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:

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'.

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	Bundesverband deutscher Banken (BdB)
Activity	Associations, professional bodies, industry representatives
Are you representing an association?	☒
Country / Region	Germany

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>

In the current market infrastructure, T+0 is primarily an all-encompassing process issue. Only limited statements can be made in this regard.

(i) Impact on T+1 processes and workflows:
Trading hours in Europe are currently not at all compatible in parts with a T+1 settlement cycle in Europe. Germany as example:

- Stock exchange trading is possible until 22:00 pm (trading hours have been continuously extended, especially in recent years).
- Settlement on T2S for a settlement day starts at 20:00 pm on the previous evening.
- This means that if, for example, trading takes place at 21:00 pm, settlement for T+1 has already started one hour earlier.
- Furthermore, the ECB has emphasised in recent years that the aim should be to settle during the night in order to have as much settled as possible by the next morning. This is also encouraged by the fact that prices are more favourable during the night.
- With T+1 or T+0, this would no longer be possible in the future; processes and schedules would have to be adapted and changed.

(ii) Impairments (in no particular order)

- Short time frame between transmission of order execution and start of settlement
- Exchanges/brokers often do not operate in real time, so order executions are delayed.
- Aggregation of transactions is hampered as they cannot be processed individually.
- Cross-border and arbitrage activities
- Start of settlement day on T2S the evening before (=S-1 20 pm)
- Late trading hours of the exchanges (trading until 22:00 pm vs. start of settlement usually the evening before)
- Manual processes for participants
- Batch-driven processing will be impacted and difficult (omnibus account structure, hold and release process, netting, aggregation, high impact expected on CSDR, impact on actual / contractual processing with respect to time pressure)

<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>

(a) The hedging transaction may not be completed on time due to the tight deadline. There is likely to be more pre-hedging to minimise risk.

(b) FX transactions are likely to become "more expensive" as the required FX is not procured at FX spot rates, i.e. rates will deteriorate or participants will take risks on their books (value date difference between FX and WP transactions).

<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>

Post-trade processes between trading and settlement are complex and typically involve "hand-offs" (the exchange of information) between multiple actors. The process can vary significantly according to the type of transaction, the type of instrument, and the actors involved.

There are both "horizontal" processes – whereby information is transmitted between the buyer and seller (or intermediaries acting on their behalf), and "vertical" processes – whereby information is transmitted from the buyer/seller through the chain of custody to the CSD.

Considering the number of actors involved, no single entity has a clear end-to-end view of a particular transaction to determine whether there was a manual intervention at any point in the transaction lifecycle. Further, there are good reasons why a particular actor may not allow the straight-through processing of a transaction. For example, provision checks must be completed by custodians before sending an instruction to the CSD.

The following example from one of our members should be interpreted in this context:

Overall STP-Rate in the year 2023 (quarters 1 – 3 of 2023)

Settlement instructions	Q1 2023	Q2 2023	Q3 2023
Total Settlement instructions	5.583.332	5.312.649	5.334.637
Non-STP Volume	8.721	8.406	8.096

Non-STP %	0,16%	0,16%	0,15%
SPT Rate %	99,84%	99,84%	99,85%

<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>

5. Functioning of Markets

6. It is envisaged that there will be a substantial impact on securities lending processes, which play an important role in facilitating broader market activity.

7. Market-makers are essential to the provision of liquidity in particular in less-liquid instruments. Given capital constraints, they in many cases offer two-way pricing of securities which they do not immediately hold within their inventory. A shorter settlement cycle constrains the time available to source any securities on which they execute a sale. This could result in market-makers increasing bid-offer spreads on less liquid securities, or even removing them from their offering.

8. Within the EU, securities financing transactions are typically collateralised by non-cash assets (i.e., other securities) and often via tri-party agents. A compression of the settlement cycle would create friction in collateral processes, potentially meaning trading parties post excess collateral. This would result in reduced capital efficiency.

- Corporate actions will be more complex in the future, as they are likely to be more open transactions. This will, among other things, lead to more market claims and an increased need for coordination.

- Impact on trading, possibly adjustments to trading hours and possibly the end of late trading.

9. Retail Investors

10. We support further focus on potential measures to improve the attractiveness of EU capital markets to retail investors. We have not identified any material expected impact (either positive or negative) on retail investors of shortening the settlement cycle to T+1.

<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>

At this early stage the necessary analysis has not been started yet; therefore no estimations/concrete figures can be given, but project costs, extensive IT costs and costs for new hardware have to be expected.

Due to a quite complex IT environment the whole process chain with all interfaces for order management and settlement has to be analyzed. It can be assumed that a huge number of adaptions has to be processed which is expected to be highly cost intense and time consuming. A conservative initial estimate for the T + 1 project is at least a seven-figure sum (in Euro). No estimations can be made about the running costs.

<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>

At this early stage the necessary analysis has not been started yet; therefore no reliable estimations/concrete figures can be given. An increase in settlement/cash penalties depends massively on how the synchronization of markets will take place. We understand that frequently the rate improves in the market after a while as soon as the market is altogether running on the basis of the new cycle.

Careful rough estimate: T+1 in the single-digit percentage range, T+0 in the double-digit percentage range in the short term.

<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>

- Settlement efficiency will temporarily decline (see Q6).
- Foreign exchange procurement will become more problematic as securities and foreign exchange markets diverge further.
- Cross-border/arbitrage activities will become more difficult or expensive.

We suggest to observe, where possible, the impact on settlement fails in other markets which transition to T+1 before the EU. For example, we note anecdotal evidence that there was a temporary spike in fails in the Indian market after moving to T+1, with fails returning to normal levels. It will be helpful to observe whether there is a similar impact in North America – although we caution against direct comparison between US and EU settlement rates due to lack of available data and the differences in market structure.

<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>

Yes. Costs for erroneous transactions, interest costs, CSDR penalties.

<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 agree with the mentioned benefits, especially:

- Reduced settlement risk
- Reduction in counterparty risk
- Potential increase in automated processes

We also think the "community" benefits of (a) aligning settlement cycles across major jurisdictions and (b) reducing overall levels of settlement risk in the ecosystem, as the core drivers of moving to a shorter settlement cycle. We note that these benefits may be less tangible and may not translate into a directly measurable cost saving. Benefits are also like to accrue over a longer time-horizon than costs.

An eventual reduction of CCP collateral requirements is expected, which would free up capital to be used elsewhere, potentially generating an improved ROI. However, the collateral savings must be balanced against the impact of changes to securities lending processes potentially resulting in posting excess margin, reducing capital efficiency.

From a risk and resilience perspective, a shortening of the settlement cycle would reduce the number of "open" transactions at any point in time (theoretically by as much as 50%). In the event of any market issue – such as a technology outage by a major infrastructure – the impact will be reduced. <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>

We note that margin requirements for non-cleared transactions typically relate to OTC derivatives, i.e. are not within the scope of CSDR Article 5. Further to this, most margin posted to CCP is related to derivatives transactions and would thus not be affected by a shortening of the settlement cycle.

The impact is difficult to quantify at this point as a depth-analysis has not been started yet.

<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>

In short-term, no benefits or savings are expected; in long-term no estimation can be made at this point in time.

<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>

11. Costs for switching to automated processes, especially for parties with low volumes
12. Function as a market maker could possibly become unattractive due to the faster provision of securities.
13. Increased pressure and complexity in securities financing transactions (SFTs) could result in additional costs and/or a reduction in the volume of securities made available in SFT markets. Deep, liquid and efficient securities lending markets support the liquidity and efficiency of broader capital markets.

<ESMA_QUESTION_SETT_12>

Q13 : What would be the benefits for retail clients?

<ESMA_QUESTION_SETT_13>

We see no benefits for retail clients.

<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>

In general, it appears that costs and benefits will occur over different time horizons for different market participants. It is likely that the costs incurred by the industry will be immediate, or short-term, and that benefits are realised over the medium or long term. As noted, the less-tangible “community” benefits arising from reduced risk and increased efficiency must be appropriately considered in any evaluation of costs versus benefits.

The potential costs associated with any knock-on impact on market liquidity should also be considered. A better understanding of the potential knock-on impacts will be gained from observing the transition to T+1 in the US.

T+1 mainly risk and security aspects, less operational aspects.

T+0 cannot be realised without fundamental changes to the entire process chain and all those involved.

<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>

Industry Changes

The recent white paper "Improving the Settlement Efficiency Landscape in Europe" by AFME sets out a number of practical recommendations for industry participants to take forward to improve efficiency in post-trade processes. We consider that many of these recommendations will become essential to deliver a successful transition to T+1.

As noted in our response to Q5, an important milestone to achieve would be ensuring that there is no degradation in the proportion of instructions which are matched at the CSD by the end of the business day before intended settlement date.

We consider that market infrastructure must be provided with sufficient time to make any technology or operational changes to their platforms – such as changes to operating hours, timings of certain processes, or enhancements to functionality such as real-time settlement or auto-partial.

Regulatory Changes

Should the EU take a decision to adopt a T+1 settlement cycle, we consider that certain amendments to CSDR may be required:

Article 5.2 of CSDR mandates that the "settlement date shall be no later than on the second business day after the trading takes place", which is not inconsistent with a T+1 settlement cycle. However, we believe an update to this article will be required, to ensure a fully harmonised adoption of T+1 across all in-scope market participants.

Further amendments to the Settlement Discipline RTS will also be required:

- Article 2 (Allocation/Confirmation): Timings would need to be amended for the allocation/confirmation process to ensure its conclusion on T+0. There could also be additional requirements to ensure that the method used to exchange this information enables straight-through-processing.

- Article 10 (Partial Settlement): Would benefit from an update to mandate of the provision of partial release functionality by CSDs. Derogation from the requirement to provide partial settlement should be removed, to ensure all CSDs provide a consistent service.

Article 11.4 (Additional Facilities and Information): Would require amendment to mandate the provision of real-time gross settlement for all settlement instructions, including partials, in all CSDs.<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>

It will be necessary to build on the various responses to Q15 received from different constituencies, and develop an agreed cross-industry implementation roadmap.

A helpful reference point may be the most recent EU initiative to shorten settlement cycles. The uniform adoption of T+2 settlement for in-scope transactions took place in most EU markets in October 2014, in order to meet the requirements of CSDR Article 5. This was approximately 31 months after the draft text of CSDR Article 5 was first proposed by the European Commission, in March 2012. We note that a move to T+1 settlement is generally considered as a more challenging implementation project than the move to T+2 (indeed, some markets such as Germany already operated on T+2 for certain instruments.)

A deeper analysis is necessary with regard to: definition of deadlines for corporate actions (record date and ex-date), cut-off times, etc.

In case of T+0: much longer preparation time will be needed as the trade/post trade would have to be completely digitalized, e.g. batch processing is no longer possible.

<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>

In our view the instruments included in the T+1 scope should not go beyond the ones of Article 5 of CSDR.

<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>

It should be avoided. It adds unnecessary complexity to systems and processes. Some instruments would be more impacted by the implementation of T+1 settlement cycle, such as the less liquid ones and ETFs in particular, for example.

<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>

Settlement efficiency per asset classes and underlying flow's readiness to adapt to a T+1 settlement cycle must be assessed, especially in relation to securing inventory at the time for settlement.

Complex financial instruments will be more difficult to migrate/will have different implications to consider in its migration. "Simple" financial instruments, such as bonds and equities will be easier to migrate. A step-by-step migration could be feasible; further analysis necessary.

Different migration times for different products etc. are possible. But it has to be considered that from our point of view different settlement periods for different asset classes increase the complexity and decrease the efficiency overall.

The reduced operating window would be more challenging for certain asset classes, i.e., ETFs, where the current settlement efficiency is below average mainly due to structural aspects of the ETFs creation process like the global composition of many ETFs, which contain underlying securities from several markets. Because the availability of newly created ETF's units is connected to the subscription of new units (and thus to the settlement of the underlying instruments), this can often lead to settlement delays in a T+2 context, due to time- zone differences, market holidays and cross-border settlement challenges. Consequently, this process for creating new units can become even more critical in a T+1 settlement cycle and would significantly impact timely settlement.

We consider that it is preferable to adopt a single migration date for all in-scope markets, transaction types and asset classes.

<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>

No. We believe that the current scope of CSDR Article 5 is sufficient.

<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>

In the Asian markets, and particularly in Australia, transfers are already very time-critical due to the time difference. If these markets were to move to T+1, the impact would be even more critical. Negative effects may also occur in markets where custodian cut-off times are before the close of trading.

Therefore the following impacts are to be expected:

Change in trading behavior

- Higher rate in settlement fails within the EU markets, especially Germany where a lot of foreign securities are traded – trading processes have to be adjusted,
- Major impact on trading participants and market makers (to be elaborated by those parties)

<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>

In order to avoid additional complexity, it will be necessary to ensure a harmonized approach throughout EU and an orderly migration (even by asset type), preventing that some markets settle T+1 and others T+2 for the same ISIN/Asset Type.

<ESMA_QUESTION_SETT_22>

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

<ESMA_QUESTION_SETT_23>

Yes, standardised processing. Fewer cross-border and arbitrage issues.

<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>

- Reduced settlement risk
- Reduction in counterparty risk
- Potential increase in automated processes

<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>

Every exemption makes the changeover more complex.

<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>

Yes. As it was already the case in the past when the EU was T+2 and the US T+3 until 2017. Nevertheless, it should rather be a temporary situation because of the following reasons:

- Cross-border/arbitrage activities will become more difficult.
- Settlement of a trade in the EU may no longer be in time for a transfer and therefore settlement in the USA.
- Overall, day-to-day business will become more complex as more intra-day deadlines may need to be met.
- Settlement cycles have been harmonised as part of T2S, so it is questionable why they should be removed.

Before moving to T+1 a thorough impact analysis and a detailed action plan have to be completed, also a migration date has to be identified.

<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>

No in-depth-analysis has been made in this regard so far but the assumptions are the following:

• If the duration from trading to settlement is shorter, that shortens the time for manual intervention. If manual intervention is needed (e.g. correction of trades) or required (e.g. liquidate positions through counter trades or cancellation), the shorter the time is, the larger the risk is these mitigating measures cannot be performed leading to increased risk for the settlement institution.

• Settlement efficiency will decrease significantly for the Broker/Dealer; different time zones – opening hours of exchanges will make it impossible to have overnight batches etc.

<ESMA_QUESTION_SETT_27>