Clearing and settlement: main regulatory developments and further issues

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1. Clearing: EMIR 3 agreement and next steps

1.1. Key measures agreed in the EMIR 3 review

The EMIR 3 review, which was agreed by the co-legislators in February 2024, aims at achieving three main objectives.

First, the review seeks to improve the competitiveness of the EU clearing ecosystem, with measures to reduce approval timelines for risk model changes and product extensions deemed minor, in order to shorten the time to market for new products and models. EMIR 3 also creates a new central database where EU CCPs will be required to submit in one place their applications for authorisation, extensions of services and validations of risk models.

The second objective is to improve the safety and resilience of the EU clearing ecosystem in the perspective of an increase of EU clearing volumes, with a reinforced EMIR framework[1]. The final text supports a stronger coordination role for ESMA, in particular in emergency situations, and focuses on enhancing supervisory convergence between National Competent Authorities (NCAs), with for example the co-chairing with ESMA of the CCP supervisory colleges and the new requirement for ESMA to provide Opinions on the compliance of EU CCPs with EMIR provisions and on the annual reviews of CCPs conducted by the NCAs.

The third objective is to reduce the EU's excessive reliance on third-country CCPs, with the introduction of a requirement for EU market participants to hold an active account at EU CCPs. The final text agrees to implement the Active Account Requirement (AAR) in a phased manner, with first a minimum level of representative activity to be cleared in the AAs at EU CCPs, followed by a programmed report by ESMA on the impact of this measure 18 months after the entry into force, based on an aggregate monitoring of the AAR at EU level by the Joint Monitoring Mechanism[2], and a review clause by the Commission within 24 months of the entry into force.

1.2. Main next steps

An important number of EMIR 3 requirements remain to be further specified by ESMA. This includes the clarification of changes (e.g. of risk models, products...) for which a reduced approval timeline should be requested and a specification of the conditions to be met by counterparties under the AAR.

ESMA has also been tasked with developing forward-looking reports in several areas beyond EMIR 3, including the possible extension of EMIR to CCPs clearing spot commodities and crypto-assets and considerations around the potential segregation of accounts across the clearing chain of non-financial and financial counterparties.

2. Settlement: T+1 assessments and measures proposed to support CMU

2.1. Progress made in the European settlement space

The efficiency and resilience of post-trading activities are crucial for the growth and integration of EU capital markets. Over the past two decades, substantial progress has been made in the settlement space, including the removal of most of the Giovannini barriers, the implementation of the

1. Measures include increased transparency and reporting requirements, stricter risk management obligations for CCPs.

2. The Joint Monitoring Mechanism (JMM) in EMIR 3.0 is a supervisory framework designed to ensure compliance with the new regulatory requirements, particularly those related to the active account requirement. The JMM will track the use and proportion of AA across the EU to reduce excessive reliance on the non-EU (third-country) CCPs that are seen as posing risks to EU financial stability. This mechanism will collect key data metrics, such as the number of AA and the volume of transactions cleared through them. It aims to support authorities in monitoring cross-border risks and ensuring that the policies promoting EU financial stability and clearing independence are effective.

Central Securities Depository Regulation (CSDR), and the launch of TARGET2-Securities (T2S), which have driven significant harmonization and integration improvements, as well as greater settlement discipline.

Despite these advancements and industry-led consolidation efforts, the EU post-trading landscape remains fragmented. For example, the EU still has 28 active CSDs for equities, with the top five handling over 80% of the volumes, compared to just one in the US. This fragmentation limits economies of scale and hampers cross-border settlement. In addition, the implementation of T2S has not led so far to a development of cross-CSD settlement[3]. Persistently divergent legal and tax systems, as well as differing market practices across Member States, further complicate and increase the cost of cross-border transactions, hindering deeper integration of EU securities markets.

Harmonization efforts in the post-trading space are continuing, albeit incrementally. The latest CMU Action Plan proposes a targeted harmonization of corporate insolvency frameworks and improvements to withholding tax procedures to boost efficiency and security. In May 2024, the Council reached an agreement (general approach) on the FASTER Directive (Faster and Safer Relief of Excess Withholding Taxes), aimed at simplifying withholding tax procedures across the EU while reinforcing protections against tax fraud and abuse.

Additionally, the recently adopted CSDR Refit regulation aims to reduce the financial and regulatory burdens of CSDR on CSDs, enhance their ability to operate across borders, and bolster financial stability. Key measures include simplifying the passporting regime, improving supervisory cooperation, expanding access to bank-like ancillary services, and strengthening the settlement discipline regime.

2.2. Additional actions being considered

Further improvements are being considered in two main areas: shortening settlement cycles and deepening the integration of EU post-trading to support the Capital Markets Union (CMU).

In May 2024, the US, Canada, and Mexico transitioned to a T+1 (trade date plus one day) settlement cycle, while India equity markets have been operating on a T+1 basis since 2023. In the UK, the Accelerated Settlement Taskforce has recommended moving to T+1 by the end of 2027. In response, a technical group established by the UK government is expected to present recommendations on the next steps for the implementation of T+1 by the end of 2024.

Meanwhile, ESMA has conducted a call for evidence to assess the impact of shortening the securities settlement cycle in the EU. This assessment examined the effects of a shift to T+1 on market participants' operations, the potential benefits and costs, and the practicalities of implementation. ESMA will submit a report on T+1 to the European Parliament and the Council by mid-January 2025.

Preliminary findings indicate that T+1 could bring significant benefits to the European market, including increased efficiency, improved resilience, lower margin requirements, while addressing the difficulties created for EU market stakeholders by the misalignment with some key markets such as the US[4]. However, this transition also presents challenges, such as the need for all market participants to adapt their processes and align with international timelines in a timely manner, which will require clear regulatory guidance, effective industry collaboration and a robust governance framework. Consideration must also be given to the EU's unique market characteristics, including its diversity of currencies, market infrastructures, and differing tax and legal systems across Member States.

Although no timeline has been set yet for the implementation of T+1 in the EU, many market participants have suggested that aligning the timeframe with the UK and Switzerland would be desirable.

The further integration of securities post-trading at the EU level is also considered crucial for supporting CMU, as simplifying and reducing the cost of cross-border settlement could stimulate greater capital flows within the EU. Several reports published in 2023/24 on the future steps of the CMU[5] and also the Letta report on the single market, recommend achieving a single pan-

3. According to a report on CMU published by the French Ministry of Finance in April 2024 (Proposals for a Savings and Investments Union), transactions with a cross-border dimension (flows directly on T2S by two CSDs referred to as cross-CSD settlement) only amounted to less than 1.5% of settlement volumes and 4% of settlement amounts on T2S in 2022. This means that the vast majority of settlement is "intra-CSD" settlement with a single CSD handling the transaction flows on T2S for other CSDs, including cross-border transactions. In effect T2S has not become a node of interoperability for cross-border transactions according to the report but is rather a tool for outsourcing certain technical tasks, mainly used for national purposes. It is hoped that further harmonization efforts concerning *e.g.* collateral management, withholding tax procedures… will contribute to increase T2S cross-border settlement volumes.

4. Concerns for issuers seeking funding in the EU and in the US and the difficulties stemming from the misaligned settlement cycles for their corporate events have been raised. Issues for the asset management industry, for instance with regards to ETFs invested in securities in jurisdictions with different settlement cycles have also been mentioned. See *Eurofi Views Magazine* September 2024, Natasha Cazenave, ESMA.

5. Proposals on the further integration of securities markets and harmonization of securities rules are made for example in the Eurogroup statement on CMU (March 2024), the ESMA position paper on CMU (May 2024), the proposals of the French Ministry of Finance for a savings and investment union (April 2024).

European rulebook for securities clearing, settlement, and collateral management, as well as pursuing harmonization efforts on legal aspects that currently hinder the integration of securities post-trading activities, such as certain areas of corporate laws, securities laws, tax processes, accounting frameworks, and corporate insolvency regimes[6].

An additional suggestion from the CMU report drafted by the French Ministry of Finance[7] is to expand the role of T2S in cross-border settlement, which remains limited. Achieving this would require further convergence of securities laws, collateral management and withholding tax procedures as well as measures to increase the role of T2S in cross-border transactions[8]. A longer-term option proposed involves creating a "European unified ledger" – a single blockchain infrastructure that could potentially be developed in connection with T2S – to provide a common platform for a future digital CMU based on asset tokenization.

Additionally, the Letta report suggests pooling certain existing market segments at the EU level – such as SME markets – that currently lack the size, liquidity, and visibility to attract EU and international investors. It also recommends creating EU-level exchanges focusing on new market segments – such as deep tech or digital assets - which would also potentially need to be supported by common post-trading infrastructures.

6. Notably with regard to the ranking of claims and insolvency triggers or the rules for financial collateral.

7. Proposals of the French Ministry of Finance for a savings and investment union (April 2024).

8. The report of the French Finance Ministry suggests that this requires inter alia allowing T2S to perform some functions traditionally offered by CSDs and making T2S more attractive for its users by extending the operating hours of the platform or reducing operating costs.