SwissFinanceCouncil
Fostering International Dialogue

SFC position on reduction of the settlement cycle to T+1

The Swiss Finance Council (SFC) engages in dialogue around policy developments in finance at a European level. Our members, including among the largest global asset and wealth management firms, have substantial activities internationally.

We have a strong interest in the discussion on shortening the settlement cycle to T+1 across equities, fixed income and ETFs in Europe because Swiss, EU and UK securities markets are closely interconnected and in the post-trade area apply the same principles and technical standards.

This is a complex area that will require careful analysis and policy development to assist firms in managing the significant operational challenges that will stem from the transition. A guiding principle in a European transition (including Switzerland, the EU and UK) should be to manage market impact and disruption. A starting point for this must be that the European transition is closely coordinated between neighbouring jurisdictions with interconnected financial markets. Failing to agree this would introduce significant and unnecessary complexity and undermine a smooth transition. At the minimum, coordination should involve transitioning on the same date but we would strongly recommend the establishment of a formal forum/dialogue that seeks align to processes and anticipate issues that may arise between jurisdictions.

This paper also provides feedback on where the EU can mitigate the impact of the US transition on EU market participants. Our members are active in EU markets and in some cases, have significant holdings of UCITS funds domiciled within the EU. While a shortened settlement cycle promises to reduce settlement risks and increase operational and capital efficiency for financial institutions selling financial products, it creates new operational and FX settlement risks for asset managers who are buyers of these financial products. Asset managers operating and investing in European securities markets will in particular face significant operational and regulatory challenges emanating from the settlement mismatch between the US and EU, given the US move to a T+1 settlement cycle in May 2024 and Europe and many other jurisdictions remaining on T+2.

The below sets out our views on how the reduction of the settlement cycle to T+1 in Europe can be managed with a view to minimise operational risks to market participants and increased costs to end investors.

1. Establish a dialogue between the EU, Switzerland and UK to facilitate an aligned move to T+1

Harmonising settlement cycles between the EU/EEA, Switzerland and the UK would reduce complexity in post-trade processes. A number of technical and operational issues need to be considered, including impact on the efficient use of collateral and netting and whether the broader funds cycle would need to be adjusted. Without such harmonisation, underlying securities could settle in different cycles in different jurisdictions, and there would potentially be an impact on cross-market funding.

An aligned move to a T+1 settlement cycle between the EU, Switzerland and the UK would significantly help asset and wealth management firms operating and investing in European's securities markets to manage operational risk. More broadly, harmonisation and efficiency initiatives in the area of securities post-trade processing are essential to ensure that Europe's capital markets remain competitive against the rest of the world. We therefore recommend the establishment of a dedicated forum/dialogue between the EU, Switzerland and the UK to coordinate T+1 implementation plans.

2. The EU in 2024 should commit to a timely transition to T+1

An appropriate timeframe is required for all parties involved to implement the necessary technical and operational changes to move to a T+1 settlement cycle in the EU. However, if Europe remains on T+2 for a prolonged period, European investors may bear the ultimate costs as a result of a persistent funding gap.

ESMA and the European Commission should provide certainty by committing in early 2024 to move to T+1 settlement and working with industry on a clear implementation roadmap that seeks alignment with Switzerland and the UK.

T+2 should remain the legal reference for the transition period between US T+1 and the EU T+1 go-live date, in line with the Central Securities Depositaries Regulation (CSDR). However, certain segments of the market may move to T+1 on a voluntary basis, for competitiveness reasons.

3. Address impact of US T+1 settlement on compliance with EU regulation

The move to T+1 in the US presents several challenges for EU market participants. The misalignment of settlement cycles will lead to inflows of cash into an EU fund when US securities have been sold for a redemption, but the fund itself is still settling on a T+2 basis. This will lead to regular active cash breaches, as UCITS limits the amount of cash a fund can hold to 20% of the net assets of the fund, which will have to be reported to the regulator.

We request that ESMA and the European Commission provide regulatory guidance according to which cash breaches due to misaligned settlement cycles will not be considered a breach, and at the very least not considered an active breach.

Similarly for fund subscriptions, US securities will be purchased on a T+1 basis leading to a shortfall of cash, as the fund units themselves and investors' cash are not settled before T+2. This would increase the need to access credit lines or establish overdrafts, but can bring about breaches of UCITS fund borrowing limits of 10% Net Asset Value (NAV).

While the cash shortfall could be addressed by prefunding by the fund itself, this will increase costs that may be passed on to investors. Therefore, we would welcome regulatory forbearance on the borrowing limits which may be exceeded for 1 day again due to the mismatch.

Separately, moving to T+1 in European markets is more challenging than the earlier move to T+2. An EU move to a shorter settlement cycle is widely expected to increase settlement fails, in particular for cross-border transactions, for a time. Given the new provisions for mandatory buy-ins under the Central Securities Depositaries Regulation (CSDR) Refit, and the fact that increased fails could lead to mandatory-buy-ins being triggered and financial penalties, we strongly recommend that the settlement discipline regime provisions be reviewed in light of the expected, temporary impact of the settlement mismatch between the US and EU.