1 Questions

Q1 : Please describe the impacts on the processes and operations from compressing the intended settlement date to T+1 and to T+0. Please:

(i) provide as much detail as possible on what issues would emerge in both cases and how they could be addressed with special attention to critical processes (matching, allocation, affirmation and confirmation) and interdependencies. Where relevant please explain if these are general or asset class/instrument/ trade specific.

(ii) Identify processes, operations or types of transaction or financial instrument class that would be severely impacted or no longer doable in a T+1 and in a T+0 environment.

Please, suggest if there are legislative or regulatory actions that would help address the problems. Where relevant please explain if these are general or asset class/instrument/ trade specific.

<ESMA_QUESTION_SETT_1>

While CLS is not directly involved in the trading, processing and operations for securities, our CLSSettlement service is integral to the safe settlement of FX transactions, a percentage of which is interdependent on securities trading. CLSSettlement provides settlement risk mitigation for FX via our payment versus payment (PvP) solution, settling $6.5trillion on an average day. Any compression of settlement cycles for securities has a knock-on impact for related FX and it is crucial that this is considered so that the positive rationale for any change in the settlement timeline for securities does not have a negative impact on other aspects of related securities processes and workflows. Much has been learnt in this respect from the impending move in US Securities to T+1, and it is important to highlight the potential risks to the FX market from that experience so that this impact is fully considered in respect of ESMA's Call for evidence.

CLS provides PvP settlement risk mitigation alongside other liquidity and operational benefits to its 74 members who consist of the largest FX global, regional and custodial banks. Many of our members in turn offer access to CLSSettlement to their own clients, including other smaller custodian banks, asset managers and funds. CLS has over 500 asset managers that utilise the service via our members which in turn equates to over 30,000 underlying funds. It is this community that are most highly impacted by any potential changes in settlement cycles for securities globally.

For asset managers and funds accessing CLSSettlement via their member custodians, CLSSettlement facilitates PvP for FX transactions up to and including T+1. By design, it does not offer FX settlement risk mitigation and the additional benefits for FX transactions to settle T+0 (same day or even instant).

While T+1 is available for FX transactions and CLSSettlement allows for their settlement, there are nuances to this that need to be outlined in more detail to ensure additional risk implications are fully understood and considered.

For FX transactions to be settled via PvP on T+1, CLSSettlement has in place a deadline of 12am CET at which point CLS initiates the multilateral netting process and issues the Initial Pay-In Schedule (IPIS) to members. In order to facilitate this on behalf of their clients, our members (in this context predominately custodians) impose their own deadlines (custodian cut-offs) on their asset manager and fund clients to allow them to fulfil their obligations to CLSSettlement, which ensures that the service settles $6.5trillion average on a daily basis safely via PvP. The deadlines that members impose on their clients are not determined by CLS, nor do we have visibility of these. They are defined by members, reflecting their own internal processes, procedures and operations that are conscious of, and in response to, CLSSettlement's operational timelines. Of note for this discussion is the potential impact to the drive for settlement risk reduction in FX by global regulators and participants that exists, should these deadlines not be met in a T+1 securities environment.

As such, any compression of settlement cycles for securities needs to consider the 'usual' practice for execution of securities and time required for necessary post trade processes (for example, matching, allocations, affirmation, and confirmation). If, as is the case in US equities, a majority of execution is transacted "Market on Close", with securities post trade processes required to be completed prior to the raising of the necessary FX transaction to fund the securities transaction, this workflow needs to be outlined and mapped out fully in conjunction with custodian and CLSSettlement deadlines. It would need to be ensured that asset managers and funds are able to finalise the FX transaction at a time of the day when the FX market offers ample liquidity (supporting best executions goals for asset managers and funds), alongside being able to conduct post trade processes including confirmation and matching in CLSSettlement prior to existing custodian cut off times and in turn the CLS deadline.

<ESMA_QUESTION_SETT_1>

Q2 : What would be the consequences of a move to a shorter settlement cycle for (a) hedging practices (i.e. would it lead to increase pre-hedging practices?), (b) transactions with an FX component?

<ESMA_QUESTION_SETT_2>

As highlighted in the response to Q1, dependant on the execution process for European securities and when the FX requirement, leading to a FX trade is triggered, this may have an impact on asset managers' and funds' ability to fulfil their fiduciary responsibility dependant on market liquidity at the time of FX execution. However, unlike the US where 'Market on Close' execution of securities may lead to FX execution post 4pm EST, FX liquidity remains accessible through the close of London and Europe markets into the NY morning. From a post trade perspective, as long as the custodian cut-off times still allow the FX payment obligations to be submitted to CLSSettlement by 6pm EST / 12am CET, then PvP, netting and other operational benefits remain intact. Any delays in processing or early custodian cut-off times will impact this and increase the need for gross or net settlement outside of PvP, heightening potential fails, increasing settlement risk and costs.

<ESMA_QUESTION_SETT_2>

Q3 : Which is your current rate of straight-through processing (STP), in percentage of the number and of the volume of transactions broken down per type of transaction or per instrument as relevant? In case STP is used only for certain processes/operations, please identify them. Which are the anticipated challenges that you envisage in improving your current rate of STP?

<ESMA_QUESTION_SETT_3>

Not applicable for CLS

<ESMA_QUESTION_SETT_3>

Q4 : Please describe the impacts that, in your views, the shortening of the securities settlement cycle could have beyond post-trade processes, in particular on the functioning of markets (trading) and on the access of retail investors to financial markets. If you identify any negative impact, please identify the piece of legislation affected (MiFID II, MiFIR, Short Selling Regulation…) and elaborate on possible avenues to address it.

<ESMA_QUESTION_SETT_4>

The only point to highlight here is with respect to the orderly functioning of the market and as outlined, potential increase in FX settlement risk if the FX workflow is not fully considered.

<ESMA_QUESTION_SETT_4>

Q5 : What would be the costs you would have to incur in order to implement the technology and operational changes required to work in a T+1 environment? And in a T+0 environment? Please differentiate between one-off costs and on-going costs, comparing the on-going costs of T+1 and T+0 to those in the current T+2 environment. Where relevant please explain if these are general or asset class/instrument/ trade specific.

<ESMA_QUESTION_SETT_5>

CLS are currently undergoing a feasibility study internally and with our members to understand what is possible to support a shift in CLS's 12am CET IPIS deadline (up to a maximum 90 minutes) to assist the market on the back of challenges raised by the FX community as a response to the proposed move of US securities to T+1. Any adjustments, if undertaken (subject to the findings of our internal risk assessment, member ableness and regulatory approval), would be available to benefit participants, including those impacted by an EU move to T+1. If applied however, any effectiveness will be reliant on custodian cut-off times being adjusted to accommodate for the timings FX trading and post trade operations in the EU T+1 environment.

CLSSettlement provides a five-hour window for funding and settlement on T+1 for trades that have been received by 12am CET on T+0.[1] By design, CLSSettlement therefore supports up to T+1 settlement cycles but not T+0 same day or instant settlement. In a T+0 environment, the CLSSettlement model would need to be revisited. CLSSettlement not only mitigates FX settlement risk through PvP, but also delivers huge liquidity efficiencies. Multilateral netting and additional liquidity optimization measures result in CLS settlements needing to fund only around 1% of the total value of their payment

[1] 2 The PvP cycle of CLSSettlement is based on two separate but linked processes: (i) Settlement takes place over a two-hour period (07:00 to 09:00 CET) on the accounts of the relevant settlement members on CLS's books. (ii) Funding occurs over a five-hour window (07:00 to 12:00 CET) in which the 18 RTGS systems of the CLS-eligible currencies have overlapping processing hours.

instructions (USD65 billion instead of USD6.5 trillion). T+0 same day would reduce and T+0 instant fully eliminate, such liquidity savings.

<ESMA_QUESTION_SETT_5>

Q6 : In your view, by how much would settlement fails increase if T+1 would be required in the short, medium and long term? What about T+0? Please provide estimates where possible.

<ESMA_QUESTION_SETT_6>

From an FX perspective as long as the CLSSettlement and custodian cut-off times are met, access to PvP can continue, mitigating the chance of settlement fails for FX. However, as previously outlined, if custodian cut-off times are prohibitive or in a T+0 environment, this would force more transactions to settle gross or net bilaterally, outside of PVP, increasing settlement risk and higher funding requirements throughout the FX ecosystem.

<ESMA_QUESTION_SETT_6>

Q7 : In your opinion, would the increase in settlement fails/cash penalties remain permanent or would you expect settlement efficiency to come back to higher rates with time? Please elaborate.

<ESMA_QUESTION_SETT_7>

As to settlement fails in FX, as noted previously, a move to T+1 that impact the timing of FX execution and the ability for participants to meet custodian cut off times for CLSSettlement will likely increase the number of trades settling bilaterally (without participant process changes) and lead to an increase in potential settlement fails and a rise in associated costs.

<ESMA_QUESTION_SETT_7>

Q8 : Is there any other cost (in particular those resulting from potential impacts to trading identified in the previous section) that ESMA should take into consideration? If yes, please describe the type of cost and provide estimates.

<ESMA_QUESTION_SETT_8>

For FX, execution costs may increase dependant on market liquidity when the FX transaction associated with the securities takes place. If timelines are such that there are risks to settlement of FX outside PvP if the FX execution is not accelerated, then pre-funding costs may also be a consideration. From a post trade perspective, increased STP will be required throughout both the securities and FX trade lifecycle which will likely require investment and development of technology. Lastly, trades unable to settle PvP will likely require additional funding and liquidity costs to facilitate gross or net bilateral settlement, may be subject to increased late payments and associated costs and are not protected from settlement (principal) risk.

<ESMA_QUESTION_SETT_8>

Q9 : Do you agree with the mentioned benefits? Are there other benefits that should be accounted for in the assessment of an eventual shortening of the securities settlement cycle?

<ESMA_QUESTION_SETT_9>

Not applicable to CLS

<ESMA_QUESTION_SETT_9>

Q10 : Please quantify the expected savings from an eventual reduction of collateral requirements derived from T+1 and T+0 (for cleared transactions as well as for non-cleared transactions subject to margin requirements).

<ESMA_QUESTION_SETT_10>

Not applicable for CLS.

<ESMA_QUESTION_SETT_10>

Q11 : If possible, please provide estimates of the benefits that you would expect from T+1 and from T+0, for example the on-going savings of potentially more automated processes.

<ESMA_QUESTION_SETT_11>

Not applicable to CLS

<ESMA_QUESTION_SETT_11>

Q12 : How do you assess the impact that a shorter settlement cycle could have on the liquidity for EU markets (from your perspective and for the market in general)? Please differentiate between T+1 and T+0 where possible.

<ESMA_QUESTION_SETT_12>

If the FX related transaction is executed in time to meet custodian cut-off times in a T+1 environment, then this would enable participants to execute in the London / European day or early NY morning when FX liquidity is still available from multiple sources. Should this be delayed, then there are FX liquidity challenges that would need to be considered. Whilst FX liquidity is available for FX execution T+0, it is subject to liquidity and additional costs and subject to banks' own liquidity cut-off times (distinct from Custodian cut-off times) and appetite to support.

<ESMA_QUESTION_SETT_12>

Q13 : What would be the benefits for retail clients?

<ESMA_QUESTION_SETT_13>

Not applicable to CLS

<ESMA_QUESTION_SETT_13>

Q14 : How would you weigh the benefits against the costs of moving to a shorter settlement cycle? Please differentiate between a potential move to T+1 and to T+0.

<ESMA_QUESTION_SETT_14>

Not applicable to CLS

<ESMA_QUESTION_SETT_14>

Q15 : Please describe the main steps that you would envisage to achieve an eventual shorter securities settlement cycle. In particular, specify: (i) the regulatory and industry milestones; and (ii) the time needed for each milestone and the proposed ultimate deadline.

<ESMA_QUESTION_SETT_15>

Not applicable for CLS.

<ESMA_QUESTION_SETT_15>

Q16 : Assuming that the EU institutions would decide to shorten the securities settlement cycle in the EU, how long would you need to adapt to the new settlement cycle? And in the case of a move to T+0?

<ESMA_QUESTION_SETT_16>

CLS can already accommodate T+1 transactions up to 12am CET day of value. Asset managers and funds are reliant on custodian cut-off times being set at a time that allows for FX trading in optimal markets and access to CLSSettlement prior to the CLS deadline.

As mentioned above, T+0 (same-day or instant) would not be compatible with the process design of CLSSettlement. Depending on the concrete T+0 arrangement, the liquidity efficiencies that CLSSettlement currently brings through multilateral netting and additional liquidity saving tools would be substantially reduced or eliminated.

<ESMA_QUESTION_SETT_16>

Q17 : Do you think that the CSDR scope of financial instruments is adequate for a shorter settlement cycle? If not, what would be in your views a more adequate scope?

<ESMA_QUESTION_SETT_17>

Not applicable for CLS.

<ESMA_QUESTION_SETT_17>

Q18 : Is it feasible to have different settlement cycles across different instruments? Which are the ones that would benefit most? Which least?

<ESMA_QUESTION_SETT_18>

Potential issues highlighted as applicable to FX. CLS is not in a position to comment on other instruments.

<ESMA_QUESTION_SETT_18>

Q19 : Which financial instruments/ transaction types are easier to migrate to a shorter settlement period in the EU capital markets? Does the answer differ by asset class? Should it be feasible/advisable to have different migration times for different products/markets/assets? If yes, please elaborate.

<ESMA_QUESTION_SETT_19>

Not applicable to CLS

<ESMA_QUESTION_SETT_19>

Q20 : Do you think that the settlement cycle for transactions currently excluded by Article 5 of CSDR should be regulated? If you think that the settlement cycle of some or all of these transactions should be regulated, what would be in your view an appropriate length for their settlement cycle?

<ESMA_QUESTION_SETT_20>

Not applicable to CLS

<ESMA_QUESTION_SETT_20>

Q21 : Please describe the impact(s) that the transition to T+1 in other jurisdictions has had or will have on your operations, assuming the EU remains on a T+2 cycle.

<ESMA_QUESTION_SETT_21>

As outlined in the response to Q1, the planned move for US securities to T+1 has a potential impact on FX settlement and a percentage of the FX transactions currently settled within CLS by asset managers and funds. We have estimated that this could impact approx. 1% of CLS notional value from this community ($65bn) which is flow that is today executed late in the day on T+2 or currently T+1, that, in a compressed timeline, will move into T+0 and therefore not meet custodian cut-offs and therefore will not get processed into CLSSettlement for PvP and safe settlement. The issues highlighted will still remain whether the EU looks to harmonise their cycle with other jurisdictions or remains T+2. There may be additional considerations if the EU and UK move at different times to a T+1 environment.

<ESMA_QUESTION_SETT_21>

Q22 : Can you identify any EU legislative or regulatory action that would reduce the impact of the move to T+1 in third countries for EU market participants? Please specify the content of the regulatory action and justify why it would be necessary. In particular, please

clarify whether those regulatory actions would be necessary in the event of a transition of the EU to a shorter settlement cycle, or they would be specific only to address the misaligned cycles.

<ESMA_QUESTION_SETT_22>

Not applicable to CLS

<ESMA_QUESTION_SETT_22>

Q23 : Do you see benefits in the harmonisation of settlement cycles with other non-EU jurisdictions?

<ESMA_QUESTION_SETT_23>

Not applicable to CLS

<ESMA_QUESTION_SETT_23>

Q24 : Would reducing the settlement cycle bring any other indirect benefits to the Capital Markets Union and the EU's position internationally?

<ESMA_QUESTION_SETT_24>

Not applicable to CLS

<ESMA_QUESTION_SETT_24>

Q25 : Do you consider that the adaptation of EU market participants to the shorter settlement cycles in other jurisdictions could facilitate the adoption of T+1 or T+0 in the EU? Please elaborate.

<ESMA_QUESTION_SETT_25>

Not applicable to CLS

<ESMA_QUESTION_SETT_25>

Q26 : Would different settlement cycles in the EU and other non-EU jurisdictions be a viable option?

<ESMA_QUESTION_SETT_26>

From an FX perspective as previously stated, the challenges for investors (asset managers and funds) with the proposed move for US securities to T+1 remains whether settlement cycles align in EU and non-EU jurisdictions or not. There may be additional considerations if the EU and UK move at different times to a T+1 environment.

<ESMA_QUESTION_SETT_26>

Q27 : Please elaborate about any other issue in relation to the shortening of the securities settlement cycle in the EU or in third-country jurisdictions not previously addressed in the Call for Evidence.

<ESMA_QUESTION_SETT_27>

Not applicable to CLS

<ESMA_QUESTION_SETT_27>