



# Settlement T+1

20 June 2024

## Agenda

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- 2) Intesa Sanpaolo lessons learned
- 3) General overview
- 4) Main operational impacts
- 5) Potential costs and benefits
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## Reference Context

- On Feb. 15, 2023, the Securities & Exchange Commission (SEC) announced rule changes that will **shorten the settlement of most U.S. securities from two business days after trade date (T+2) to one business day after trade date (T+1)**;
- The SEC's initiative was prompted in part by settlement issues that arose during the COVID-19 pandemic. **Recent episodes of market volatility have exposed potential vulnerabilities in operational processes** which could be mitigated by shortening the settlement cycle;
- US securities which are moving to T+1 are Equities, Fixed Income and Money Markets
- Securities & Exchange Commission (SEC) rule changes that shortened the settlement cycle for most US securities to one business day after the trade date (T+1) **came into effect on 28 May 2024**
- Mexico and Canada **carried out the same changes on May 27, 2024**

## OBJECTIVES OF THE DOCUMENT

- In this context, the **purpose of this document** is to:
  - ✓ illustrate and describe the **general impact** of shortening the settlement cycle **from Intesa Sanpaolo's point of view**;
  - ✓ to stimulate discussion and reflection on a number of **issues which are considered fundamental** in view of a potential transition to T+1 settlement in Europe.
- More in detail, the **following slides aims to**:
  - ✓ Share **lessons learned** by Intesa Sanpaolo during the T+1 implementation process;
  - ✓ Identify **main operational impacts**;
  - ✓ Illustrate a **costs / benefits** analysis;
  - ✓ Propose possible **preparatory steps and future developments for EU Markets**;

## Intesa Sanpaolo lessons learned

Intesa Sanpaolo's direct experience in these early months following the effective reduction of the settlement cycle in the US markets leads us to the following considerations...

### 1. Greater harmonization of EU Rules

Given the complexity and fragmented nature of existing settlement models in Europe, a joint effort to create a **level playing field between EU countries** is a necessary condition to increase the efficiency of financial markets and reduce the risk of settlement failure

### 2. IT infrastructure and processes

The shortening of the settlement cycle to T+1 for US Markets required a **complete review of operational supply chains** in order to adapt technological processes / tools accordingly and reduce manual effort

### 3. EU common planning and central coordination

In order to effectively manage a possible future reduction of the settlement cycle to t+1 or t+0 in Europe, there is a need for a clear and **common definition of mandatory actions and adjustment timeframes**, through the adoption of joint planning and with the support/guidance of **central coordination**



### 4. US vs EU markets

The reduction in the US settlement cycle **has definitely generated greater competitiveness/attractiveness of US Markets** at the expense of European ones

### 5. Multi-listed Securities

The management of multi-listed securities is **one of the main issues to be addressed with a view to the adjustment of European markets** (see the recent case of the NVIDIA stock traded on both US and EU markets with different treatment in terms of corporate actions)

### 6. Investment Funds

While the T+1 settlement cycle in the US will **reduce counterparty risk** for Investment Funds, on the other hand the allocation process will lead to a **de-optimization in usage of cash amount**. It will also be necessary to make significant provisions on the various currencies, exposing Investment Funds to **substitution risk**

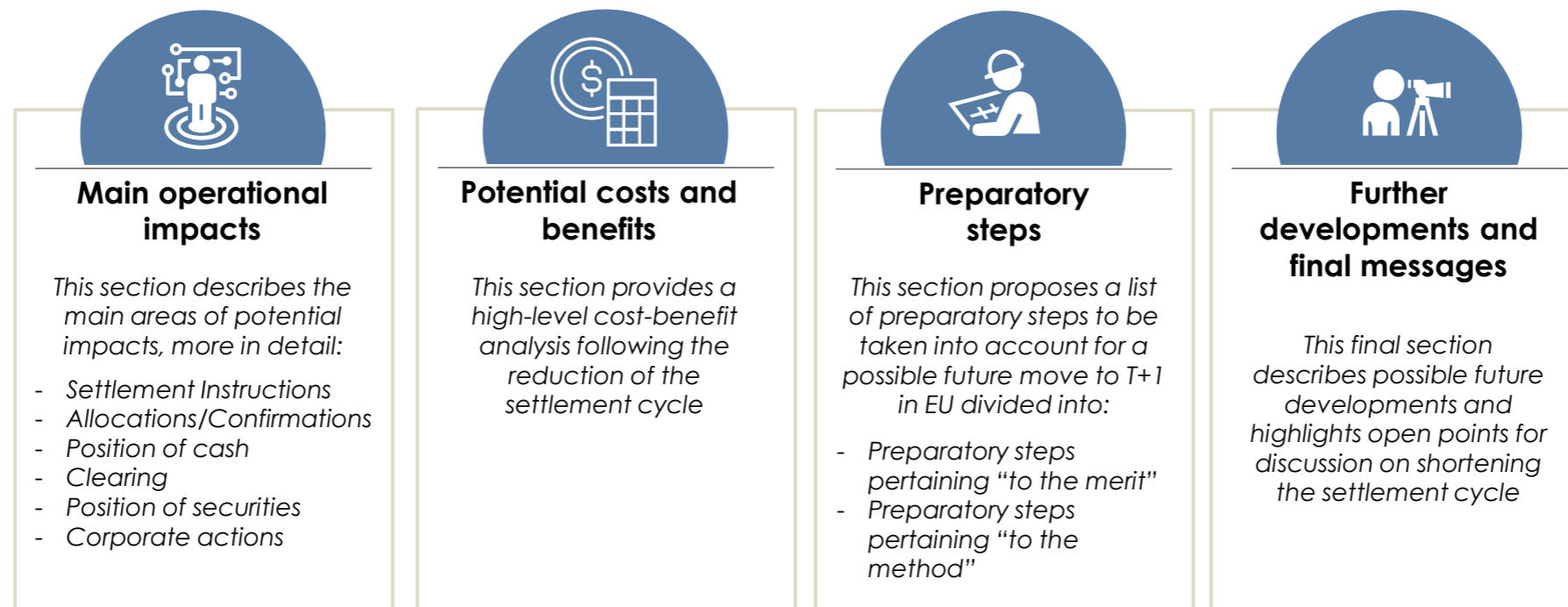
## General overview

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Shortening of the settlement cycle to T+1 would mark a change, representing a material compression of the time available to complete all the post trade processes and impacting all actors, including market infrastructure and trading counterparties. Settlement cycle reduction may imply a change in time scheduling of some markets. In absence of improvements, the T+1 cycle can generate an increase of settlement fails and costs.

**The following are the topics that will be covered during the presentation in order to provide a comprehensive overview of the evolution of US market settlement cycles and the possible implications for European markets**



*For more details on each of the above sections, please refer to the following slides*

# Main operational impacts

**1 SETTLEMENT INSTRUCTIONS**

- **Generation and matching of settlement instructions** will be one of the areas mostly sensitive and mostly affected by a shift towards reduced settlement cycle
- Possibility to **process any manual / late bookings or resolve any mismatches** would shrink, pushing the automatic matching systems adoption
- This outcome is likely to be particularly challenging for two groups: market participants based in other regions different from the EU and less sophisticated participants that heavily rely on manual process

**2 ALLOCATIONS - CONFIRMATIONS**

- The lack of data standards, the inaccuracy of the economic information and EU markets local settlement specificities **hamper efficient confirmation**
- Allocation and confirmation processes **should take place on trade date**, allowing settlement instructions reaching the CSDs before cut-offs
- **Resolving exceptions in a reduced timeframe will become even more challenging** i) during times of high market volatility or ii) during system outages experienced by market infrastructures / major participants

**3 POSITION OF CASH**

- The **availability of sufficient cash in the correct currency** by the purchaser is also key to ensuring the completion of the settlement process.
- **FX trades** would have to be i) booked on the same day/T+1 or ii) alternatively, pre-funded, requiring T+0 confirmation
- It would be **unfeasible to handle "Asian" currencies**, unless a very huge liquidity cushion has been pre-emptively established.
- The reduced time span that would be **available to access liquidity in FX markets** is likely to lead i) to higher costs to settle FX transactions, ii) to a decrease in the volume of FX transactions which are settled payment vs payment (PVP) through the CLS platform iii) to an increase of the settlement risk on the FX transactions

**4 CLEARING**

**The timing of processes by market infrastructures and their members should probably be reviewed** (e.g. timing for the collection of margins by CCPs) It must be also considered that if margin collection was to happen during the evening of Trade date, trades would be settled after ECB cut-off time, preventing participants to pay those margin calls. On the other hand, the ECB Euro payments cut-off would also need to be reconsidered.

**5 POSITIONS OF SECURITIES**

- **The availability of the relevant securities in the correct CSD account is key** to ensuring the completion of the settlement process
- Regarding securities lending activity, it could be **challenging to find counterparties having the required securities**, reducing the EU markets efficiency
- CSDs have a **compressed time span** to perform realignment activities
- Market participants should **optimize their process** to manage inventories
- "Multi-CSDs" securities and those that may be deemed as "external cross-border" (i.e. involving Countries who have joined T2S and Countries who have not joined T2S) raise **additional concern related to the lack of harmonization across different CSDs**

**6 CORPORATE ACTIONS**

Key dates should be updated in T+1 scenario, **making the Ex Date coincide with the Record Date**. Should this not be the case, the risk of a significant increase in reverse market claims is likely to materialize.



# Potential costs and benefits

**Dichotomies**

- One-off/short term costs (e.g. IT procedures) vs longer term costs (e.g. availability of IT systems and personnel)
- Direct costs (e.g. technological developments, human resources to cover longer working hours) vs indirect costs (e.g. infrastructure transformation, possible impacts on securities lending and liquidity)

**IT infrastructure**

Costs related to internal systems upgrade (software, hardware...) and to provide connections to external platforms (matching utilities, data providers, communication channels)

**Legal and Compliance**

Costs related to reaper and update contractual terms in order to comply with regulatory changes

**People**

Staff costs in order to cover the project phase, the implementations cost and the possible need of extended working hours

**Asymmetry**

Smaller players may have to undertake more significant preparation costs

**COSTS**

**Reduction of risks**

Reducing the number of days between trade execution and settlement will reduce i) counterparty ii) market and iii) credit risk across the settlement ecosystem, especially during periods of high market volatility

**Reduction of costs**

Thanks to the reduction of the open exposures over the settlement period, a reduction in margin requirements will materialize, improving the ability of market participants to manage capital and liquidity risks

**Modernization of capital markets**

The industry will have to remove dependencies on manual processes, embracing automation and to optimize inventory management

**Global alignment**

Since extra-EU jurisdictions will be adopting T+1, the end users of capital markets – companies seeking to issue capital and consumers seeking to invest capital – may benefit from the EU pursuing the same trajectory, increasing the competitiveness of EU capital markets with respect to global peers

**BENEFITS**

- These benefits:
- may not translate into a measurable cost savings
  - are likely to accrue over a longer time
  - may depend on the Entity size and its positioning in the settlement chain





# Preparatory steps (1 of 2)

Pertaining to the «Merit»

## PREPARATORY STEPS PERTAINING TO THE «MERIT»

### Improving settlement efficiency and enhancing harmonization among CSDs...



Main initiatives that could be pursued prior to shortening settlement cycle in the EU:

- 1 Provision of public information regarding securities and settlement; establishment of EU-wide centralized database, to be operated by ESMA
- 2 Improving matching rates through increased automation, adoption of industry best practices, centralized SSI repositories
- 3 Improving the allocation and confirmation phase\* 🔍
- 4 Increased use of partial settlement by CSDs and concurrent increased use of partial release\*\* 🔍
- 5 Promoting the highest possible degree of alignment among CSDs and addressing the differences in terms of availability of critical functionalities which may impact overall performance levels (e.g. Partial settlement, Partial release, Real time settlement, DVP cut-off, «batch» settlement processes timing)

#### \*Allocation and confirmation phase

- Allocation and confirmation process should take place on trade date, allowing sufficient time for the settlement instructions to cascade through the custody chain to reach the CSD prior to its cut-off deadline
- Straight-through-processing at the level of trading parties could be necessary to reduce operational inefficiencies
- Pre-settlement matching platforms may have to incorporate additional controls to help early identification of potential settlement issues
- A centralized SSI repository could be considered
- Further adoption of the UTI to enhance transparency and automation in the post-trade process across the EU

#### \*\*Use of partial settlement

- Making partial settlement mandatory could effectively counteract the increase in fails
- Partial settlement could be made mandatory for the main asset classes, but not for specific business (e.g. stock lending) and specific types of instructions (e.g. portfolio transfers, new issuances, "mark-up/mark-downs" and claims)

...Points of attention 🔍

### ... Adapting the regulatory framework



Any compression of the settlement cycle should be decided and implemented by the EU institutions only after the changes required by CSDR regulatory framework. The move to T+1 at the EU level would require the following amendments about settlement discipline:

- 1 Article 5(2) of CSDR prescribes that the "intended settlement date shall be no later than on the second business day after the trading takes place". From a legally formal point of view, the above-mentioned provision **is not inconsistent with a T+1 settlement cycle**. However, it would be advisable to update to this provision in order to achieve a fundamental goal: **to ensure that the move to T+1 is adopted and implemented by all in-scope market participants in a harmonized way across the EU as a whole.**
- 2 Proposal amendments to RTS:
  - A) Article 2 (Measures concerning professional clients): the relevant timings should be amended with reference to the allocation/confirmation process in order to ensure its conclusion on T+0, through the widest adoption of straight-through-processes
  - B) Article 10 (Partial Settlement): an update to mandate of the provision of partial release functionality by CSDs could be required. Derogation from the requirement to provide partial settlement should be removed, to ensure all CSDs provide a consistent service.
  - C) Article 11.4 (Additional Facilities and Information): an amendment would be required to mandate the provision of real-time gross settlement for all settlement instructions, including partials, in all CSDs





## Preparatory steps (2 of 2)

Pertaining to the «Method»

### PREPARATORY STEPS PERTAINING TO THE «METHOD»

Awareness of the unique EU setting and complexities...



With respect to other settlement cycle reductions, it is important to highlight that:

- 1 EU move to T+1/T+0 vs EU move to T+2:** move to T+2 was the outcome of many years of planning, testing and coordination. The time span that will be required for market participants to adapt to an EU decision to move to T+1 or T+0 **will have to be necessarily longer than the one envisaged on the occasion of the move to T+2**
- 2 EU move vs other jurisdictions to T+1/T+0:** European region includes multinational EEA jurisdiction, UK and Swiss national markets, while US, Canada constitute single national markets. **European capital markets stand out for their considerable i) heterogeneity ii) complexity** of their legal, tax and regulatory frameworks iii) number of regulatory and supervisory bodies as well as market infrastructures entities and other stakeholders
- 3 US vs EU comparison:** US market structure features a remarkably higher degree of concentration. Post-trade operations **are centralized and integrated** through a single CCP (NSCC) and CSD (DTC), both operated by the Depository Trust and Clearing Corporation. In addition US ecosystem includes **the process of affirmation process but doesn't have the equivalent of the EU CSDR cash penalties mechanism**. The higher proportion of cross-border transactions creates additional complexity.

... Collaboration between EU authorities and the industry



A reduction in the operational window for settlement will create challenges for the operational processes involving all types of market participant, from trading parties, through the custody chain to CSDs. **Therefore, a successful implementation will be dependent on a high degree of coordination and agreement across all stakeholders**

**It is suggested establishing a taskforce/group of experts/Steering Committee including representatives from the EU authorities and from the industry** (including CSDs, CCPs, buy-side, brokers, custodians, central banks)

The **key mandate** should be:





- 1** as a minimum, to provide **inputs for the EC to develop a quantitative and evidence-based impact assessment/feasibility study** addressing the move to T+1/T+0
- 2** Eventually, based on the previous point to set out a coordinated **roadmap and a detailed implementation plan** (similar to the US T+1 Implementation Playbook) and to identify a **go-live date for the transition to T+1**

In the light of that, it is fair to draw at least **these conclusions**:

- "all other things being equal", **the shift to T+1 in the US might turn out to be much easier to accomplish than any potential similar shift by the EU**
- due to the inherent complexities of the European capital markets that are unknown to other jurisdictions, **the time span that will be required for market participants to adapt to an EU decision to move to T+1 or T+0 will have to be necessarily longer**
- **A high degree of coordination between EU countries, authorities and market participants is essential for a successful transition to T+1 or T+0**



## Further developments and final messages

	<p><b>Collaboration between EU authorities and the industry</b></p>	<ul style="list-style-type: none"> <li>To face successfully the consequences of reduction of settlement cycle, <b>a high degree of coordination and agreement across all European Markets will be required.</b> All involved stakeholders should consider a harmonic approach to T+1 transition, assuming a "single European Market" hypothesis. A <b>taskforce should be established</b> including representatives from the EU authorities and from the industry in order to provide a coordinated roadmap and a detailed implementation plan</li> </ul>
	<p><b>Multi-listed securities</b></p>	<ul style="list-style-type: none"> <li>The different positions from EU markets participant has highlighted the <b>need of a common policy</b> to avoid price discrepancies, liquidity related issues and tax related impacts. Moreover, the possibility of the T+1 settlement cycle being adopted in the UK and Swiss markets before the transition to the EU would create an even more heterogeneous picture</li> </ul>
	<p><b>Impact assessment / feasibility study</b></p>	<ul style="list-style-type: none"> <li>It is highly recommended to anchor any EU legislative proposal to a sound, robust, quantitative and evidence-based <b>impact assessment/feasibility study that should be developed by the European Commission</b> in co-operation with the above-mentioned taskforce</li> </ul>
	<p><b>T+1 adoption time span</b></p>	<ul style="list-style-type: none"> <li>ESMA in its Feedback Statement on the Call for Evidence states that preliminary analysis suggests that an eventual transition to T+1: <b>1) could take place no earlier than 32 months</b> from the date industry is informed that the change needs to happen; <b>2) should not be initiated at a moment where there is traditionally significant activity in the area of corporate actions</b></li> </ul>

At the current stage, it seems premature to make forecasts/estimates as to the time span eventually needed to adapt to the new settlement cycle both in the case of T+1 and in the case of a T+0 scenario.

**NOT RUSH IN SETTING A DATE FOR SWITCHING TO T+1 IN EU, BUT ONCE THIS IS SET, NO STEP-BACK!**

