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	The Global Association of Central Counterparties, CCP Global
Activity	Associations, professional bodies, industry representatives
Are you representing an association?	☒
Country / Region	International

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>

For Central Counterparties ("CCPs"), the integrity, reliability, and robustness of settlement procedures is a key concern. The impact of a shortening of the settlement cycle is itself not necessarily a heavy impact on CCPs, but doing so may increase pressure on the members and participants of CCPs, various service providers, intermediaries and other Financial Market Infrastructures involved in the settlement and reconciliation process. As part of our response, CCP Global and its Members would like to draw a clear distinction between settlement cycles in the traditional sense, which includes T+3, T+2, and T+1, wherein netting is applied to trades at a fixed point in time, and T+0. Currently, T+0 is not precisely defined within industry discussions at present, but the aspects of it which are typically highlighted, such as immediate "atomic" settlement, make clear that this is a completely different mode of operating. At a minimum, moves to such a T+0 regime necessitate great changes in how legal and practical netting is conducted, and we would urge ESMA and other stakeholders to carefully evaluate the impact of potential definitions of T+0 as these are in some cases radically different to existing market practices and security features.

We would also like to highlight that shortening the settlement cycle can be undertaken with various technological solutions. In particular, Distributed Ledger Technology is not necessary for faster settlement, and indeed may prove to be unsuitable if precision and definitiveness is desired in a rapid manner. Indeed, many CCPs currently have the possibility to move to T+1, or offer this either for a particular market or provide their participants with the ability to select such settlement for specific trades. We would stress that shortening a settlement cycle is complex to arrange; this requires a very large ecosystem of linked systems and interconnected processes across global financial markets to be coordinated.

For T+0, and regardless of asset class, market segment, or instrument type, the impact on the ecosystem, provided that key legal questions around settlement finality are addressed, are:

1. A virtual removal of the need for forward looking margin at CCPs. This is by virtue that all trades settle immediately, with a presumed DvP conducted virtually simultaneously to trade execution.

2. A dramatic increase in liquidity and instrument pre-positioning. As all trades are settled immediately, the entire participant chain must hold funding in advance of every trade. This is the same as pre-funded (intra-day) gross settlement.

3. The impact on processes and operational risk is mixed, and would depend highly on how market participants would practically configure their operations for such settlement speed. It seems reasonable to assume to technology costs for the investments would be substantial.

4. In a T+0 environment, trade adjustments, corrections, and mis-trades would not be possible to execute.

5. Late trading, or offering extended trading hours could be substantially impaired by such a settlement approach, limiting the availability of Financial Market Infrastructure facilitation of their services across time zones.

For T+1, and regardless of asset class, market segment, or instrument type, the effect of shortening the settlement cycle has the following effects:

6. The total amount of forward looking margin (Initial Margin) is lower, as the CCP holds initial margin for a shorter period of time (assuming similar trading across days). Note that this point is not affected by the Margin Period of Risk of the CCP.

7. The funding requirements are higher, as participants must be prepared to meet calls with faster velocity per settlement date in the right currency. The impact of this will vary by participant, in particular if they are ultimately funding their Union currency trading from a Third Country.

8. The operational risk is increased, since there is less time to prepare for settlement.

9. The overlap between late trading and the start of Night-Time Settlement (NTS) for T+1 is a challenged for CCPs. They need to align on the time for netting and the sending of settlement instructions amongst involved market participants.

Given that acceleration of settlement creates a (partial) trade-off between the enormous cost savings and benefits of multilateral netting with finalising settlement as close to trading, we would stress that in general, any move to change settlement timing requires careful consideration and industry coordination or balance these features.

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

If pre-funded (intra-day) gross settlement was enacted, this would have a dramatically negative effect on intermediaries' liquidity management, and consequently their pricing or willingness or serve in those roles.

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

We would not agree with all the benefits as outlined. In particular, while T+0 settlement would in essence reduce counterparty risk, there would be a renewal of execution risk wherein all-to-all trading would be substantially impaired if counterparties do not trust that execution would follow. Furthermore, it is not clear that the reduction in collateral held would not be outweighed by the increased liquidity pressures. Given the distinction to be made, we focus out further comments to the potential benefits of T+1.

As per the US Equity market analysis, outlined in US T+1 documentation, primary benefits of a T+1 cycle include an increase in the overall efficiency of the securities markets, risk mitigation, create better use of capital, and promote financial stability, provided that the appropriate balance is achieved between increasing efficiencies and mitigating risk.

Several of these benefits could be in principle achieved in the EU:

1. **Reduction of risk**, particularly during periods of high volume and volatility: All things being equal shorter cycles may be better than longer cycles. Over time, and based on

specific conditions of each market, reducing the volume of unsettled trades over a single trading day and the time between trade and settlement may bring about a reduction in systemic, counterparty, and operational risks.

2. **Reduction in funding requirements**: With firms' market and counterparty exposure over the settlement period reduced, there is a possible reduction in margin requirements alloing clearing members to better manage their funding requirements.

3. **Modernisation and standardisation**: operational efficiencies include modernising the ecosystem and standardising processes which could eventually be beneficial for the clearing and bilateral markets. Among others, market participants have an opportunity to standardize and synchronize processes in order to facilitate greater transparency and real-time / near-time access to critical data across the financial ecosystem

<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>

TYPE YOUR TEXT HERE

<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>

Automation, where possible, is nearly always a long-term positive for efficiency, but this is not settlement cycle dependent (although very short settlement cycles create a greater urgency to use automation). CCPs are well aware that their ability to support huge and complex trading by hundreds or thousands of accounts in a reliable manner is dependent on a large degree of automation. Automation, when designed, built, and maintained appropriately, is also more reliable.

Automation of the procedures and stages of the trade cycle have other benefits beyond efficiency; they also enable various types of transparency to be yielded in a manner that bespoke or ill-organised trade tickets and idiosyncratic settlements could not. CCPs deploy this, for instance, in their risk management as they can determine open trades precisely and promptly, and evaluate them at current market prices. Supervisors and participants themselves also yield the benefit of prompt reports and a verifiable record of their activity.

<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>

From a purely CCP perspective, we do not think that a move to T+1 will have an impact on the liquidity of the market for better or worse. We would however note that this does put increased strain of market participants that manage their trading and cross-currency funding requirements, including across time zones. For T+0, we assume that this would have a negative effect on liquidity, given the serious effect that gross settlement and pre-positioning would require.

<ESMA_QUESTION_SETT_12>

Q13 : What would be the benefits for retail clients?

<ESMA_QUESTION_SETT_13>

TYPE YOUR TEXT HERE

<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>

We believe there will not only be one-time costs for making adjustments to IT systems and procedures to T+1, but also running costs as a result of higher operational efforts to process more buy-ins. Weighing the benefits against the costs would require a proper impact analysis beforehand which requires time.

<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>

The primary step is for regulatory decision and indication of the desired end-state, including a time line to do so. As noted, it is currently possible for market participants to elect shorter settlement procedures, and it is technically enabled in certain circumstances. Thus, we interpret the question to mean a complete industry move, in which case regulatory clarity and drive is essential. We anticipate it useful for the industry to partake in the creation of a Roadmap.

To help structure this, we would highlight the following steps that would be undertaken by CCPs alongside the broader industry;

- requirements analysis taking into account the requirements of Clearing Members and settlement schedule,
- assessment of impacts on procedures and IT systems,
- streamline the clearing processing between end-of-trading and start-of-settlement (if required by Clearing Members),
- alignment of target schedule with trading venues, Clearing Members and CSDs,
- adjust and potentially de-couple certain system and member reporting processes for the reduced lead up time to settlement (if required by Clearing Members),
- revise the timeline of reporting of pending transactions to their Clearing Members,
- potentially adapt methodologies for margin calculations,
- implement changes on operational processes,
- implement software changes and adjust IT infrastructures from T+2 to T+1 and
- testing, internal and end-to-end with trading venues, Clearing Members and all settlement locations.

<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>

To ensure appropriate coordination and investment and upgrades, we would assume between 18 months to 24 months after the publication in the Official Journal, at a minimum is required. We are basing this on previous harmonisation timelines for moving to T+2 in broad terms.

<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>

For future products on fixed-income securities the settlement date of allocated physical deliveries in government bonds should ideally be kept two business days after the last trading date of the fixed-income futures (large size of transactions).

<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>

Generally speaking, for a CCP it is possible to handle different settlement cycles across different instruments. The settlement cycle is defined technically by the Trading Venue. The impact for the processing on the trade day evening would follow the instruments with the shorter settlement cycle, i.e. T+1. Hence, from a CCP perspective a staggered approach per instrument or instrument type is not beneficial.

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

From a CCP perspective view industry alignment is needed for potential changes of T2S schedules and alignment with UK to avoid any misalignment cycles in Europe.

<ESMA_QUESTION_SETT_22>

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

<ESMA_QUESTION_SETT_23>

TYPE YOUR TEXT HERE

<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>

A transition to T+1 would enforce the pressure to automate post-trade processes which in the end could result in an even higher settlement efficiency than with T+2 and CSDR settlement discipline regime as of today.

<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>

TYPE YOUR TEXT HERE

<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>

This is currently the case, and market participants have organised themselves to work in this manner. We would highlight that there are variations on how failures are treated across the world; in some jurisdictions these are virtually non-existent based on a strong culture and regime for adhering to existing timelines, and in others these occur frequently but with penalties.

<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 call for evidence has a brilliant conceptual graphic explaining the interplay of EU markets with the US. However, we would suggest that ESMA also consider markets in other jurisdictions, most notably eastern time zones in Asia-Pacific that are affected by potential EU changes.

<ESMA_QUESTION_SETT_27>