ESMA
European Securities and Markets Authority

5 October 2023
ESMA74-2119945925-1616

Call for evidence

On shortening 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:

1. respond to the question stated;
2. indicate the specific question to which the comment relates;
3. contain a clear rationale; and
4. 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'.

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.

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1 Executive Summary

Reasons for publication

In 2014, CSDR introduced for the first time in the EU a requirement for all transactions in transferable securities which are executed on trading venues to be settled by no later than the second business day after the trading takes place (commonly referred to as a “T+2” settlement cycle). Due to recent developments, the question of shortening the securities settlement cycle has emerged.

Through this call for evidence, ESMA is seeking to collect stakeholders’ views as well as quantitative evidence to form a better understanding of the issue and help ESMA to then produce an assessment of the costs and benefits linked to the potential reduction of the securities settlement cycle in the EU. In parallel to this call for evidence, ESMA is consulting central banks as well as the T2S operator on what would be the impact of a shorter settlement cycle for the operation of T2S.

Contents

In this call for evidence, ESMA is seeking feedback on the following issues:

- What would be the impact of the reduction of the securities settlement cycle in the operations of market players;
- What would be the benefits and the costs that a shorter securities settlement cycle would bring;
- If it is concluded that a mandatory shorter settlement cycle should be imposed, how and when a shorter settlement cycle could be achieved;
- What are the impacts on the EU’s capital markets resulting from international developments related to securities settlement.

Next Steps

ESMA will consider the feedback it receives from this consultation in Q1 2024 and intends to submit to the European Commission and publish a final report in Q4 2024 at the latest. Feedback received with regards to section 3.4, might require ESMA to report to the Commission on some of the specific topics therein as soon as possible after the closing of the public consultation.

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2 Background

1. Central Securities Depositories (CSDs) are systemically important institutions for financial markets. Among other tasks, they operate securities settlement systems, enabling the settlement of trades, i.e., the exchange of the security against cash. Until the adoption of the Central Securities Depositories Regulation[1] (CSDR) in 2014, the length of the securities settlement cycle (the time between trade and settlement) was not harmonised in the EU.

2. This lack of harmonisation was identified by the European Commission as a risk for safe cross-border settlement. For this reason, in 2014, CSDR introduced for the first time in the EU a requirement for all transactions in transferable securities which are executed on trading venues to be settled by no later than the second business day after the trading takes place[2]. This requirement is commonly referred to as a "T+2" settlement cycle.

3. Since CSDR entered into force, financial markets and technology have continued to evolve. Market events in the past years have prompted some jurisdictions outside the EU to shorten their settlement cycles to T+1 (or even T+0) in order to reduce counterparty risk (and thus collateral requirements) and the risks linked to excessive volatility between trade and settlement. On the technological side, Distributed Ledger Technology (DLT) could open up opportunities for efficiency improvements in the entire trading and post-trading life-cycle, including potentially instantaneous settlement.

4. In this context, and while remaining technologically neutral in its approach to policy making, ESMA is of the view that the question of the current duration of the settlement cycle is an important one for the EU.

5. Shortening the settlement cycle in the EU might bring benefits in terms of increased efficiency and reduction of counterparty credit risk and the related collateral needs. This might also increase the competitiveness and the attractiveness of EU financial markets, which are goals pursued by the Capital Markets Union.

6. Shortening the securities settlement cycle will require increased operational efficiency by market participants to adapt their current post-trade processes, including possibly phasing out manual interventions, as well as their funding practices, especially for FX transactions. Importantly, unlike other jurisdictions, the EU has a complex post-trade landscape with a high number of market infrastructures (CSDs, CCPs and trading

[1] Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories
[2] Article 5 of CSDR.

venues), several currencies, matching model[3], and a common settlement platform (T2S[4]) which does not support all currency denominations of the instruments traded and settled in the EU and in which not all EU CSDs participate.

7. It is also worth mentioning the robust and detailed framework for settlement set out in CSDR (including the settlement discilpline requirements) and the Settlement Finality Directive that coexists with a lack of harmonisation of national securities laws. In this respect, shortening the settlement cycle in the EU might be operationally more complex than in jurisdictions with centralised post-trade financial markets infrastructure, with no settlement discipline and harmonised securities law. Therefore, considerations of costs and benefits should be mindful of the specificities of the EU landscape.

8. Through this call for evidence, ESMA is seeking to collect stakeholders' views supported by quantitative evidence to form a better understanding of the issue and produce an assessment of the costs and benefits linked to the harmonised shortening of the securities settlement cycle in the EU. ESMA is looking to consider all the possibilities for a shotened settlement cycle, including both T+1 and T+0. In their answers to the different questions put forward in this call for evidence, respondents are invited to elaborate on T+1 and on T+0, allowing ESMA to assess both situations. In parallel to this call for evidence, ESMA is consulting central banks as well as the T2S operator and the T2S oversight function on what would be the impact of a shorter settlement cycle for the operation of T2S.

[3] Which differs from the affirmation model used in other jurisdictions.
[4] https://www.ecb.europa.eu/paym/target/t2s/html/index.en.html

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3 Call for evidence

9. There is no legal or regulatory impediment in the EU to operate settlement cycles shorter than T+2. However, regulatory intervention can be necessary to achieve this objective in a harmonised way, given that it could be difficult for a single operator to implement the change if all others do not follow.

10. At the same time, a decision to shorten the securities settlement cycle in the EU needs to be based on a proper assessment of the costs and benefits that such a change would bring to all users of financial markets in the EU. The objective of this call for evidence is to complement the information at ESMA's disposal in order to produce such an assessment.

11. ESMA has divided this call for evidence into four separate sections which look into the following aspects of the assessment:

- What would be the impact of the reduction of the settlement cycle on the operations of market players, as well as any other impact that such reduction could be expected to have on trading, liquidity formation or on access to financial markets by investors;

- What would be the costs (differentiating between one-off costs linked to operational changes required for operating in accordance with a shorter settlement cycle and ongoing costs linked to a potential increase of settlement fails or securities lending fees) and the benefits that a shorter securities settlement cycle would bring;

- If it is concluded that a mandatory shorter settlement cycle should be imposed, how and by when could it be achieved;

- What are the impacts on the EU's capital markets resulting from international developments related to securities settlement.

12. Respondents are invited to share as much quantitative evidence as possible in support of their responses to the different questions asked throughout this call for evidence.

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

13. The two business days between the trading date and the "intended settlement date"[5] are used by the different market players involved in the transaction (e.g. CSD, CCP, trading venue, intermediaries such as the custodian and the broker, the buy-side) to carry out all the post-trade processes necessary for efficient settlement.

14. Those processes include matching of the details of both sides of the transaction, allocation, affirmation and confirmation, across different entities and IT platforms. Furthermore, in some circumstances, the effective settlement of a transaction routinely requires ancillary post-trade processes to take place in conjunction with the specific transaction, such as netting of positions, funding of treasury and securities flows and matching of the currency of payments on the currency markets.

15. When harmonising the securities settlement cycle in the EU to T+2, CSDR introduced through the "settlement discipline regime" a series of requirements to prevent settlement fails[6], in particular through harmonised requirements for sending written allocations and confirmations as well as requirements on automation of settlement instructions.

16. Further shortening the intended settlement date to "the first business day after the trading takes place" (i.e. T+1) would significantly reduce the time available for these post-trade processes, which most likely would have to be finalised by T+0 (i.e. the day on which the trade is executed). The reduction of time available for post-trade processes would be even more acute if the settlement cycle were reduced to T+0 (i.e. the day on which trading takes place).

17. In recent interactions with industry experts, ESMA has gathered feedback on how the shortening of the settlement cycle would impact the operations of different market players. From this initial feedback it seems that the level of readiness for a settlement cycle shorter than T+2 is uneven. The closer the market player is to the actual settlement, the readier and less impacted it would be and vice versa.

18. While many CSDs and CCPs have already indicated to ESMA that shortening the settlement cycle would have no major impact for them (some CCPs already operate in

[5] Article 5 of CSDR
[6] Chapter II of RTS 2018/1229 on settlement discipline https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1579691857526&uri=CELEX:32018R1229

T+1 for some asset classes, and CSDs seem to have the technology in place to allow for a settlement cycle as short as T+0), a few asset management industry representatives have raised concerns with regard to the costs they would incur and the difficulties it would entail for them to operate in a shorter settlement cycle environment. ESMA is conscious that this can be particularly relevant for Exchange Traded Funds (ETFs).

19. Through this first section of the call for evidence, ESMA wishes to gain a detailed understanding of how the different market players involved in the trading, lending and settlement of transactions would be impacted from an operational point of view by a shortening of the securities settlement cycle in the EU across a broad spectrum of instruments and asset classes (in both cases, i.e. T+1 and T+0).

20. In particular, ESMA is interested in learning whether there are incompressible processes, or unacceptable risks involved in the settlement cycle compression; if they are specific to a particular product or asset class or transaction; and if they are due to technology, market practice or regulatory constraints.

21. Beyond post-trade processes and the current operations of market participants, ESMA would like to gather views from stakeholders on potential impacts that the shortening of the securities settlement cycle could have on the funcioning of trading and on retail access to financial markets (which is one of the objectives of the CMU). In this specific case, ESMA would like to insist on the importance of hearing views from those entities that are further down the settlement chain, such as market participants, settlement internalisers, intermediaries and wholesale and retail investors.

Q1. Please describe the impacts on the processes and operations which could result from compressing the settlement cycle 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, focusing on 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, types of transaction or settlement instructions (e.g. DvP[7], FoP[8]) or financial instrument class that would be severely impacted or no longer feasible in a T+1 and in a T+0 environment.

[7] Delivery versus payment
[8] Free of payment

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

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?

Q3. What is your current rate of straight-through processing (STP[9]), 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?

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

3.2 Costs and benefits of a shorter securities settlement cycle

Cost related to operational changes

22. Establishing and maintaining post-trade processes entails inherent costs but those would in turn ensure efficient settlement and reduce market, operational or counterparty risks (through the different post-trade processes already mentioned, such as allocation, affirmation and confirmation as well as through clearing where relevant).

23. ESMA is aware that since the adoption of CSDR, market players in the EU have invested in systems and processes allowing them to comply with all the settlement discipline requirements (including but not limited to settlement fails reporting and systems for the management of cash penalties).

24. Reducing the duration of the securities settlement cycle by changing the maximum intended settlement date in CSDR would entail costs for market players related to the phasing out of manual processes or investing in further automation, among other cost-incurring measures. Such costs could be passed-on to clients/end investors (including

[9] Not involving any manual intervention.

retail clients). Furthermore, anu changes to the current settlement cycle duration could have an impact on the compliance with other pieces of EU legislation.

25. Most of the obstacles hampering the reduction of the settlement cycle to T+1 would also exist in case of a reduction to T+0. In particular, a settlement cycle reduction to T+0 would be heavily dependent on the automation and digitalisation of other activities in the invesment value chain, such as payment and settlement systems and FX processing.

26. Through the responses to the questions in the previous section, ESMA should be able to obtain a detailed overview of the operational changes required by stakeholders to work in an environment with a shorter settlement cycle. The following questions focus on the costs that those changes would represent. In particular, ESMA would like to know whether the investments and processes to meet the T+2 deadline are also compatible with shorter cycles, and what would be the implications in terms of IT investments and organisation of the work (e.g., working shifts, controls, ancillary services).

27. ESMA invites respondents to identify processes that might not be possible to shorten (or that could be shortened at an excessive cost) that would discourage an eventual move to T+1 or to T+0, differentiating between both as relevant.

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

Costs linked to cash penalties

28. Settlement efficiency in the EU is a high priority for ESMA. The already mentioned EU settlement discipline framework introduced a series of measures to address settlement fails[10]. These include, among others, cash penalties applicable in case of settlement fails. In recent interactions with the industry, ESMA has been made aware of the risk of increased settlement fails if a shorter settlement cycle was implemented in the EU without sufficient time for stakeholders to prepare for it and the consequent cost increase produced by cash penalties.

29. ESMA would like to gather further quantitative evidence on how settlement fails would increase if a shorter settlement cycle was to be implemented in the EU in the short,

[10] Chapter III of RTS 2018/1229 on settlement discipline https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1579691857526&uri=CELEX:32018R1229

medium and long term. Also, views are sought on the additional amount of cash penalties that may be incurred by market participants due to increased settlement fails potentially caused by a move to a shorter settlement cycle.

30. In particular, ESMA is keen to understand whether all or part of that increase would be temporary, and if part of that increase would be permanent, whether it would be driven by structural reasons. Where relevant, please explain if these are general or asset class/instrument/ trade specific.

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

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.

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.

Benefits

31. ESMA is also aware of the theoretical benefits of moving to a shorter settlement cycle, including: the reduction of counterparty risk; encouraging additional automation and STP (contributing to increased settlement efficiency); lower collateral requirements (and thus possible liquidity improvements); elimination of issues associated with unharmonised settlement cycles, promoting international harmonisation and increasing the attractiveness of EU markets.

32. ESMA notes that some of the benefits of reducing the settlement cycle could be even greater in the scenario that T+0 is adopted (less counterparty risk, capital and liquidity savings, etc.). Therefore, ESMA asks stakeholders to identify separately the benefits of T+0 and T+1 vis-a-vis T+2.

33. Apart from the above-mentioned benefits, a look at the international context shows that the shift to T+1 is imminent in some jurisdictions (US) while others are considering it (UK[11]). From that angle, ESMA understands that the alignment of the settlement cycle

[11] The Accelerated Settlement Taskforce, chaired by Charlie Geffen, was launched by the Chancellor on 9 December 2022 to explore the potential for faster settlement of financial trades in the UK https://www.gov.uk/government/publications/accelerated-settlement-taskforce#:~:text=The%20Accelerated%20Settlement%20Taskforce%2C%20chaired,financial%20trades%20in%20the%20UK.

with the cycles of other jurisdictions with which EU financial market participants have important links could provide additional benefits and requests the views of market participants on them.

34. Although some of these benefits might be more difficult to quantify than others, ESMA is seeking the views from stakeholders on how these benefits would weigh in the global assessment on moving to a shorter settlement cycle.

35. Where relevant please explain if these are general or asset class/instrument/ trade specific.

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?

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).

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

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

Q13: What would be the benefits for retail clients?

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.

3.3 How and when to move to a shorter securities settlement cycle

36. The analysis regarding an potential transition to a shorter settlement cycle in the EU would be incomplete without addressing the timing and process of that transition.

37. Taking the US and Canada as an example[12], ESMA understands that sufficient time should precede the implementation of a shorter settlement cycle in the EU to

[12] T1_Industry_Implementation_Playbook_vF.pdf (sifma.org)

accommodate a public consultation on the proposed changes to the legal framework, updates to trading and post-trade processes by market participants (trade processing, asset servicing, documentation, securities lending, prime brokerage, funding and liquidity arrangements, etc.), testing under the shortened settlement cycle, and effective migration.

38. In that regard, ESMA is aware of existing industry initiatives to advise on whether the EU should transition to a shorter settlement cycle and if so, how and when it should happen[13].

39. Along the same line, ESMA requested the views of its Post-trade Consultative Working Group on how a potential transition to T+1 should be carried out in the EU. The recommendations received can be grouped as follows:

40. Any decision to shorten the settlement cycle in the EU should be based on a proper cost-benefit analysis which should also consider the competitiveness of EU markets and should take into consideration the experience of other jurisdictions having already moved to shorter settlement cycles (e.g. the US, India or China).

41. The complexity of the EU landscape would require an initiative from EU regulators to trigger a coordinated industry transition to a shorter settlement cycle.

42. Some stakeholders considered that regulators should foster the conditions for the voluntary adoption of a shorter settlement cycle rather than imposing it.

43. ESMA is keen to gather the views from a broad range of market participants regarding the timing and process of a potential transition to a shorter settlement cycle in the EU, encouraging respondents to be as specific as possible and differentiate between T+1 and T+0 scenarios. Where relevant, please explain if these are general or asset class/instrument/trade specific.

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

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

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[13] For example, see https://www.afme.eu/news/press-releases/details/afme-announces-establishment-of-t1-industry-taskforce-

44. Currently, the intended settlement date requirement in Article 5 of CSDR applies to transactions in transferable securities, money market instruments, units in collective investment undertakings and emission allowances which are executed on trading venues. Furthermore, this same Article excludes from the obligation to settle on T+2 transactions which are negotiated privately but executed on a trading venue, transactions which are executed bilaterally but reported to a trading venue and the first transaction where the transferable securities concerned are subject to initial recording in book-entry form.

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

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

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

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

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

45. An increasing number of jurisdictions have transitioned or are transitioning to shorter settlement cycles, while the EU is still operating in T+2. In particular, China has transitioned to T+0 on Interbank Market government bonds and India has already moved to T+1 for shares traded on exchange, while the US and Canada are planning to do it for

a broader set of financial instruments by the end of May 2024[14]. Other jurisdictions may follow – for instance, the UK is assessing a possible move to T+1 or T+0[15].

46. Given the high level of interaction with third-country jurisdictions in general and with the US and the UK in particular[16], it is necessary to identify the impacts of the coexistence of T+2 and shorter settlement cycles for EU stakeholders, as well as the possible solutions to address those impacts.

47. ESMA has undertaken a preliminary fact-finding exercise across its consultative bodies in the post-trade area to identify the foreseeable impacts of this misalignment. The primary objective is to determine whether any legislative or regulatory action could smoothen these impacts for EU market participants.

48. The main consequences identified at this stage can be grouped as follows:

- EU market participants must carry out all settlement-related processes in US financial instruments during night-time: as shown in the graph below, EU market participants would have to undertake the allocation and affirmation processes derived from the execution of "market-on-close" orders out of office hours (between 22:00 and 3:00 AM CET) so that the settlement process can be finalised by 21:30 the next trading day[17].

[14] However, there are several differences between the EU regulatory landscape and the US move to T+1. For example, not all financial instruments are covered. There are exemptions to the T+1 rules:

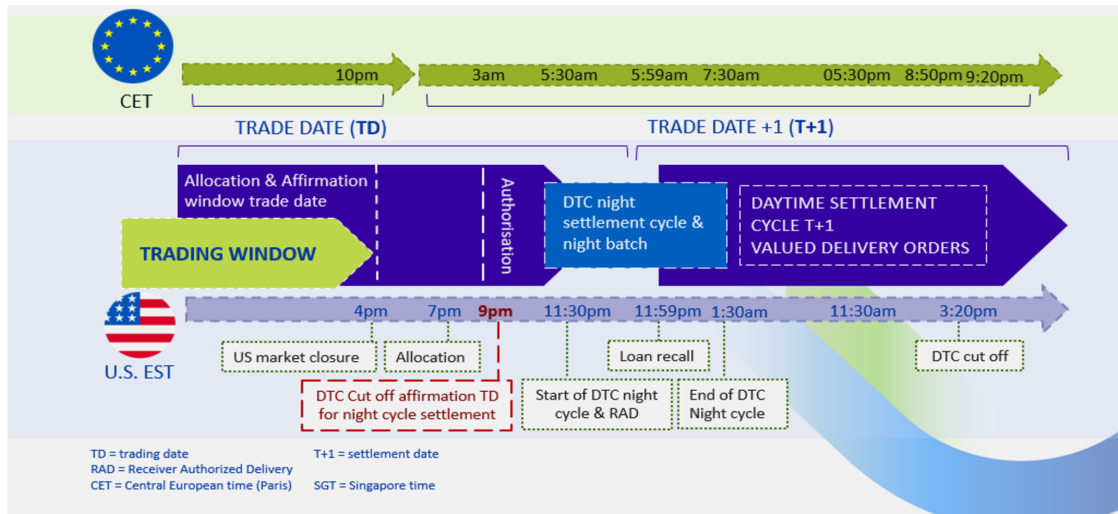
- Where the parties agree to settle later than on T+1
- Securities based swaps are exempted

Also, there is no sanction if transactions in scope are not settled on T+1 (eventually this may lead to a breach of best execution obligation for the broker, but there is no sanction in case of breach of T+1 rule)

[15] Accelerated Settlement Taskforce - GOV.UK (www.gov.uk)

[16] 19.6% of all U.S. securities and 16% of the U.S. equity market are held outside of the US. Of this, 48% of foreign holdings of US equities are held in Europe. https://home.treasury.gov/system/files/136/shl2022_report.pdf

[17] It is worth noting that, although the US system does not provide "sanctions" for settlement fails as CSDR, the DTCC daytime settlement cycle is more expensive, hence the need for each market participant to assess if they settle during the night cycle (working during night time, having a middle office in the US, and other possible solutions) or paying higher fees to DTCC to settle during the day cycle.



Source: member of ESMA Post-Trading Consultative Working Group

- There is a need to carry out all settlement-related processes (confirmation/affirmation, generation of settlement instructions, funding and FX hedging, securities lending recall, etc) within a much shorter period of time. Many remaining manual processes would most likely need to be automated to settle within this compressed time window.

- A liquidity mismatch when a transaction concluded and settled in the EU (settled on T+2, T+3 or more) has a US component (settled on T+1) (e.g. for multi-listed securities or shares/units of funds the baskets of which include US securities). For example, in the specific case of ETFs, in the situation where there is a request for the creation of a share of an ETF in the EU, the fund manager will not receive the funds for that share of ETF until it is settled in a T+2 environment in the EU, however the purchase of the US security composing the basket will be settled in T+1. This would create a liquidity mismatch which could be covered in different ways, such as credit lines, overdrafts or pre-funding. These solutions could have the following negative consequences:

    - Very high costs in a high interest rate environment and in particular for ETFs as some of them may settle at T+3 for creations and redemptions.

    - Possible breaches of investment or cash restrictions that UCITS (or AIFs) might be subject to pursuant to national law or the fund rules. This is due to the amount of cash that the fund would have to hold in order to pre-fund transactions.

    - Potential increase in settlement fails for instruments traded in more than one jurisdiction, such as global ETFs, ADRs and for multi-listed securities, when the duration of settlement cycles across jurisdictions is misaligned (e.g. jurisdictions operating in T+1 vs jurisdictions operating in T+2).

- Arbitrage and portfolio management would also be impacted as resources (both securities and cash) might not be available in one jurisdiction to be used in another one.

- Finally, the FX component of transactions in US securities might also increase the time pressure on EU market players. Although the Euro and some other EU currencies are CLS[18] eligible, if the CLS cut-off time for the settlement of the FX transaction is not met (12am CET on T+0), this would increase the risk of not having the funding available in dollars to pay for the US security on T+1.

49. The feedback ESMA has received so far also noted that these problems would be more acute for smaller players than for big institutions.

50. Most of these impacts come from the reduced available time to execute all the post-trade processes in a T+1 environment together with the different time zones in the US and in the EU, but not from the coexistence of T+1 and T+2.

51. The summary above also indicates that the different stakeholders would need to heavily streamline their post-trade processes and invest in STP. However, nothing at this stage suggests a need for legislative or regulatory action to smoothen the impact of T+1 abroad on EU market participants.

52. In this context, ESMA requests the views of stakeholders to identify the impacts of the transition to T+1 in several jurisdictions. ESMA also recommends to focus on the impacts derived from the coexistence of T+2 in the EU with T+1 in the US.

53. ESMA strongly suggests to focus on those impacts that would require legislative or regulatory action to reduce the impact of T+1 on EU market participants, irrespective of which is the piece of the EU legislative framework affected. In other words, ESMA seeks input regarding the possible regulatory actions in relation to any piece of EU legislation and not only CSDR.

54. Where relevant, please explain if these are general or asset class/instrument/ trade specific.

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.

[18] Continuous Linked Settlement: market infrastructure specialised in cross-border payment system for the settlement of foreign exchange trades established in 2003 with the aim of eliminating/reducing settlement risk.

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.

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

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

55. Furthermore, as EU market players operating in the US and in other third-country jurisdictions will have to adapt their processes and operational set up to the new settlement cycle there, ESMA would like to gather intelligence on whether that would then make the adoption of a shorter settlement cycle easier in the EU.

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.

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

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.

4 Annexes

4.1 Annex I

Summary of 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.

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?

Q3. Which is your current rate of straight-through processing (STP[19]), 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?

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.

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[19] Not involving any manual intervention.

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.

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.

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.

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.

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?

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).

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.

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.

Q13: What would be the benefits for retail clients?

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.

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.

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?

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?

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

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.

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?

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.

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.

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

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

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.

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

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.