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December 15, 2023

Carsten Ostermann and Antonio Ocana
European Securities and Markets Authority
201-203 rue de Bercy – CS90910
Paris, France 755889

Re: Call for Evidence: On Shortening the Settlement Cycle

Dear Mr. Ostermann and Mr. Ocana,

The Investment Company Institute (ICI)[1] and ICI Global welcome the opportunity to respond to the European Securities Market Authority's (ESMA) call for evidence on shortening the settlement cycle. As the trade association representing regulated funds globally, we have a strong interest in promoting efficient capital markets for the benefit of long-term individual investors.

We have provided detailed answers to the questions posed by ESMA, and would like to take the opportunity to summarise our key points, as follows:

- We support efforts to shorten the standard settlement cycle from two business days after the trade date (T+2) to one business day after the trade date (T+1). Moving to T+1 settlement will deliver significant benefits to EU capital markets and to global investors in UCITS and other regulated funds.

- We encourage EU authorities to decide in early 2024 to move to T+1 settlement and to communicate a clear path for implementation in a 24-30-month timeframe. This will provide policymakers, stakeholders, and market participants a reasonable and practicable implementation period to facilitate the move.

[1] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI's members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in other jurisdictions. Its members manage €28.0 trillion invested in funds registered under the US Investment Company Act of 1940, serving more than 100 million investors. Members manage an additional €8.0 trillion in regulated fund assets managed outside the United States, including in the EU. ICI carries out its international work through ICI Global, with offices in Brussels, London and Washington, DC.

- With North American markets moving to T+1 settlement in May 2024, an EU move to T+1 settlement in 24-30 months is needed to minimise the duration of settlement misalignment among these major markets.

- We also encourage EU authorities to coordinate closely with other jurisdictions and to establish a dedicated T+1 dialogue with authorities in the UK and Switzerland, so that these markets can move to T+1 in alignment with the EU.

- We do not support an EU move to T+0 settlement at this time, as this would contribute to misalignment of settlement cycles among major jurisdictions and would reduce the efficiency of EU capital markets, as we explain in our detailed responses.

- ICI and ICI Global stand ready to support the EU on a move to T+1, which will advance the shared objectives of creating more efficient, liquid, and equitable conditions for all investors. We recognise that moving to T+1 in Europe is a challenging and complex undertaking, but with broad-based buy-in from market participants, stakeholders, and policymakers, it is highly feasible to implement.

Please do not hesitate to contact either of us or RJ Rondini and Kirsten Robbins on our teams.

Sincerely,

/s/ Michael N. Pedroni

Michael N. Pedroni
Chief Global Affairs Officer, ICI, and
Head of ICI Global

/s/ Jeff Naylor

Jeff Naylor
Chief Industry Operations Officer
Investment Company Institute

CC: Verena Ross
Natasha Cazenave
Eric Pan
Charles Geffen
UK Accelerated Settlement Taskforce

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December 15, 2023

<u>ICI and ICI Global Response to the European Securities Market Authority's (ESMA) *Call for Evidence: On Shortening the Settlement Cycle*</u>

Submitted by electronic form to ESMA.

Q1 Please describe the impacts on the processes and operations from compressing the intended settlement date to T+1 and to T+0.

(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.

The Investment Company Institute (ICI)[2] and ICI Global welcome the opportunity to respond to the European Securities Market Authority's (ESMA) call for evidence on shortening the settlement cycle. As the trade association representing regulated funds[3] globally, we have a

[2] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI's members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in other jurisdictions. Its members manage €28.0 trillion invested in funds registered under the US Investment Company Act of 1940, serving more than 100 million investors. Members manage an additional €8.0 trillion in regulated fund assets managed outside the United States, including in the EU. ICI carries out its international work through ICI Global, with offices in Brussels, London and Washington, DC.

[3] For purposes of this letter, the term "regulated fund" refers to any fund that is organised, formed and regulated under national law, and is authorised for public sale. Such funds typically are subject to substantive regulation in

strong interest in promoting efficient capital markets for the benefit of long-term individual investors.

We support efforts to shorten the standard settlement cycle from two business days after the trade date (T+2) to one business day after the trade date (T+1). We encourage EU authorities to decide in early 2024 to move to T+1 settlement and to communicate a clear path for implementation in a 24-30 month timeframe. This would provide policymakers, stakeholders, and market participants a reasonable and practicable implementation period to facilitate the move.

As discussed more fully below, moving to T+1 settlement would deliver significant benefits to global investors, including UCITS and other regulated funds, and the capital markets. Moreover, with the North American markets moving to T+1 settlement in May 2024, an EU move to T+1 settlement in 24-30 months is needed to minimise the duration of settlement misalignment among these major markets.

We also encourage EU authorities to coordinate closely with other jurisdictions and to establish a dedicated T+1 dialogue with authorities in the UK and Switzerland, so that these markets can move to T+1 in alignment with the EU. We recognise that moving to T+1 in Europe is a challenging and complex undertaking. ICI and ICI Global stand ready to support this effort.

Because of the complexity and challenges with such a transition, among other reasons, we urge the EU not to pursue moving to T+0 settlement at this time. Rather, the EU should focus its efforts on moving to T+1 and to provide clear guidance to market participants, so that the industry can undertake the necessary coordination and steps to reach this important goal.

ICI and ICI Global are committed to supporting the transition to a T+1 settlement. We are prepared to extend our leadership in the markets and work with ESMA and other stakeholders in the EU to overcome the challenges associated with reducing the settlement cycle and advance the shared objectives of creating more efficient, liquid, and equitable conditions for all investors.

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areas such as disclosure, form of organisation, custody, minimum capital, valuation, investment restrictions (*e.g.*, leverage, types of investments or "eligible assets," concentration limits and/or diversification standards). Examples of such funds include EU UCITS and US investment companies regulated under the Investment Company Act of 1940.

Moving to T+1 would benefit investors

Shortening the settlement cycle to T+1 benefits organisations across the financial services industry and throughout the trade lifecycle in jurisdictions around the world. A measured reduction in the settlement cycle to T+1 in EU capital markets would deliver reduced operational and counterparty risk, a significant reduction in collateral and margin requirements, increased liquidity and capital efficiency, continued modernisation of post-trade infrastructure, and expedited cash and security deliveries to investors. In addition, it would close the settlement misalignment with the North American capital markets, reducing the costs and risks associated with that (and any major cross-market) misalignment and increasing the competitiveness of EU capital markets. As investors in the markets, UCITS and other regulated funds would benefit from a shortened settlement cycle, and these benefits would flow to fund shareholders.

Generally, reducing the time between trade and settlement results in a reduction in systemic, counterparty, and operational risk across the settlement ecosystem, particularly in times of market volatility. The associated reduced collateral requirements permit market participants, including UCITS and other regulated funds, to improve their cash and liquidity management, leading to more efficient and liquid capital markets.

In addition, shortening the settlement cycle incentivises market participants to modernise their processes through greater use of technology, automation, and standardisation, which leads to more efficient and cost-effective operations. For example, moving to T+1 accelerates the industry's adoption of Straight-Through Processing (STP), which requires automating manual processes. Automating such processes significantly reduces operational risk, increases productivity, and reduces friction for market participants. Among other benefits, STP can help to eliminate redundant processes, save time and expenses, and reduce manual errors.

For UCITS and other regulated funds, moving to a T+1 settlement cycle would enhance cash and liquidity management. Migrating to T+1 would result in lower counterparty exposure, which in turn reduces margin requirements. Particularly in times of market volatility, UCITS and other regulated fund managers would be better able to manage their capital and liquidity risk and efficiently use their available capital.

Retail investors benefit from expedited cash and securities deliveries. In addition, reducing risk and increasing efficiencies generally can lead to lower costs, which can improve returns on investments. We anticipate a shorter settlement cycle to deliver benefits and cost savings to market investors, including retail investors, year over year.

Global alignment of settlement cycles benefits investors

Global alignment of settlement cycles across major markets delivers clear benefits to investors by reducing operational risks and costs that arise from fragmentation. Following the North American move to T+1 in May 2024, it is in all investors' interests that T+1 should be the current global standard for securities settlement.

A dislocation between North American and EU settlement timelines will arise in May 2024. Our members are concerned that the frictions created by this dislocation will increase operational risks and the cost of investing in the EU, which they are further concerned could constrain liquidity providers' ability to trade and thereby impair liquidity in the EU. For example, European ETFs that hold securities in North America are likely to incur financing and funding costs resulting in wider spreads on ETF prices – which negatively impact ETF investors.

Shortening the settlement cycle to T+1 in the EU would bring realignment between the North American and EU markets and is expected to eliminate the negative impacts that occur following the North American move. Moreover – and critically – shortening the EU's settlement cycle would enable the EU to maintain alignment with the UK and Switzerland, which are working to move to T+1. Because there is significant interconnectedness between the EU and these other major markets, our members are deeply concerned about the significant negative impacts arising from potential dislocation. The magnitude of the potential negative impacts of misalignment is directly related to the depth of this interconnectedness. Our members' concerns grow with the anticipated duration of the misalignment.

Therefore, to minimise the costly effects of misalignment with the North American markets, we encourage EU authorities to decide in early 2024 to move to T+1 settlement and to communicate a clear path for implementation in a 24-30-month timeframe. This will provide policymakers, stakeholders, and market participants a reasonable and practicable implementation period to facilitate the move. In addition, we encourage EU authorities to coordinate closely with other jurisdictions and to establish a dedicated T+1 dialogue with authorities in the UK and Switzerland, so that these markets can move to T+1 in alignment with the EU. Alignment of settlement cycles across these markets is needed to mitigate risks associated with having different settlement cycles and help market participants, including UCITS and other regulated funds, to better manage liquidity, which can reduce and simplify financing needs.

We recognise that shortening the settlement cycle to T+1 will involve substantial effort and coordination across policymakers, stakeholders, and market participants, so the implementation date should be carefully set. An implementation period of 24-30 months should provide market participants enough time to assess the changes they need to undertake, program the necessary systems, develop appropriate processes and procedures, and conduct comprehensive industry-wide testing. In addition, an implementation period of 24-30 months would minimise the duration of the dislocation with the North American markets. Therefore, we encourage EU authorities to decide in early 2024 tomove to T+1 settlement and to communicate a clear path for implementation in a 24-30-month timeframe.

T+0 should not be pursued

Moving to T+0 settlement would be a substantially more complex undertaking than moving to T+1 settlement, and we urge the EU not to pursue T+0 at this time.

We have many concerns about shortening the settlement cycle to T+0. First, such a move would require a complete overhaul of many securities processing functions and systems, including for institutional trade processing, ETF processing, options, margin investing, prime brokerage, fund pricing and administration, securities lending, FX markets, global settlements, primary offerings, derivative markets, and corporate actions. Indeed, moving to T+0 would require fundamentally reengineering most, if not all, legacy trading and settlement processes and systems.

Second, moving to T+0 would create many issues related to trade processing, which include cutoffs for batch processing and settlement services at Central Securities Depositories (CSDs). Various ancillary post-trade workflows for market participants, such as those related to margin collateral and financing, and position and cash management reporting, would need to be significantly enhanced to operate on a more frequent or even real-time basis.

Third, the markets that have already pursued T+0 settlement have done so through pre-funding settlement. Indeed, the move to T+0 settlement may not be possible without pre-funding, but the regulatory and risk issues and prohibitive costs appear to make pre-funding impracticable in the EU. Pre-funding accounts is already a concern for some market participants in moving to a T+1 settlement cycle. If T+0 settlement were adopted, pre-funding would likely become the reality for nearly all investors and this raises significant concerns. Moving to T+0 would also create several issues for UCITS and regulated funds, as they would need to set aside more cash or rely more on short-term funding instruments for same-day settlement. Pre-funding would create a drag on a fund portfolio’s performance and increase tracking error. Further, T+0 settlement would also make it difficult for funds to take advantage of trading opportunities, since they would need to quickly raise the cash that day to execute a buy order.

Fourth, T+0 settlement would significantly constrain multilateral netting, which is a significant liquidity and risk mitigation mechanism. Reducing or eliminating multilateral netting would reverse many of the benefits gained by shortening the settlement cycle to T+1. Without netting, extremely high volumes of bilateral cash and securities transactions would be required to move through the financial system throughout the trading day, resulting in capital inefficiencies, increasing credit and operational risks, increasing settlement fails, and increasing costs between trading parties.

Finally, moving to T+0 in the EU would exacerbate challenges associated with misalignment of settlement cycle between the EU and North American markets, which are moving to T+1, and possibly with the UK and Switzerland. In contrast, shortening the settlement cycle to T+1 would reduce the frictions associated with misalignment with those other markets.

We urge EU authorities to focus their current efforts on adopting T+1 settlement and to decide in early 2024 to move to T+1 settlement and to communicate a clear path for implementation in a 24-30-month timeframe. This will provide policymakers, stakeholders, and market participants a reasonable and practicable implementation periods, so that they can undertake the necessary coordination and steps to reach this important goal. In light of the impracticality of moving to T+0 at this time, we focus our responses to this Call for Evidence on moving to T+1 settlement.[4]

ICI and ICI Global committed to assisting the transition to a T+1 settlement cycle

Shortening the settlement cycle requires careful deliberation and consideration and a balanced approach so that settlement can be achieved as quickly as practicable, without creating capital inefficiencies or new, unintended risks. ICI and ICI Global are prepared to extend our leadership in the markets and work with ESMA and other stakeholders in the EU to overcome the challenges associated with reducing the settlement cycle and advance the shared objectives of creating more efficient, liquid, and equitable conditions for all investors.

ICI has helped to lead industry efforts to prepare for the move to T+1 in the North American markets through the Industry Working Group (IWG), made up of more than 800 subject matter advisors representing more than 160 firms from buy- and sell-side firms, custodians, vendors, and clearinghouses. This work has been successful in identifying critical steps and considerations

[4] Following the implementation of T+1 as the global standard for securities settlement across major markets, including the EU, we recognise that it may be appropriate to engage in work regarding longer-term optimisation of securities markets. We affirm our willingness to participate in such longer-term work.

necessary to facilitate the transition to T+1 settlement. We are bringing this experience to the European industry task force, which has been convened by the Association for Financial Markets in Europe (AFME). Because of the interconnectedness of global markets, the path forward requires significant coordination and effort among market participants and across jurisdictions. ICI and ICI Global are committed to assisting in this effort.

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?

No response provided.

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?

No response provided.

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.

As we discussed in our response to Question 1, shortening the settlement cycle benefits organisations across the financial services industry and throughout the trade lifecycle in jurisdictions around the world. A measured reduction in the settlement cycle to T+1 in EU capital markets would deliver reduced operational and counterparty risk, a significant reduction in collateral and margin requirements, increased liquidity and capital efficiency, continued modernisation of post-trade infrastructure, and expedited cash and security deliveries to investors. In addition, it would close the settlement misalignment with the North American capital markets, reducing the costs and risks associated with that (and any major cross-market) misalignment and increasing the competitiveness of EU capital markets. As investors in the markets, UCITS and other regulated funds would benefit from a shortened settlement cycle and these benefits would flow to fund shareholders.

Generally, reducing the time between trade and settlement results in a reduction in systemic, counterparty, and operational risk across the settlement ecosystem, particularly in times of market volatility. The associated reduced collateral requirements permit market participants, UCITS and other regulated funds, to improve their cash and liquidity management, leading to more efficient and liquid capital markets.

In addition, shortening the settlement cycle incentivises market participants to modernise their processes through greater use of technology, automation, and standardisation, which leads to more efficient and cost-effective operations. For example, moving to T+1 accelerates the industry's adoption of Straight-Through Processing (STP), which requires automating manual processes. Automating such processes significantly reduces operational risk, increases productivity, and reduces friction for market participants. Among other benefits, STP can help to eliminate redundant processes, save time and expenses, and reduce manual errors.

For UCITS and other regulated funds, moving to a T+1 settlement cycle would enhance cash and liquidity management. Migrating to T+1 would result in lower counterparty exposure, which in turn reduces margin requirements. Particularly in times of market volatility, UCITS and other regulated fund managers would be better able to manage their capital and liquidity risk and efficiently use their available capital.

Retail investors benefit from expedited cash and securities deliveries. In addition, reducing risk and increasing efficiencies generally can lead to lower costs, which can ultimately improve returns on investments. We anticipate a shorter settlement cycle to deliver benefits and cost savings to market investors, including retail investors, year over year.

In addition – and critically – moving to T+1 settlement enables the EU to be aligned with the North American markets and to eliminate the costs associated with that misalignment.

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.

ICI has engaged in significant consideration of the costs associated with moving from T+2 to T+1 through its co-leadership of the Industry Working Group (IWG) to prepare for the North American transition to T+1. Shortening the settlement cycles largely involves upfront industry investments to improve market infrastructure and prepare for transition. Because these costs benefit the entire financial ecosystem, it is not appropriate or feasible to compare the accrual to specific asset classes/instruments/trades.

Other costs vary on a firm-by-firm basis, making them difficult to quantify. Certain factors including the number of systems that must be acquired or updated and their ease of interoperability are important contributors toward cost. These costs generally accrue in the short-term and are associated with actions to:

- assess, build, and install necessary system updates;
- enter into appropriate contracts;
- update processes, procedures, applications, and other documents;
- coordinate with counterparties as appropriate;
- perform all industry-wide testing as needed;
- remediate any issues identified during testing; and
- resolve any outstanding technical or operational issues with minimal disruption to actual market operations prior to the markets' opening on the migration date.

Following these upfront investments, we anticipate a shorter settlement cycle to deliver benefits and cost savings to market investors, including retail investors, year over year.

In addition – and critically – moving to T+1 settlement enables the EU to be aligned with the North American markets and to eliminate the costs associated with that misalignment.

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.

Settlement errors and trade fails regularly occur in a T+2 settlement environment, although they are a small percentage of executed trades. If a settlement mismatch is not corrected in a timely manner before settlement date, the trade will likely fail. In a T+2 settlement cycle, participants have two days to remediate settlement mismatches. Transitioning to a T+1 settlement cycle decreases the time during which participants can prevent settlement mismatches from becoming failed trades. The decrease in remediation time incentivises participants to heighten their focus on prevention and more efficient remediation of mismatched trades.

In preparation for the North American markets' move to T+1, the Industry Working Group (IWG) has examined the prevalence of trade fails and the causes of settlement errors. The T+1 Securities Settlement Industry Playbook (Industry Playbook) identifies processes participants should review and steps they should take to mitigate the potential for settlement mismatches, the most important and impactful of which is for participants to ensure they have up-to-date and accurate standing settlement instructions (SSIs) in place. In both the EU and US markets, inaccurate or out-of-date SSIs are a major contributor to fails that can be prevented.

While most participants are expected to plan for and deploy improvements to their post-trade processes, including those outlined in the Industry Playbook, there is a general expectation that there will be an increase in trade fails during the transition to T+1 settlement. The increase is expected to be a short-term, temporary issue, however, with trade fails expected to return to existing levels by the medium-term.

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.

No response provided.

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.

No response provided.

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?

We agree with the benefits associated with shortening the settlement cycle from T+2 to T+1 that ESMA describes in the Call for Evidence, which include "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."[5]

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[5] Call for Evidence at ¶ 31.

As we discussed in response to Question 1, shortening the settlement cycle benefits organisations across the financial services industry and throughout the trade lifecycle in jurisdictions around the world. A measured reduction in the settlement cycle to T+1 in EU capital markets would deliver reduced operational and counterparty risk, a significant reduction in collateral and margin requirements, increased liquidity and capital efficiency, continued modernisation of post-trade infrastructure, and expedited cash and security deliveries to investors. In addition, it would close the settlement misalignment with the North American capital markets, reducing the costs and risks associated with that misalignment and increasing the competitiveness of EU capital markets. As investors in the markets, UCITS and other regulated funds would benefit from a shortened settlement cycle and these benefits would flow to fund shareholders.

Generally, reducing the time between trade and settlement results in a reduction in systemic, counterparty, and operational risk across the settlement ecosystem, particularly in times of market volatility. The associated reduced collateral requirements permit market participants, including UCITS and other regulated funds, to improve their cash and liquidity management, leading to more efficient and liquid capital markets.

In addition, shortening the settlement cycle incentivises market participants to modernise their processes through greater use of technology, automation, and standardisation, which leads to more efficient and cost-effective operations. For example, automating manual processes significantly reduces operational risk, increases productivity, and reduces friction for market participants. Moving to T+1 accelerates the industry's adoption of Straight-Through Processing (STP), which eliminates redundant processes, saves time and expenses, and reduces manual errors.

For UCITS and other regulated funds, moving to a T+1 settlement cycle would enhance cash and liquidity management. Migrating to T+1 would result in lower counterparty exposure, which in turn reduces margin requirements. Particularly in times of market volatility, UCITS and other regulated fund managers would be better able to manage their capital and liquidity risk and efficiently use their available capital.

Retail investors benefit from expedited cash and securities deliveries. In addition, reducing risk and increasing efficiencies generally can lead to lower costs, which can ultimately improve returns on investments. We anticipate a shorter settlement cycle to deliver benefits and cost savings to market investors, including retail investors, year over year.

In addition – and critically – moving to T+1 settlement enables the EU to be aligned with the North American markets and to eliminate the costs associated with that misalignment.

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).

No response provided.

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.

No response provided.

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.

For UCITS and other regulated funds, moving to a T+1 settlement cycle would enhance cash and liquidity management. Migrating to T+1 would result in lower counterparty exposure, which in turn reduces margin requirements. Particularly in times of market volatility, UCITS and other regulated fund managers would be better able to manage their capital and liquidity risk and efficiently use their available capital.

A dislocation between North American and EU and settlement timelines will arise in May 2024. Our members are concerned that the frictions created by this dislocation will increase operational risks and the cost of investing in the EU, which they are further concerned could constrain liquidity providers' ability to trade and thereby impair liquidity in the EU. For example, European ETFs that hold securities in North America are likely to incur financing and funding costs through wider spreads on ETF prices – which negatively impact ETF investors.

Our members have expressed concern that these and other costs incurred because of misaligned settlement cycles could constrain liquidity providers' ability to trade and impair liquidity in the EU. This concern grows with the anticipated duration of the misalignment. Realignment of the settlement cycles is anticipated to mitigate such liquidity concerns.

Q13 What would be the benefits for retail clients?

The decrease in risks associated with moving from T+2 to T+1 is expected to result in benefits to retail investors. Retail investors benefit from expedited cash and securities deliveries. In addition, reducing risk and increasing efficiencies generally can lead to lower costs, which can ultimately improve returns on investments. We anticipate a shorter settlement cycle to deliver benefits and cost savings to market investors, including retail investors, year over year.

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.

As discussed in response to Question 1, shortening the settlement cycle benefits organisations across the financial services industry and throughout the trade lifecycle in jurisdictions around the world. A measured reduction in the settlement cycle to T+1 in EU capital markets would deliver reduced operational and counterparty risk, a significant reduction in collateral and margin requirements, increased liquidity and capital efficiency, continued modernisation of post-trade infrastructure, and expedited cash and security deliveries to investors. In addition, it would close the settlement misalignment with the North American capital markets, reducing the costs and risks associated with that misalignment and increasing the competitiveness of EU capital markets. As investors in the markets, UCITS and other regulated funds would benefit from a shortened settlement cycle and these benefits would flow to fund shareholders.

Generally, reducing the time between trade and settlement results in a reduction in systemic, counterparty, and operational risk across the settlement ecosystem, particularly in times of market volatility. The associated reduced collateral requirements permit market participants, including UCITS and other regulated funds, to improve their cash and liquidity management, leading to more efficient and liquid capital markets.

In addition, shortening the settlement cycle incentivises market participants to modernise their processes through greater use of technology, automation, and standardisation, which leads to more efficient and cost-effective operations. For example, automating manual processes significantly reduces operational risk, increases productivity, and reduces friction for market participants. Moving to T+1 accelerates the industry's adoption of Straight-Through Processing (STP), which eliminates redundant processes, saves time and expenses, and reduces manual errors.

For UCITS and other regulated funds, moving to a T+1 settlement cycle would enhance cash and liquidity management. Migrating to T+1 would result in lower counterparty exposure, which in turn reduces margin requirements. Particularly in times of market volatility, UCITS and other regulated fund managers would be better able to manage their capital and liquidity risk and efficiently use their available capital.

Retail investors benefit from expedited cash and securities deliveries. In addition, reducing risk and increasing efficiencies generally can lead to lower costs, which can ultimately improve returns on investments. We anticipate a shorter settlement cycle to deliver benefits and cost savings to market investors, including retail investors, year over year.

As demonstrated through the extensive preparations for the North American market transition, migrating to T+1 settlement is a significant endeavour that requires these diverse industry members to perform extensive planning, coordination, socialisation, and testing over a multi-year period. The costs associated with this effort are largely upfront industry investments to improve market infrastructure and prepare for transition. Moreover – and critically—moving to T+1 settlement enables the EU to be aligned with the North American markets and to eliminate the costs associated with that misalignment. This cost avoidance, along with the anticipated benefits of a shortened settlement cycle, justify the anticipated costs.

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.

Moving to T+1 requires coordination across the industry, requiring broad adoption of technology and behavioural changes to achieve optimal settlements. Participants must examine trade execution, processing, financing, payments, and settlement.

The Industry Working Group (IWG) has prepared a detailed roadmap to prepare for the implementation of T+1 in the North American markets. The T+1 Securities Settlement Industry Playbook (Industry Playbook) identifies key issues across a number of business areas that industry participants need to consider in moving to T+1, providing a timeline and milestones to address each issue. These issues include trade processing, asset servicing, documentation, securities lending, prime brokerage, and funding and liquidity.

The Industry Playbook is designed so that market participants can select the activities that are relevant to their organisation's requirements and structure and identify which industry participants are most likely to be impacted by respective activities. It also provides considerations for implementation and sets forth a framework to use in planning and executing impact assessments with dimensions organisations can consider such as: business model, product type, vendor and service bureau support, trading venue, risk and compliance, customer experience, and technology enablers.

Recognising the increased complexity of the EU markets, we envisage that EU market participants could leverage the IWG's work as a first step in identifying the steps to be taken to reach T+1 in the EU.

Following the identification of an implementation date, across the industry, participants will need to:

- assess, build, and install necessary system updates;
- enter into appropriate contracts;
- update processes, procedures, applications, and other documents;
- coordinate with counterparties as appropriate;
- perform all industry-wide testing as needed;
- remediate any issues identified during testing; and
- resolve any outstanding technical or operational issues with minimal disruption to actual market operations prior to the markets' opening on the implementation date.

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?

To minimise the costly effects of misalignment with the North American markets, we urge EU authorities to decide in early 2024 to move to T+1 settlement and to communicate a clear path for implementation in a 24-30-month timeframe. This will provide policymakers, stakeholders, and market participants a reasonable and practicable implementation period of 24-30 months to facilitate the move as soon as practicable. Transitioning to T+1 settlement will require coordination and effort across the industry, and the sooner market participants know that the EU is planning to move to T+1, the sooner they can begin transition planning. We note that, in the United States, the US Securities and Exchange Commission (SEC) proposed rule changes in February 2022 and adopted rule changes in February 2023, with a compliance date of May 28, 2024.

Our members generally agree that the EU could safely move to T+1 in a similar timeframe of 24-30 months, following clear notice from EU authorities that the EU will move to T+1 settlement. While we envisage that EU market participants could leverage the IWG's work in identifying the steps to be taken to reach T+1 in the EU, we do not advise shortening the implementation period because of the increased complexity of the EU markets. The increased complexity means the breadth of coordination and work is expanded. There could be unforeseen implementation issues and additional testing and enhancements may be needed.

Clear and definitive communications regarding the transition date are critical to the success of the transition, so that industry participants can prepare expeditiously and focus efforts on undertaking the necessary work.[6]

As set forth in the response to Question 1, we strongly recommend against attempting to move to T+0 and therefore do not even endeavour to estimate a timeframe for an ill-advised move.

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?

No response provided.

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

No.

Having different settlement cycles across instruments is not feasible. Instrument-specific misalignment would likely lead to increased short-term financing costs, increased trade fails, and decreased returns to investors, including retail investors. For these reasons, we strongly urge EU authorities not to consider different settlement cycles across different instruments.

A simple example using equity and fixed income markets illustrates these concerns. In a scenario where equities settle on a T+1 cycle and fixed income remains on a T+2 cycle, any investor,

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[6] In the United States, the Industry Working Group began its efforts soon after the proposed rule changes were announced and published its first iteration of the T+1 Securities Settlement Industry Playbook (Industry Playbook) in December 2022 – prior to SEC adoption of final rule changes. We strongly encourage the EU to adopt a similar model, with industry implementation planning overlapping the regulatory rule change vetting and approval processes. Implementation planning by the industry is an important step to validating that the proposed regulatory changes are feasible.

including regulated funds that employ a balanced investing strategy, would incur additional burdens each time they rebalance even a simple portfolio.

When selling equities to purchase bonds, for example, the investor would experience one day with uninvested cash on account, resulting from the receipt of cash on the equity sale one day prior to settlement of the bond purchase. This would then result in a deviation from the intended portfolio strategy and potentially reduced portfolio returns. In the reverse scenario, when selling bonds to buy equities, the investor would either need to borrow cash to settle the equity trade, or allow the equity trade to fail for one day, until the proceeds from the bond sale are realised.

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.

Having different settlement cycles across instruments is not feasible. Instrument-specific misalignment would likely lead to increased short-term financing costs, increased trade fails, and decreased returns to investors, including retail investors. For these reasons, we strongly urge EU authorities not to consider different settlement cycles across different instruments or different migration times for different products/markets/assets.

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?

No response provided.

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.

Global alignment of settlement cycles across major markets delivers clear benefits to investors by reducing operational risks and costs that arise from fragmentation. Following the North American move to T+1 in May 2024, it is in all investors' interests that T+1 should be the current global standard for securities settlement. We support efforts to expeditiously move to T+1 in the EU in order to minimise the period of misalignment and the associated impacts on our members. We recognise that the industry will need to undertake a tremendous effort and stand ready to support the transition.

A dislocation between North American and EU and settlement timelines will arise in May 2024. Our members are concerned that the frictions created by this dislocation will increase operational risks and the cost of investing in the EU, which they are further concerned could constrain liquidity providers' ability to trade and impair liquidity in the EU. Our members agree that it is vital to minimise the misalignment period to mitigate the negative impacts.

In addition, our members are concerned that negative impacts associated with misaligned settlement cycles would be exacerbated if there is misalignment between the EU, UK, and Switzerland, since the size of the negative impacts is directly related to the interconnectedness of the misaligned markets. Our members identify coordination of settlement timelines across these markets as critical because of the depth of their interconnectedness. We encourage EU authorities to coordinate closely with other jurisdictions and to establish a dedicated T+1 dialogue with authorities in the UK and Switzerland to avoid causing avoidable frictions for EU market participants and impairments to the EU markets.

ETFs provide an instructive example of the negative impacts caused by misaligned settlement cycles. Cash management issues and increased settlement fails may arise for European ETFs with global components, as the underlying securities in North American markets will settle on T+1 but the funds will settle on a T+2 basis. We expect that the bid/offer spreads on ETFs will widen, factoring in the additional costs of trading, borrowing, hedging and/or settlement that are associated with the settlement cycle dislocation.

European fund investors may also experience greater volatility, as it will be more challenging to provide valuations based on close-of-business prices. In addition, we expect that misalignment would increase the costs of securities lending and the complexity to rebalance portfolios, which could result in a decrease in portfolio performance and increase the cost to invest in the EU.

EU participants can address the funding and operational challenges associated with misaligned settlement cycles in many ways. We expect these costs to reach investors. We recognise that some upfront costs must be incurred as the EU transitions to T+1, but once alignment is reestablished, many of the impacts caused by misaligned settlement cycles will no longer be of concern.

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.

No response provided.

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

Yes.

Global alignment of settlement cycles across major markets delivers clear benefits to investors by reducing operational risks and costs that arise from fragmentation. Following the North American move to T+1 in May 2024, it is in all investors' interests that T+1 should be the current global standard for securities settlement.

A dislocation between North American and EU and settlement timelines will arise in May 2024. Our members are concerned that the frictions created by this dislocation will increase operational risks and the cost of investing in the EU, which they are further concerned could constrain liquidity providers' ability to trade and impair liquidity in the EU. For example, European ETFs that hold securities in North America are likely to incur financing and funding costs resulting in wider spreads on ETF prices – which negatively impact ETF investors.

Shortening the settlement cycle in the EU would bring realignment between the North American and EU markets and is expected to eliminate the negative impacts that occur following the North American move to T+1. Moreover – and critically – shortening the EU's settlement cycle would enable the EU to maintain alignment with the UK and Switzerland, which are working to move to T+1. Because there is significant interconnectedness between the EU and these other major markets, our members are deeply concerned about the significant negative impacts arising from potential dislocation. The magnitude of the potential negative impacts of misalignment is directly related to the depth of this interconnectedness. Our members' concerns grow with the anticipated duration of the misalignment.

Therefore, to minimise the costly effects of misalignment with the North American markets, we encourage EU authorities to decide in early 2024 to move to T+1 settlement and to communicate a clear path for implementation in a 24-30-month timeframe. This will provide policymakers, stakeholders, and market participants a reasonable and practicable implementation period of 24-30 months to facilitate the move as soon as practicable. In addition, we also encourage EU authorities to coordinate closely with other jurisdictions and to establish a dedicated T+1 dialogue with authorities in the UK and Switzerland, so that these markets can move to T+1 in alignment. Alignment of settlement cycles across these markets would mitigate risks associated with having different settlement cycles and help market participants, including UCITS and other regulated funds, to better manage liquidity, which can reduce and simplify financing needs.

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

Yes. Moving to T+1 settlement enables the EU to be aligned with the North American markets and to eliminate the costs associated with that misalignment.

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.

EU market participants could leverage the North American Industry Working Group's (IWG) work as a first step in identifying the steps to be taken to reach T+1 in the EU. In addition, EU market participants will need to take steps to address the shortening of the North American settlement cycle to T+1 and many of these steps will be necessary to implementing T+1 in the EU.

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

No, our members do not view a permanent misalignment of settlement cycles as a viable option. Misalignment of settlement cycles creates unnecessary operational and liquidity concerns and increases risk. A permanent misalignment of settlement cycles would unnecessarily entail increased counterparty and liquidity risks, funding issues, and operational concerns. Investors would face higher costs associated with the solutions to address the impacts of the dislocation.

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.

It is critical that EU authorities provide clarity in early 2024 regarding the EU's commitment to move to T+1 settlement with a reasonable implementation period of 24-30 months. We are concerned that a lack of clear commitment or undue delays in the process could create a risk that some market participants determine to voluntarily implement T+1 settlement standards before the EU has moved to T+1 settlement and, thus, create market fragmentation. We urge EU authorities to act decisively and expeditiously to avoid such a result.