US T+1 impact on EU CSDs and settlement

Update from ECSDA

15 November 2023

UPDATE ON ECSDA & EU CSD INVOLVEMENT IN T+1 RELATED INITIATIVES

I. Broader EU context

- CSDs are used to different cycles. The EU moved to T+2 in 2014 and while the US was on T+3 cycle until 2017.
- There is no problem requiring an urgent change of cycle in the EU. The EU has not considered the shortening of the settlement cycle as a priority until the US move.
- The EU has a considerable harmonisation agenda and pursues the work to ensure a higher level of settlement efficiency (already for T+2).

II. Industry initiatives since the US T+1 announcement

- ECSDA actively participate in the EU Cross-Industry T+1 Task Force, including ~20 Trade Associations, particularly in its i) Steering Committee and ii) its sub-groups streams (9 sub-groups)
  - ✓ *ECSDA is in the lead, together with AGC, of the Settlement sub-group stream, but ECSDA experts do attend other streams, such as the matching, clearing, national specificities*

III. EU Regulators initiatives

- ESMA issued recently a Call for evidence on the Shortening Settlement Cycle (SSC) with the deadline on 15 December
- Prior to such a deadline, ESMA will hold a workshop on T+1 on ESMA premises in Paris
- The Call also speaks about T+0

IV. ECSDA internal activities

- In addition to the Settlement Working Group, ECSDA has a dedicated Shortening Settlement Cycle (SSC) Task Force

Conflict of jurisdictions

Based on the CSDR, the EU Settlement Cycle rule applies to the transactions settled by the EU CSDs

Article 5.2
"As regards transactions in transferable securities referred to in paragraph 1 which are executed on trading venues, the ***intended settlement date shall be no later than on the second business day after the trading takes place****. That requirement shall not apply to transactions which are negotiated privately but executed on a trading venue, to transactions which are executed bilaterally but reported to a trading venue or to the first transaction where the transferable securities concerned are subject to initial recording in book-entry form pursuant to Article 3(2). "*

- **Settlement:** the US/other region's institutions may be subject to a different settlement cycle requirement but are generally exempt from their domestic settlement-related obligations when the transaction is settling in a CSD in a different jurisdiction. When the ultimate place of settlement is in the EU, T+2 cycle would still apply.

- **Corporate actions:** the market arrangement needs to be taken into account.

US T+1 MOVE IMPACT ON EU CSDs

Impact of bifurcated settlement cycle between US and EU

- *Increased settlement risk* - The time difference can introduce potential risks related to counterparty exposure and liquidity management and tighter deadlines in trade capturing, matching and reconciliation
- *For multi-listed securities*, it has to be considered how to manage the EX date close to corporate events since it is differently set in the case of T+2 (EX=RD-1) versus T+1 EX=RD)
- Issues in handling settlement with multi-listed securities in such a short timeframe, may lead to a *decrease in settlement efficiency and an increase in US market reversals* due to a less efficient post-trading activity
- This also has an *impact on resources*: human, with a potential increase of working hours, and economical, with a need for further automation, minimising human intervention

T+1 and Cross-border

- In a T+1 environment, cross-border activity is more negatively affected than the domestic. More processes are needed (e.g. realignments or
- of the securities holdings moving from one market/CSD where they are held to the market/CSD where the sale is going to be settled) and hence larger chains of intermediaries are needed to settle the trade.

- Due to the importance of the trading to settlement flows, for the EU, the timing of the UK is of high relevance. Also, many conventions and decisions may need to be agreed already by the UK move.

Does the US move lead us to consider T+1 for the EU ? Preliminary consideration of impact on settlement

- **Increase in operational risk due to the time pressure**
  - **Less time to perform all the processes.** We estimate the required compression to be 83%. STP and the use of solving issues solutions and efficiency tools is key.
  - **Possible impacts on** settlement cycles in CSDs' (and T2S):
    - Possible delay of Start-of-day activities (due to the earlier processes to be finalised at pre-settlement level), hence also possible impact on night-time settlement.
    - Possible need to delay delivery versus payment cut-off times (in coordination with NCBs, if needed). -> FOP deadline affected.
    - Possible increase in activity during the day due to the impacts on nighttime settlement.
- **Shorter time across the chain will impact settlement efficiency rates and corresponding CSDR penalties**
- **Corporate actions impact: increase in reverse market claims and need for change of conventions**
    - The trading date counts to define whether the investor receives it "cum" or "ex". If the trade is on the Ex Date, it is "ex". If the trade is before, it is "Cum".
    - Ex Date and the sequence of the dates would have to be reconvened. I.e. the Ex Date (today on D-2, would need to change) and the Record Date will be on the same date (D-1), remaining Payment Date (D) on the same day.

Preliminary considerations on EU T+1 impact on settlement (continued)

- **FX**

Should the FX cycle remain, foreign investors in different currency zones may need to pre-deposit cash, increasing liquidity costs and risks, on top of an increase in operational process complexity and risks.

Alignment of the FX settlement cycle and the securities settlement cycle is to be considered.

- **Scope of asset classes: Assets with Special Complexity (such as ETF) and illiquid/shallower markets**

CSDR cycle change presumes a broad scope, but the impact will be more or less important for some asset classes, e.g. ETF having a significantly lower settlement efficiency. For consideration:

  - Would they remain on the T+2 cycle, at least on a temporary basis? *or*
  - Would Penalties apply in a differed way?

- **Securities Financing**

More SFTs should be facilitated, as actors will have less time to solve fails.

However, T+1 could affect the ability to close securities loans to avoid the other fails, reinforcing the original transaction for which the STF is done -> even more settlement fails.

The higher settlement fail rates in Europe will affect the competitiveness of the European financial institutions and, more generally, of the European economy.

Conclusions

- The key impact of the US T+1 for the us is that **it requires other regions to consider the topic**. Although we have not yet reached the stage when we can say that the T+1 move is either urgent or important for the EU.

- To define the time of the move it is important **to assess the impacts and necessary steps for eventual implementation** and the time required for the necessary interventions. Before moving to T+1, the **milestones should be known and well-prepared**. Settlement **efficiency rates should increase,** partially to mitigate the likely drop of the first weeks/months of T+1.

- To the extent possible, we should avoid Market Actors globally engaging in a **fragmented approach.**

- CSDs **are ready to actively contribute** and provide their knowledge being the point where settlement actually takes place.

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