

# European post-trading roadmap: T+1 and harmonization challenges

## 1. Improvement of settlement efficiency

The Chair highlighted that other jurisdictions, such as the US, are moving forward with shortening the settlement cycle. It is important to understand whether Europe should also move in that direction, whether this would support the capital markets union (CMU) objectives, and also the roles that regulation, new technologies and automation may play in this context.

### 1.1 Potential benefits of improved settlement efficiency

A regulator noted that supervisors want settlement activities to be safe and efficient. Settlement efficiency is important for buyers and sellers of securities, as it conditions the fact that assets are purchased and cash received safely, without extra penalties and costs. Settlement efficiency has improved significantly in Europe, particularly for equity transactions, with the implementation of the Central Securities Depositories Regulation (CSDR), which established measures to reduce settlement failures. The CSDR review aims to increase efficiency further. ESMA is also working on measures to improve the penalty mechanism.

The main current question, the regulator stressed, is whether the settlement cycle should be shortened to T+1. ESMA launched a call for evidence a few months ago, the results of which are being analysed. One benefit is that reducing settlement time to T+1 reduces liquidity needs and counterparty risk. In theory, there may also be a reduction in collateral needs and collateral margins, leading to some savings, although they seem fairly limited. It is also important to align with other jurisdictions, given that the US, Canada and Mexico are moving to T+1 in two months and the UK is initiating a debate on this topic.

An industry representative suggested that moving to T+1 could be a catalyst for a further harmonisation of practices and a removal of remaining post-trading barriers. However, from a custodian perspective, the potential savings seem very small compared to the costs. The results of ESMA's cost/benefit analysis should be waited for before any final decision is taken. The figures that have been shared by the European Association of Clearing Houses (EACH) so far demonstrate that the savings in terms of margin calls are equal to 0.5% in the equity market, but the costs will probably be more than that, because such a project requires a huge amount of resources and capacity. The Commission has argued that moving to T+1 will enhance the competitiveness of EU capital markets, but the attractiveness of European markets and the competitiveness of EU players has nothing to do with the settlement cycle.

### 1.2 Operational implications and challenges of a move to T+1

A regulator emphasised that the EU has a very complex ecosystem. There are more than 20 CSDs and several currencies. If the settlement cycle is reduced, that should not be to the detriment of settlement efficiency. The reduction will also require significant investment in automation and technology.

An industry representative noted that when the discussion about possible migration to T+1 started in Europe, the CSDs decided to take a neutral position, as they are already prepared to settle at T+1, if needed. CSDs will follow the decisions of the public authorities, but there is a need for the whole market to be prepared, which is a challenge in a context where many regulatory changes and ECB projects like the Eurosystem Collateral Management System (ECMS) are already being implemented. The migration to T+1 implies a huge change for all stakeholders, and for custodians even more so than for the CSDs. Significant preparation and testing will be necessary, as well as taking into account the learnings from the US experience, as moving to T+1 is more complex than the previous change from T+3 to T+2. In terms of timing, a possible migration should occur in the second half of the year to avoid the season of corporate events, which is very important for CSDs and the markets, and if possible at the same time in the EU, the UK, and Switzerland.

A second industry representative agreed that the whole ecosystem end-to-end must prepare for a transition to T+1. One of objectives of CMU is to make European markets more attractive, which includes attracting investors from different time zones, but T+1 will create further challenges for certain products and activities, such as FX and exchange-traded funds (ETFs). Lending desks in a T+1 environment are also going to have higher risks of settlement fail and of being in breach of the regulatory framework.

A third industry representative noted that a move to T+0, which is sometimes mentioned, would be even more challenging and is not a desirable objective for the industry in the short to medium term. There are two types of T+0: end of the day and instant atomic settlement. The latter form of T+0 would require a huge change in terms of legacy infrastructure, and is not necessarily in the common interest of all participants, because it would require a pre-funding of each trade, which would increase the costs of transactions and have liquidity consequences.

### 1.3 Next steps for preparing to move to T+1

A regulator suggested that moving to T+1 seems inevitable, given that the US, Canada and several other jurisdictions are currently doing so. The question is therefore not if the EU should move, but how and when, as recently stated by Commissioner McGuinness. Being

aligned in the process with the UK and Switzerland is important, as is having a joint purpose and strong co-ordination among all market stakeholders.

An industry representative emphasised that the need to move to T+1 must be quickly and carefully assessed, because having different settlement cycles in the various jurisdictions is suboptimal. The decision of the US and Canada to move to T+1 has more implications than India or Mexico, which do not have the same levels of cross-border transaction volumes. A pragmatic approach should be taken and the consequences should be assessed product by product. Products that have a strong non-EU component, such as exchange-traded funds (ETFs) with US underlying, FX or depository receipts, are most important to consider. Nonetheless, the EU will not be moving to T+1 in two months, so there will be different settlement cycles for a period of time.

A second industry representative stated that collaboration across all sectors of the industry and with regulators is critical to successfully implement T+1, according to the experience in the US. SIFMA, ICI, DTCC and the SEC worked collaboratively over a number of years to produce a roadmap for the US industry's transition to T+1 including a playbook, a set of testing plans and documentation for firms. The UK's Accelerated Settlement Taskforce is looking to bring a similar collaboration into play. In the initial phase, it is looking at publishing best practices and defining how to increase standardisation and harmonisation in the market, and then it will endeavour to build out the transition plan. The question for Europe is how to mobilise its own market. A sensible approach would be to set up a task force in charge of driving that implementation, and defining a transition plan in close collaboration with the UK and Switzerland.

A third industry representative agreed that creating an industry working group to prepare the implementation of T+1 with an end-to-end perspective is very important. The group needs to include the buy side, the sell side and the market infrastructures and also consider the possible unintended consequences of that change.

#### **1.4 Interplay with the digitalisation and automation of settlement processes**

The Chair asked how the objective of shortening the settlement cycle interacts with the increasing digitalisation of securities processes and the ongoing implementation of new technologies such as distributed ledger technology (DLT).

An industry representative suggested that a successful transition to a T+1 settlement cycle in the EU will require an increase in the current levels of post-trade automation. T+1 provides an opportunity to enhance operational efficiencies by encouraging an automation of manual processes, and an adoption of industry standards and best practices.

The industry representative emphasised that there has been a lack of investment in the automation of post-trading processes in the EU and progress is needed independently from the objective of moving to T+1. Automation is particularly needed in two main areas: trade matching and standing settlement instructions

(SSIs). Trade matching is a critical part of the post-trade lifecycle and serves as the first safety check after execution has taken place and the buyer and seller have agreed on the details of the transaction and before the settlement process begins. Trade matching allows counterparties to identify and address exceptions that might cause the transaction to fail. The quicker this can be done, the higher the chances are of meeting an accelerated settlement timeline. Trade confirmation, allocation and matching should take place on the trade date, to allow for T+1 settlement. SSIs which relate to information that remains the same from one transaction to another are another critical component of the post-trade lifecycle that requires further standardisation and automation to avoid trade fails and facilitate accelerated settlement. Manual SSIs and the current absence of storing, and sharing of SSI data in a standard and automated fashion across the industry lead to inaccuracies and incompleteness. This introduces risks and inefficiencies in the post-trade process and is often the primary reason for trade failures.

To address both areas - trade matching and SSIs - firms should evaluate best practice solutions that allow for automation and improvement of these post-trade processes, and then make the necessary investments. Automated central matching platforms, enriched with golden source SSI data and workflows that facilitate accelerated settlement already exist, and are key to achieving greater settlement efficiency. Moving towards further automation requires collective work throughout the industry on how to drive more efficient workflows from an end-to-end perspective and how to interoperate.

A Central Bank official noted that the policy discussions on T+1 have a shorter-term horizon than the perspective of using at large scale new technologies, such as DLT, in settlement processes. The challenges of moving to T+1 for cash securities transactions do not stem from the limitations of existing infrastructures, but from the lack of automation and straight-through processing.

DLT and other technologies such as robotic process automation or AI are not a panacea for tackling automation issues, the official stressed, however, they can definitely support process improvements. Use cases should be developed and the assessment of how DLT can add value in the post-trading space should continue. The EU DLT pilot regime will support this, and the ECB, together with several national central banks, is very active in this area, for example by conducting work on how wholesale financial transactions recorded on DLT platforms could be settled in central bank money.

## **2. Further improvements needed in the post-trading space**

### **2.1 Enhancing harmonisation, standardisation and integration**

A Central Bank official presented the main initiatives that are being conducted by the Eurosystem in the securities settlement space. The Eurosystem is continuing to develop the TARGET Services, which aim to ensure the

free flow of cash, securities and collateral across Europe and settlement in central bank money. These include TARGET2 (T2) for settling payments, TARGET2 Securities (T2S) for settling securities, TARGET Instant Payment Settlement (TIPS), and ECMS for collateral management. Moreover, in the previous year, 5 new markets onboarded to T2S while ECMS is scheduled to go live later this year. Finally, separately from the TARGET services, the EU issuance service which has been developed also with the support of the ECB / Eurosystem, was launched in January 2024.

Going forward, the focus should be on harmonisation and standardisation in order to reduce fragmentation and increase efficiency in the European market. Work on standardisation has already made significant progress in the context of the Eurosystem's Advisory Group on Market Infrastructures for Securities and Collateral (AMI-SeCo)<sup>1</sup>, which has agreed on standards for European markets and committed to their implementation. One area where AMI-SeCo has played a key role in terms of harmonisation is corporate events processing, which includes corporate actions, shareholder identification and general meetings. AMI-SeCo published the 2023 Corporate Events Compliance report which provides an assessment of the current levels of compliance with European corporate events standards<sup>2</sup>. The monitoring exercise shows improvements in compliance, but the level of compliance remains insufficient. Non-compliant entities are being contacted to encourage them to make progress at a faster rate. A second area is collateral management. The 7th AMI-SeCo SCoREBOARD reporting the progress in implementing the Single Collateral Management Rulebook for Europe (SCoRE) was published in December 2023<sup>3</sup>. Although significant progress has been achieved overall by the monitored actors, several markets reported delays. The rescheduling of the SCoRE Standards implementation date to November 2024, in line with the go-live date of ECMS, gives markets more time to prepare.

Further areas of harmonisation concern withholding tax procedures and the ISO 20022 messaging standard, the official noted. The European Commission published the Faster and Safer Relief of Excess Withholding Taxes (FASTER) proposal in June 2023, which sets out new rules to make these procedures more efficient and secure, and to prevent tax abuse in the single market. The adoption of the ISO 20022 messaging and data dictionary will also help to drive simplification and convergence, foster further improvements, while reducing manual interventions and risk of operational errors. Beyond these standardisation efforts, AMI-SeCo is working on the identification of any remaining barriers to integration in the post-trading space and based on this fact-finding may discuss further harmonisation areas.

An industry representative remarked that there is currently no uniform identification reference added to

transactions that persists throughout a transaction's lifecycle. This could also support standardization. Securities markets should look to how derivatives markets solved this problem with the introduction of Unique Transaction Identifiers (UTIs) for trade reporting purposes. UTIs allow transaction identification to happen near instantaneously and create greater visibility across the transaction chain. This enables quicker identification and resolution of bottlenecks or settlement lifecycle issues, while reducing operational risks and costs arising from potential settlement fails. Many elements, such as UTIs that may support further standardisation are already available, but they are not all fully implemented, and also need to be considered from a cross-market perspective. The focus should be on implementing existing rules rather than issuing new ones, and on ways to leverage the technology already in place in traditional markets to its maximum.

A second industry representative highlighted that although there is still fragmentation in European post-trade, a great deal has already been done to improve the situation. When making comparisons between the US and EU infrastructure, it is important to consider that achieving the same level of integration will not be possible, because the US is a single jurisdiction with one currency and one language, which is not the case in Europe. Further progress can nevertheless be made to reduce fragmentation. One of the key drivers for this is T2S, which was initiated in July 2006 and implemented from September 2015. However, T2S is not being utilised for cross-CSD transactions at present. Only 1.5% of cross-CSD transactions are settled in T2S and traditional approaches with the International Central Securities Depositories (ICSDs) and global custodians acting as intermediaries are still predominantly being used instead. An increased use of 'highways' like T2S is needed to achieve an integrated settlement system in Europe. A first step for this is to identify the remaining barriers that need to be overcome, which AMI-SeCo is currently doing. Withholding tax procedures is one of the most important barriers.

A third industry representative noted that the European jurisdiction is complex with 27 member states, many CSDs, many CCPs, many trading venues, many competent authorities, different tax regimes and 14 currencies. The first Giovannini report on post-trading barriers was published 23 years ago, but the lifting of these barriers is still not achieved.

## 2.2 Evolutions needed to support the CMU objectives

A regulator remarked that the broader issue going forward is defining a relevant European post-trading roadmap to support the CMU objectives. EU markets and infrastructures need to operate in an efficient way, in order to support investments in the capital markets and the funding of companies. EU markets should also be competitive internationally in terms of cost, and be safe

1. AMI-SeCo is a market stakeholder forum sponsored by the Eurosystem (i.e. the ECB and the national Central Banks of the countries that have adopted the euro), bringing together central securities depositories, central counterparties, banks, central banks, issuers and industry associations. It covers the European Economic Area, UK and Swiss markets.

2. i.e. Market Standards for Corporate Actions Processing, Shareholder Identification and T2S Corporate Actions Standards.

3. SCoRE Standards cover Triparty Collateral Management, Corporate Actions and Billing Processes (while AMI-SeCo aims to define further SCoRE Standards).

in order to bolster investor confidence and contribute to financial stability. Prioritisation is needed, as resources are limited at the policy-maker and supervisory levels. It is important to keep in mind the final objective of CMU in order to allocate resources appropriately and make sure that the right incentives are provided. The market will do the rest.

An industry representative suggested that T+1 could trigger a reshaping of the competitive post-trading landscape. This may lead to re-examine the issues raised by the current fragmentation of central counterparty clearing houses (CCPs) and central securities depositories (CSDs) in Europe, in terms of costs and complexity of clearing and settlement activities and evaluate the benefits of further consolidation.

Another industry representative noted that it is often suggested that further consolidation in the post-trade environment would make European markets more attractive, but in reality post-trading is already efficient and working well in Europe. The top five CSDs in Europe already represent 83% of the European capital market. The main challenge ahead is to attract more investment flows into European corporates, notably from the larger US and Asian asset managers. That requires a better understanding of the needs and behaviour of these players, and implementing adequate incentives to drive more investment. Fast action is needed, because Europe is losing ground to the US and Asia in terms of investments. Improving the plumbing will not contribute significantly to that objective. It is not certain either that further consolidation of CSDs would contribute to driving more investments into Europe, and whether member states would be ready to give up part of their current role in this space. On the retail side, the Markets in Financial Instruments Directive (MiFID) rules are also an obstacle.

That needs to be tackled in order to increase retail investment in European capital markets, as well as providing appropriate fiscal incentives.

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## Conclusion

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The Chair summarised that, with regard to shortening the settlement cycle, there are mixed views about the benefits. There is a general agreement that securities settlement works well at present in the EU, and this achievement should not be compromised. In addition, the European post-trade landscape is more complex than in the other main jurisdictions. However, the political pressure appears to be quite high for there to be a move to T+1. That evolution should be prepared for and conducted in a pragmatic and collaborative way. Dialogue is needed at market level, for example in a cross-sector industry working group, to formulate a clear transition plan. ESMA's assessment of the costs and benefits of moving to T+1 is needed, but reflecting on the topic should be initiated at industry level in the meantime.

Regarding additional improvements and policy priorities in the post-trading space, there are ongoing initiatives on harmonisation and standardisation at the Eurosystem level, and significant achievements related to the TARGET systems, including ECMS going live at the end of the year. The settlement systems in Europe are generally working well, following a number of improvements in recent years. Automation should be improved across the market. DLT will not solve all of the issues at stake, but it should be part of the solution. The key questions are how to attract more investment into Europe, and what further incentives are needed to that end.