to result in a **high-cost project that increases transaction costs and therefore, in the short term, may rather reduce attractiveness for savers than increase it**.

[10] See Enrico Letta's report – "*Much more than a market*" – April 2024; Christian Noyer's report – "*Developing European Capital Markets to finance the future - Proposals for a Savings and Investments Union*" – April 2024; And Mario Draghi's report "*The future of European competitiveness* » - September 2024.

The move to **T+1 should be considered in regards other important project** such as an update of the CSDR penalty regime which is currently under discussion by ESMA (penalty and buy-in) or any other update or introduction of major regulations to **avoid any overlaps**. In any case, any move to T+1 must be implemented while maintaining a level playing field between jurisdictions. As such, the **CSDR penalty regime**, which finds no equivalent in the US in particular, **will have to be reviewed so that EU actors do not bear additional costs compared to other market players and namely penalty costs as well as cost of set up** (dedicated staff, information tools etc.) which would put them at a competitive disadvantage. The same applies to some UCITS provisions regarding cash and borrowing limits for instance that must be well considered with regard to US and UK regulations notably.

In a constructive manner with the aim of limiting the impact of the project, we insist on the fact that Europe must **elaborate a strategic approach, drawing lessons from the US and** other jurisdiction's move to T+1, **carrying out a real impact assessment and cost benefit analysis** with **central consideration for the competitiveness and attractiveness of EU market participants**. We must facilitate discussions with authorities, all stakeholders and other jurisdictions and pay great attention to CSDR and settlement efficiency rules. The timing to complete the T+1 project must be tailored according to the above assessments and taking a holistic approach (i.e that considers the whole value chain). **A coordinated approach between jurisdictions is important (e.g. the EU, the UK and Switzerland), but the European agenda should take into account the alignment of sole jurisdictions (UK, Switzerland) on the multipartite one (the EU)**. Such a move would be feasible and successful provided each sector involved in the settlement chain throughout EU jurisdictions is granted sufficient time to prepare, which may seem ambitious for a number of them (as well as their interconnectedness) before at least **end of 2028**.