

Shortening the settlement cycle to T+1 in the EU

AMAFI and FPM's high-level position

In a tense geopolitical environment and a context of technological and environmental disruption, the development of deep, liquid and competitive EU capital markets is critical for the financing of the Union's economy.

In preparation of the future EU legislative agenda, several initiatives¹ are underway to propose reforms to develop EU capital markets. In a context where the US, Canada and India have decided to shorten their settlement cycle to from T+2 to T+1 (effective end of May 2024 for the sooner), European jurisdictions (the EU, the UK and Switzerland) have launched workstreams aimed at assessing the appropriateness of also moving to T+1.

In their answers to the recent ESMA's call for evidence on this topic², FPM³ and AMAFI⁴ have emphasised their reserves on the arguments put forward to shorten the settlement cycle. We stressed that (i) the return on investment for market intermediaries would be extremely low and that (ii) there is no evidence that T+1 would improve the competitiveness and attractiveness of EU markets.

With this in mind, we are particularly worried by the impression that EU authorities seem to have made their decision to move forward with T+1 even before a thorough assessment of the implications of such move is available, as was apparent in a recent speech by Commissioner McGuinness⁵. We consider that the move to T+1 decided in the US, Canada and India and the advanced thinking in the UK and Switzerland do not automatically oblige the Union to follow the same path, and certainly not quickly. On the contrary, careful consideration should be given to the Union's specific market structure as well as the operational and legal challenges that such a move would entail.

Even if the underlying objective were to foster the integration of EU capital markets, it should be assessed whether a move to T+1 will truly help advance this objective, and whether it is truly the most effective way to do so.

In light of the above, the purpose of this note⁶ is first to describe the main reasons why EU market intermediaries are not in favour of such a reform and, in a second part, to elaborate on the key aspects that should be taken into account as prerequisites for a decision by the European Commission to move forward.

¹ We are referring to the work of the Eurogroup, the E. Letta report, the M. Draghi report and the ESMA Task Force.

² <https://www.esma.europa.eu/press-news/consultations/call-evidence-shortening-settlement-cycle>

³ For further details please refer to [FPM's answer](#)

⁴ For further details please refer to AMAFI's answer ([AMAFI/23-85](#))

⁵ [Shortening the settlement cycle in the EU \(europa.eu\)](#)

⁶ The present document does not provide comments on T+0 settlement, either on an end of business day basis or atomic, as we are of the view that such a change would be premature. It would require a much more fundamental change than moving to T+1, which the legacy infrastructures and technologies would probably not bear. Even if we leave aside the significant technological challenge it would represent, legitimate questions exist as to whether T+0 settlement is desirable, as it could result in fewer netting possibilities and the need to prefund each individual trade, leading to prohibitively high liquidity and funding costs and negatively impacting the economics of financial markets.

1. THE UNCERTAIN BENEFIT OF T+1

The move to T+1 in the EU should be carefully assessed considering (i) its cost/benefit for market participants, (ii) its impact on the attractiveness of EU markets and (iii) its relevance considering the complexity and specificities of EU markets compared to other jurisdictions.

1. *A cost/benefit analysis should be carried out with central consideration for the competitiveness of EU market participants.*

A move to T+1 requires a thorough cost/benefit analysis of all aspects involved, from the impact on the competitiveness of EU market intermediaries to the technical issues which may appear off-putting but are essential in these matters. In our view, the cost/benefit ratio of a move to T+1 in the EU is unsatisfactory:

- The alleged benefit of reducing margin calls is in fact very minimal as highlighted by the European Association of CCP Clearing Houses (EACH) who estimates a reduction in margins for clearing members of EU CCPs of 0.5%⁷ of current total margins⁸.
- The savings are in stark contrast to the huge cost of implementation, as investments would be needed not only from market participants (notably investment firms and assets managers) but also from market infrastructures (trading venues, clearing houses, CSDs and payment systems). **This will weigh on the competitiveness of the EU financial industry, with no corresponding benefits, at a time where it is widely admitted that it is already facing a challenge in keeping up with global competition. One should ask whether this project is a good use of resources while the EU is facing many challenges to increase retail participation in capital markets, ensure the financing of European companies or address environmental issues.**
- The impact of such a move on investors located in unfavorable time zones should also be factored in, as should be the possible deterioration of liquidity⁹, especially on the corporate bond markets, which will result in higher costs for investors and less favorable financing conditions for firms.

2. *Attractiveness of EU markets*

In our opinion, the attractiveness of European markets is not primarily linked to the settlement cycle, but to their fundamental economic prospects (hope of economic gain), their accessibility (in terms of ease, cost and security) and the robustness of their settlement processes (the capacity of markets participants to settle trades with a high degree of certainty).

The shortening of the settlement cycle does not contribute to these fundamentals prospects and creates instead additional obstacles, for investors located in unfavorable time zones but also through the deterioration of liquidity and subsequent increase in costs.

As mentioned above, the substantial investment needed and the high associated costs create the risk of failing to meet investors' expectations. Investors, even those not directly impacted by the alignment of the settlement cycle with other markets, could be dissuaded from accessing the European market.

It is worth considering whether maintaining a T+2 settlement cycle may instead boost the attractiveness of EU markets for some foreign investors (notably Asian ones) given the time zone difference, whereas T+1 could have a negative impact in this respect. Taiwan for instance, which adopted a T+1 settlement cycle in the past moved back to T+2 because of the difficulties it created for foreign investors.

⁷ For further details please refer to [EACH answer](#) to ESMA's call for evidence

⁸ This is indeed consistent with the fact that margin calls on cash trades are only a small proportion of the margins market participants need to post, the bulk of the volume being on derivatives.

⁹ Indeed, on several products, and notably on corporate bonds, liquidity providers cannot trade solely on their inventories. They often offer prices on bonds that they do not own, but for which they have a view on the borrowing cost (that they integrate in their offer). If, and once, the transaction is done, they then need to secure a borrowing transaction quickly enough to ensure the settlement of the transaction with their own client. If such borrowing transaction is concluded the next day, then it will have to settle T+1. If it is concluded on T+2, it will have to be immediately settled. Reducing the settlement cycle would obviously limit the time available for liquidity providers to source liquidity, which would have a variety of effects: it would impact the quality of settlement, but also the availability and cost of liquidity offered to investors.

3. The complexity and specificity of European market infrastructures

The European markets have many specific features compared to other markets. Europe has 18 CCPs and 31 CSDs, whereas countries such as the US, Canada, the UK, and certain Asian countries have only one CCP, and one CSD. The diversity and fragmentation of the European market is also reflected in the number of competent authorities, different tax regimes and 14 different currencies used within the EU. Consequently, the operational challenges and costs associated with moving to T+1 in Europe are significantly higher than in jurisdictions with more integrated markets.

To conclude this section, we believe that the EU should not rush to T+1 and should take the time to evaluate in detail its benefits and costs, in particular in terms of attractiveness and competitiveness of EU capital markets and their participants, including companies and local and international investors, while following closely the impacts of the US move and any development in the UK.

We should avoid a situation where a rush to T+1 may result in a massive misallocation of EU resources (human and capital), which given the scale and cost of the project could ultimately harm EU firms and markets. In other words, T+1 would not contribute per se to the competitiveness of the EU and the development of the CMU nor would it give any competitive edge to EU financial markets and EU players.

2. CRITICAL PREREQUISITES TO T+1

If the decision were made to transition to T+1, we strongly advocate to consider the following prerequisites to ensure a smooth transition towards a shorter settlement cycle.

1. Coordination with the UK and Switzerland

Such coordination is essential to guarantee that transitions to T+1 are ideally simultaneous and, in case they were not, that they occur within boundaries that respect each jurisdiction. An example would be ensuring that if the UK transitions before the EU, it does so for UK securities only (those recorded in the books of CREST) and does not affect EU securities to avoid impacts on the EU settlement processes.

2. Adapt the application of CSDR to the challenges of T+1

T+1 implementation should also be assessed in light of CSDR's current and revised rules on settlement discipline (penalty and buy-in). There is no coherence so far between ESMA's approach to raise CSDR penalties and a smooth transition to T+1, as such the shortening of settlement cycle is likely to cause a higher volume of settlement issues, at least in the short term, which will be met by higher penalties.

3. Thoroughly restructure the settlement process in the EU, notably Target 2 Securities (T2S) and Target

The complexity and heterogeneity of settlement processes in the European Union are major factors contributing to the persistent fragmentation of the EU markets. Upstream, it is necessary to map out the divergent processes among CSDs and consider which efforts could be made to standardize them to the greatest extent possible. Before transitioning to T+1, it is essential to undertake the inevitably lengthy process of identifying and harmonizing these heterogeneous processes.

An analysis of the EU settlement processes needs to be conducted to identify where and why they diverge. One should also consider that the fragmentation in the EU may not be so much on the settlement processes themselves thanks to CSDR but rather on the custody. The risk is that T+1 will miss the point or even exacerbate the problems without correcting the differences. Only when the causes of heterogeneity in the EU are identified, will it be possible to decide whether T+1 is the solution to the problem.

Moreover, moving to T+1 would require a fundamental overhaul of the current functioning of T2S to enable greater integration of settlement processes in the EU. This implies that the current governance of T2S should be reviewed to make it more reactive.



About AMAFI

[AMAFI](#) is the trade association representing financial markets' participants of the sell-side industry located in France. It has a wide and diverse membership of more than 170 global and local institutions notably investment firms, credit institutions, broker-dealers, exchanges and private banks. They operate in all market segments, such as equities, bonds and derivatives including commodities derivatives. AMAFI represents and supports its members at national, European and international levels, from the drafting of the legislation to its implementation. Through our work, we seek to promote a regulatory framework that enables the development of sound, efficient and competitive capital markets for the benefit of investors, businesses and the economy in general.

About FPM

[FRANCE POST-MARCHE](#) (previously named AFTI) was created in 1990, with the goal of gathering members of organizations in the Banking and Financial Services industry involved in activities with financial instruments and specifically post trade activities.

FRANCE POST-MARCHE is an integral part of the French, European and international financial ecosystem, supporting the increasingly interdependent players in the French financial marketplace.

FRANCE POST-MARCHE (FPM) is the leading association representing the post-trade business in France and Europe.

FPM represents through its 82 members a wide range of activities: market infrastructures, custodians, account-keepers and depositaries, issuer services, reporting, and data management services, with a total staff of 28,000 in Europe of which 16,000 in France.

Our members acting as financial intermediaries account for 26% of the European market.