T+1 and other post trading priorities

1. The US experience of moving to T+1 and ongoing processes in the EU and UK

1.1 Lessons learned from the shift to T+1 in the US

An official stated that moving to T+1 was a priority in the US in order to reduce risk and margin requirements and enhance liquidity in the securities market. The US transition to T+1 went well. A key lesson from this experience is that preparation, coordination and cooperation are essential. The preparation and implementation of the change was a collective effort involving an enormous number of participants across the US private and public sectors. There were also significant interactions with foreign regulatory counterparts and key international industry players. Much time was spent in the final weeks before the deadline to ensure that the new process would work smoothly.

Other jurisdictions wishing to move to T+1 should also consider a forcing mechanism, as collective action is required and there is always a valid reason for delay if change is not mandatory. It is important to set a firm target date and then consider how to bring all stakeholders together to meet that deadline.

An industry representative agreed that the transition to T+1 in the US had gone very smoothly. This was the result of more than three years of collective effort and cooperation within the industry and between the industry and the SEC. The starting point was a clear regulatory mandate, a clear deadline and clarity for the market on the rules and expectations, which allowed the industry to come together efficiently. The goals were very specific, requiring same-day confirmation, allocation and affirmation, with a 9:00 a.m. cut-off by DTCC. Investment in automation and efforts to drive efficiencies in post-trade processing were also essential elements in supporting the move to T+1.

Metrics shared with the SEC and the industry demonstrate the success of the transition. Same-day affirmation rates rose to 95% from 65% a year ago, exceeding rates under T+2 settlement, while failures remained in line with T+2 levels. Three months after the introduction of T+1 settlement, the US clearing fund has fallen by 28%, representing a margin saving of $3.2 billion.

1.2 Ongoing assessments in the EU

A regulator noted that the EU moved to T+2 10 years ago, but the opportunity of moving to T+1 now needs to be assessed. ESMA has been mandated to examine the costs and benefits of this change and the impact on market participants' operations, and has been asked to outline a potential roadmap, taking into account the impact of ongoing changes in other jurisdictions. Accelerating the settlement cycle is a project that requires deep understanding and coordination on all fronts of the securities market. The settlement cycle must work for all market participants, as it affects all parts of the securities markets. ESMA launched a Call for Evidence to gather evidence on the impact of T+1 settlement on the EU market and published a feedback statement in March 2024.

ESMA continues to engage with market participants and industry to ensure that the issues and solutions are clearly identified. A final report on T+1 is due no later than January 2025. The European post-trade landscape is complex and T+1 is expected to be more challenging to implement than in the US. It will be important to leverage the results of the ongoing industry task forces and political guidance will be needed on the timeline.

1.3 Preparations in the UK

An official stated that the UK had taken on board the lessons of the US experience about the importance of preparation and collaboration. There is a great deal of energy in the UK around the project of moving to T+1 and significant progress is being made. An Accelerated Settlement Taskforce on T+1 reported to government in early 2024, and its recommendations on timing have been accepted. The aim is to implement T+1 in the UK by the end of 2027. A technical group has been set up in the UK to bring the industry together to analyse the technical issues needed to make T+1 a success. Nearly 500 firms are involved. It is essential to manage the process with all stakeholders.

Another important consideration is that the UK's move to T+1 should ideally be aligned with the EU and Switzerland in order to reap the full benefits of this change, with close coordination between authorities on the preparation process and timing. It is important to move together if possible because trading venues and market infrastructures operate across these different jurisdictions, for example some instruments are traded in the UK but cleared or settled in the EU.

2. Moving to T+1 in the EU: benefits and challenges

The Chair noted that the European post-trade landscape is more complex than in other major financial jurisdictions. Initially, the relevance of a move to T+1 for the EU seemed uncertain, but with the recent implementation of T+1 in the US and Canada, and other jurisdictions considering the same change, the discussion has moved forward. The question now is when and how to make the move in the EU without compromising settlement efficiency and increasing settlement risk. A broader question is to what extent shortening the settlement cycle would support the Capital Markets Union (CMU) and what other measures are needed to enhance the efficiency, integration and resilience of the EU securities post-trading landscape.

2.1 Expected benefits

A regulator stated that the feedback received in the ESMA call for evidence showed that T+1 can reduce risks and costs. Significant investments are required but they should be outweighed by the benefits. Shorter settlement means less time to cover, leading to margin savings of approximately €3 billion, which is significant and consistent with what has been observed in the US. These cost reductions can only be achieved however, if there is alignment with other jurisdictions, as the current misalignment with the US creates friction for some European participants and for firms listed in both markets.

An official stressed that T+1 will improve the functioning of the securities market and will help to provide the incentive, attention and direction for back-office optimisation, which will bring many additional improvements. The issue is more complicated for the EU than for the US, but the move to T+1 will likely bring huge improvements for investors and market participants.

2.2 Implications of T+1 for the CMU

An industry representative noted that whether T+1 will help achieve the CMU's objectives is uncertain, but in the longer term, not moving to T+1 would be an obstacle for the CMU. In the short term the investment is quite significant and could divert the attention of the ecosystem for some time from the CMU. Another issue is that the costs of such a project are specific to each firm and the benefits are general to the markets, which could create tensions within the industry. It has been suggested that T+1 could encourage consolidation in the market, with some asset managers no longer able to operate in the market due to the investment and costs associated with moving to T+1, but this remains to be proven. Although there may be benefits in the post-trading area, these will not be major, as T+1 will not help to reduce fragmentation.

Another industry representative stated that T+1 is not going to shift the CMU in a significant way, but it will bring attention to the need to improve operational efficiency and back-office operations in European post trading and will build a foundation that can help drive standardisation and efficiency further, notably at the central securities depository (CSD) level. That is a huge opportunity for both the UK and Europe when it comes to optimising the process flows.

Efficient post-trade processes and automation are vital to achieving accelerated settlement. Trade-level matching is a critical part of the post-trade lifecycle that allows counterparties to identify exceptions that may cause the transaction to fail. By completing the allocation, confirmation and trade-matching processes on the trade date, firms can increase the time available to address errors, thereby reducing the risk of settlement fails. Straight-through processing must also be a priority in the EU since there are more intermediaries and messages in the settlement process than in the US. Same-day processes should be implemented ahead of T+1 implementation to ensure preparedness.

Several issues need to be addressed that hamper upstream efficiency, including bilateral securities transactions that are executed prior to hitting a CSD, firms that still use faxes to complete transactions, and the significant over-the-counter (OTC) bilateral volume that continue to flow through the CSDs. Downstream problems at the CSD and central counterparty (CCP) level need to be addressed in parallel.

A regulator agreed that T+1 is not going to solve all the problems in the European capital markets, but it should help to increase their attractiveness. This is essential for the CMU since large amounts of funding need to be attracted to European capital markets to support innovation and sustainable projects. Fragmentation issues will remain in the settlement space, but T+1 can help in providing a push for more automation and standardisation. This will lead to a progressive harmonisation of markets and greater operational efficiency, which in turn can lead to more integrated and more attractive markets.

Another regulator concurred that the work on T+1 could be a catalyst to improve the overall efficiency of securities markets and enhance the post-trading landscape, thus supporting the CMU, because T+1 requires an improvement of processes and interconnectivity.

2.3 Implementation challenges

A regulator highlighted that the market feedback received in the Call for Evidence that concluded in March 2024 is that T+1 is feasible, but views were mixed about how and when T+1 should be implemented. The main message was to avoid sequencing the implementation and to implement T+1 for all asset classes at the same time. A number of challenges were identified related to corporate events and corporate actions. In the fund space some issues were raised around exchange traded funds (ETFs), and there was also a clear call to try to align changes in Europe with the UK and Switzerland. The market also warned against going directly to T+0, which would be too significant a change.

The debate has evolved following the successful implementation of T+1 in the US. There is now a broader consensus in Europe that T+1 can work; discussions are now focusing more on how and when to implement T+1 and how to minimise costs. It is important to pursue the assessment of the issues raised by this change in order to address them in a timely manner.

An industry representative commented that providing a cost estimate of the T+1 project at industry level has been very difficult because how it will be implemented has not yet been precisely defined. The scope of the project in terms of products, technical specificities and whether the ultimate goal is T+1 or T+0 need to be clarified. Moving to T+1 will be costly because European markets are complex and fragmented, and it is also difficult to identify a comparable project in the past. TARGET2 Securities (T2S) could be taken as a benchmark, but T+1 is more impactful than T2S because it will affect trading, clearing, settlement and custody. Europe also does not have a common market infrastructure such as DTCC in the US that can help to coordinate the project.

Defining the appropriate timing is also critical. Moving to T+1 could be a catalyst for other improvements in the market, but a rushed transition to T+1 would be detrimental for the competitiveness of the European market, given the magnitude of the project and the specificity of the European market structure. In addition, although a coordinated approach with other jurisdictions such as the UK and Switzerland seems preferable to avoid frictions, a strict alignment may not be necessary. The impact of a misalignment needs to be assessed more precisely, taking into account factors such as the volume of cross-border transactions and interdependencies between jurisdictions. It will also be necessary to determine how the approach could be implemented in the EU to decide on a timetable. The UK and Switzerland have already indicated that they are flexible in their timelines, which should be used as an opportunity to define the optimal timing for the three jurisdictions.

Another industry representative stressed that caution is needed to limit the negative implications of a move to T+1 for EU financial markets. The project must be defined and timed in such a way that it is practicable for the European post-trading industry. The potential upstream impacts on financial markets must be clarified in particular. In the bond market for example, liquidity is not spontaneous. Market makers take on risk to provide investors with immediate liquidity. When a client seeks to buy a bond, the market maker prices the bond based on factors such as the yield curve, spread and cost of sourcing liquidity. After striking a deal the market maker attempts to find a counterparty within the market to offset the position, though they often end up short and must resort to a lending and borrowing desk to source liquidity with asset owners through a borrowing transaction. The EU borrowing market currently operates with a deferred timeline, typically starting at T+1, making it compatible with a T+2 settlement environment. However, in a T+1 world this timeline would create problems for the cash leg, as the borrowing desk would not be able to secure liquidity quickly enough to settle on time. For the transition to T+1 to be successful the repo market would need to evolve into an overnight market, allowing liquidity to be immediately sourced.

Such a shift in the repo market cannot be mandated by regulation and would need to be driven by market dynamics. Asset owners would need to assess whether the benefits of lending their positions in an overnight market outweigh the costs. If the costs exceed the benefits, then some lenders may withdraw from lending altogether, while others could raise their fees. This could lead to increased costs for sourcing liquidity, which in turn would widen spreads in bond trading. These post-trade aspects need to be carefully considered in the design of the project to avoid unintended consequences for the market.

A regulator acknowledged that although an evolution towards T+1 is inevitable, possible challenges and practicalities on the industry side have to be further assessed and solved before drastic changes are made. These challenges must be addressed quickly, as other changes are coming up in the post-trading environment such as the implementation of distributed ledger technology (DLT).

An official added that while the practical consequences and the technical issues related to the shift to T+1 need to be worked through, a lesson from the US is that the official sector needs to give a clear direction to the private sector to indicate what is expected. The appropriate investments and changes then need to be implemented by the private sector.

The Chair summarised that it is clear that collective action is needed from the regulatory and private sector sides to move towards T+1 settlement in an effective way, with coordination and preparation at the forefront. One question is how long the preparation phase has to be. The project is a major one for both regulators and the private sector, and investments are high.

3. Further improvements in the post-trading space to support CMU

3.1 The prospects of further consolidation and integration in the settlement area

An industry representative highlighted that the need to address the fragmentation of post-trading has received new attention in recent reports. The Draghi report notably calls for the creation of a single CSD in the EU. This idea is conceptually appealing, as it could generate significant economies of scale and would be a decisive step in terms of integration, but it is unrealistic. It would face significant political obstacles, particularly from member states that may resist relinquishing control over their national settlement systems. Consolidation has to be a market driven process; CSDs are not isolated entities and operate within complex ecosystems involving issuers, investors and a variety of stakeholders, all of whom would need to move in unison for any consolidation efforts to succeed.

It is also important to consider that while the CSD landscape in Europe remains fragmented in terms of the number of entities, significant progress has been made in the concentration of activity. The top five domestic CSDs in the EU currently account for 80% of assets and 90% of settlements. The two international CSDs (ICSDs) also play an important role in the processing of international trades. Eurosystem initiatives such as T2S have also contributed to greater efficiency.

In the current legal, regulatory, and tax environment the potential for a further reduction of fragmentation of settlement activities seems limited. Further harmonisation of national securities laws that govern asset custody and protection is difficult and has failed in the past, but it could be tried again in a more focused way. Improvements can also be made at industry level. Issuers and investors can change CSDs, which has happened in the fixed income market. This can allow CSDs that operate under the most adequate securities laws to grow, while others may lose out, possibly leading to a further concentration of flows. More drastic measures can be considered, such as the approach Ireland took after Brexit to discontinue its national CSD and to move to an ICSD and adopt Belgian securities law.

Over the last 15 years all the attention has been focused on enhancing settlement processes with the implementation of T2S and the work on settlement efficiency and settlement penalties in the context of the CSDR. Limited progress has been made in terms of further integration, because the EU market is complex, and the custody and location of assets are fragmented. A change of focus is needed to reduce fragmentation, acknowledging the complexity of European settlement due to the inherent complexity of the EU market and focusing instead on attempting to bring the custody pools together.

A second industry representative agreed that the idea to move towards a unique CSD is aspirational but it will not be seen anytime soon, although the current situation with 16 CCPs and 30+ CSDs in Europe is far from optimal. CSDs are often seen as a tool of sovereignty by member states, which hinders any attempts to merge CSDs. Further harmonising securities law would also be a complex task. A more realistic option could be the extension of T2S, both in geographical and functional terms.

A third industry representative stated that the fragmentation of the EU post-trading market across many market infrastructures needs to be reduced in order to increase the EU's attractiveness to global investors, but that this should be done gradually. T+1 could be a catalyst, but it is only one measure. The aim should be to achieve greater convergence of insolvency and tax regimes across the EU. To take this forward, the Commission could set up a dedicated task force of public and private sector experts to identify the practical steps needed to improve the coherence of these laws in order to enhance the competitive environment of European post-trading.

A regulator noted that improving the integration of European securities markets is essential to drive the CMU forward and enhance the attractiveness of European capital markets, as was highlighted in ESMA's May 2024 position paper on the CMU. Collaborative work between the different stakeholders concerned including the Commission, the European Central Bank (ECB), and market participants could help to identify the areas where connectivity needs improving and where obstacles need lifting. Further integration is not needed in all areas of the market; in some areas it is preferable to have multiple players to support healthy competition, while in others further consolidation or integration is beneficial.

The Chair summarised that the fragmentation of post-trading must be addressed for progressing the CMU. It is uncertain whether the vision of having only one CSD or one CCP is realistic, but a long-term perspective on these issues is needed.

3.2 Enhancing the attractiveness of EU clearing

A regulator stated that improvements are also needed in the clearing space to enhance the attractiveness of EU securities markets. EMIR 3.0 which has recently been adopted, aims to make clearing in the EU more attractive and to encourage market participants to clear at EU-based CCPs, in addition to the objective of reducing the dependency of the EU on UK-based clearing by setting a minimum amount of derivatives transactions that must be cleared through an EU CCP. This is a question of attracting liquidity to the EU. Most of the liquidity for the clearing of interest rate swaps is in the UK, and liquidity attracts more liquidity.

3.3 Further integration of supervision

A regulator highlighted that moving towards a more integrated and consistent supervision of capital markets is also a potential catalyst for a more attractive and robust CMU. This proposal was made in several reports on the future steps of CMU and in the Draghi report. This is a challenging objective, but progressive evolution is possible. A first step could be to centralise reporting and capital markets data at EU level.

An official noted that adequate supervisory arrangements are needed in the EU to deal with cross-border post-trade market infrastructures located in other jurisdictions that Europe relies on.