Accelerated Settlement Taskforce Report

March 2024

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LETTER TO CHANCELLOR OF THE EXCHEQUER

Dear Chancellor

The current focus on how the capital markets operate in the UK provides a timely opportunity to review the post trade settlement process.

The financial services sector generally and the capital markets sector in particular are critical to the prosperity of the UK. They allow UK businesses to access capital and global investors to access investment opportunities. They support a highly developed ecosystem of participants and service providers operating in the UK.

It is self-evident that increasing efficiency in our capital markets processes is essential to maintain our international competitiveness.

Those who are not familiar with how securities trade are surprised by the T+2 settlement cycle.

Today consumers can buy and receive an airline or train ticket on their phone within a matter of minutes.

They can make payments through their banks and exchange currency almost instantaneously.

Yet it takes two days to settle a trade in securities.

Although these comparisons are somewhat simplistic the underlying sentiment is not wrong.

And the direction of travel in international markets is for faster settlement cycles.

All North American markets will move to T+1 in May 2024 and the EU is consulting on T+1 with a report expected in the third quarter of 2024. In India the Securities and Exchange Board have recently consulted on moving to optional T+0 and optional instant settlement.

Nearly two-thirds (62%) of institutional investors holding shares in the FTSE All Share on the LSE are non-UK investors. 40% of institutional investors are from North America with 14% from Europe (excluding the UK).[1]

One of the challenges for the capital markets sector is the diverse range of actors. Whilst the largest benefit from extensive automation many smaller participants do not.

[1] Source: LSEG January 2024

Given this diversity and the multiple post-trade processes involved it is no surprise that without regulatory compulsion back offices often struggle to attract investment.

Indeed we have heard many anecdotal comments about existing processes. These include data being transferred by email, PDF, excel or even paper rather than in a standard machine-readable format.

There have been previous attempts to encourage change and investment such as the ***Hudson Report*** established by the Bank of England and FCA.

But without co-ordinated action it is difficult. No one will invest to upgrade their technology to enable T+1 unless the whole market does so at the same time.

So for the system to improve, everybody must invest in a coordinated way. And that will only happen when mandated by regulators and government.

It is also important to recognise that a move from T+2 to T+1 requires considerably more change than the move from T+3 to T+2 in 2014.

The activities that currently take place on T+1 will now need to be completed by the end of ***Trade Date*** meaning the true reduction in time can, depending on the location, be up to 83% compared to T+2.[2]

We need to learn how the markets respond to the US move and how participants cope with shorter deadlines.

Overseas investors in distant time zones face particular challenges with a shorter settlement cycle, not least the need to execute FX trades in order to settle their securities transactions.

Nevertheless the UK cannot remain on T+2 indefinitely. According to a recent survey by Citi (Securities Services Evolution 2023) 89% of market participants now expect their own markets to move to T+1 (or T+0) within five years.

And there is significant consensus both on the need for the UK to move to T+1 and the need for more automation in back office processes.

So it is clear to me that the question to be answered is *how* the UK should move to T+1 and not *whether* it should do so.

2 Source: AFME "T+1 Settlement in Europe: Potential Benefits and Challenges" 21st September 2022

The focus now needs to shift to understanding more clearly the operational issues that will arise on a move to T+1, finding solutions and learning the lessons from the US move to T+1 in May 2024.

And for that to happen there needs to be a clear commitment to T+1.

That is why I am recommending the immediate establishment of a Technical Group to take this work forward.

An additional challenge is that whilst some would prefer to wait until the EU moves to T+1 for others misalignment with the US should be as short as possible.

And it is also the case that the cost and burden of implementing the transition to T+1 falls on different stakeholders to those who will benefit most immediately.

This means that it has been more difficult to achieve consensus over the pace at which the UK should move to T+1.

My view is that the advantages of setting a clear timeframe outweigh the disadvantages.

In order to achieve the necessary coordination there needs to be a timetable for the Technical Group to assist the market in establishing consistent standards.

That should enable planning to take place this year allowing for investment in new automation in 2025.

In turn that allows for market standards to be established and various operational processes such as ***Allocations***, ***Confirmations*** and trade level ***Matching*** to be mandated for ***Trade Date*** during 2025 in advance of the actual move to T+1.

And enables new systems to bed in while taking a pragmatic approach that allows the UK to adapt to global developments.

The Technical Group can then choose a date before the end of 2027 for the final transition to T+1.

During our work I have found a highly professional and dedicated group of people involved in post trade activities. It is fair to say that some are understandably anxious about the scale of effort and investment that will be required.

But I am confident the market can find solutions to the issues involved to ensure the UK maintains its international competitiveness.

Today we have the opportunity to make that happen.

Charlie Geffen

1. INTRODUCTION

1.1. Terms of Reference

The Taskforce was established as part of the Edinburgh Reforms announced by the Chancellor on 9th December 2022.

At its broadest our Terms of Reference ask what the case is for the UK moving to an accelerated settlement cycle such as T+1 and over the longer term to T+0 and indeed eventually to ***Atomic Settlement***.

On 15th February 2023 the ***SEC*** announced its move to T+1 with effect from 28th May 2024. This followed the earlier move to T+1 in India and China's operation of T+0 for many years.

In October 2023 ***ESMA*** published its call for evidence on shortening the settlement cycle in the EU. It is expected to report in the third quarter of 2024.

India has also recently concluded a consultation on moving to optional T+0 and optional instantaneous settlement.

The creation of this Taskforce, the move by the US and ***ESMA***'s consultation has resulted in extensive and collaborative engagement by market participants.

It quickly became evident that the general direction of travel is towards faster settlement times leading to greater harmonisation between markets, improved market resilience, reduction in risk and cost savings.

A further important benefit will be increased automation leading to improved efficiency and productivity.

Increased alignment with other markets will lead to streamlining of processes for large cross border participants. This in turn enhances efficiency and reduces risks.

The UK attracts significant overseas investors so the issue of misalignment with other markets is important.

So it became clear that the question we should address is how the UK should move to T+1 rather than whether it should do so.

To put it differently the answer to the question: "Should the UK remain indefinitely on a settlement cycle of T+2?" is self-evident.

As a consequence we set ourselves the task of identifying the challenges and risks of a move to T+1, how they could be mitigated and the timescale and phasing of any move.

1.2. Scope

The UK is a global marketplace. Its participants trade in multiple instruments denominated in multiple currencies and are subject to regulation by multiple regulators operating across multiple time zones.

The move to T+2 was effected by ***CSDR*** Art 5(2) whose scope extended to securities that trade on a recognised EU exchange and which invariably settle through an EU ***CSD***.

The point was made on numerous occasions that any regulatory or policy direction should be by reference to the start of the trading process rather than the conclusion.

If we followed these principles then the many securities that trade in the UK but settle outside the UK would be within scope.

They would include ***Euromarket Securities***, including sterling and other bonds issued by UK companies and non-UK government bonds which trade in the UK but clear or settle outside the UK.

However the possibility that the UK and the EU may have a period of misalignment of settlement cycles gives rise to a number of challenges that are described later in this report.

These include the risk of distorting the market by splitting liquidity between securities that could settle on either T+1 or T+2 depending on where they trade. It would also be inappropriate to include non UK government bonds which trade in the UK but settle elsewhere.

Further challenges would arise for ETFs if a mismatch occurs between the settlement cycle of the underlying securities and the subscription and redemption cycle.

This means that during any significant period of misalignment of settlement cycles between the UK and the EU there will need to be a safe harbour mechanism in relation to certain securities that trade in the UK but settle outside the UK.

That might make use of the privately negotiated transactions carve out in Article 5(2) ***CSDR***.

The Technical Group will need to consider how such a safe harbour mechanism should work pending alignment of settlement cycles with the EU. At that point the safe harbour would lapse so that all securities that trade in the UK but settle in the EU would move to a T+1 cycle.

We have also excluded all ***OTC*** transactions on the basis that ***OTC*** trading in securities within scope would naturally migrate on a voluntary basis. This is consistent with ***CSDR*** Art 5.

The issue of new securities operates on a timetable set out in the relevant offering documentation such as a prospectus. As a result primary issues are not within the scope of this report.

It is also clear that some of our recommendations will not be able to be addressed by UK regulators and policy makers. These will need to be solved by market participants.

1.3. How we have carried out our work

The post-trade process involves multiple parties with diverse interests.

These include asset managers and other investors, broker-dealers, trading venues, ***Custodians***, ***CSDs***, FX markets, technology and messaging providers and regulators.

There are also important differences between domestic and overseas participants caused by time zones and the need for some investors to enter into FX transactions in order to settle securities trades.

And there are different characteristics between equities, government debt, corporate debt, securities issued by overseas entities including governments and pooled funds such as ETFs. That means any change to settlement cycles will lead to different outcomes for different stakeholders.

Nevertheless I have witnessed strong and collaborative engagement across all stakeholder groups during our work.

Just under 80 organisations contacted the Taskforce including all the main trade associations who took responsibility for engaging with their members, although many such members have also directly engaged with the Taskforce.

The announcement of the Taskforce, the US commitment to move to T+1 and ***ESMA***'s consultation on accelerated settlement have accelerated the pace of industry engagement.

This has been in the form of numerous publications and events at which I and other participants in the Taskforce have engaged. It has enabled us to consult and test the ideas and thinking that has led to this report.

We approached our work by identifying:

- The multiple processes that take place between trade and settlement;
- The reasons for a move to T+1;
- The issues relating to alignment between the UK and the US, EU and FX markets;
- Changes in the processes and systems that will be required; and
- Regulatory changes that will be necessary to support a move to T+1.

On 18th July 2023 I published a letter, a copy of which is in Appendix 2, setting out our direction of travel and seeking answers to a number of questions. This was sent to all those who had contacted the Taskforce and was passed on by the trade associations to their members. The issues identified in that letter are largely reflected in this report.

I published a further letter on 18th December 2023 a copy of which is in Appendix 3.

We have also considered the potential for a move to T+0 and atomic/instantaneous settlement in due course.

Finally I have recommended a timetable for a move to T+1.

1.4. Glossary of Terms

The post trade world uses many acronyms and specialist language that has a particular meaning.

We have tried to identify most of these in a Glossary of Terms in Appendix 1. They appear in the main text of the report in ***bold italics***.

1.5. Next Steps

One of my recommendations is the immediate establishment of a Technical Group to analyse the issues identified in this report including any lessons to be learned from the US move in May 2024.

It will coordinate with the market to help establish common processes and solutions to enable the implementation of the operational changes to be mandated by the end of 2025.

Finally it will report by the end of this year to confirm the date before the end of 2027 for transition to T+1.

1.6. Thanks

Any Taskforce such as this operates entirely on a pro bono basis and I would like to thank all those who have contributed and provided their support.

In particular Deloitte have generously provided a secretariat without which the Taskforce would never have got off the ground.

All the relevant trade associations have extensively engaged with the work that has led to this report including seeking input from their members.

Ashurst, Deloitte, Freshfields, Flint Global, Greenbrook Advisory and Linklaters have all been generous with their time, support and expertise.

And many individuals have given freely of their time in the multiple working groups that have contributed to this report

I am grateful to them all.

2. EXECUTIVE SUMMARY & RECOMMENDATIONS

2.1. Summary

Consensus

There is a clear consensus in relation to three issues in particular.

First that the UK should move to a T+1 settlement cycle.

The principal reasons for this are harmonisation with international markets, improving market resilience, a reduction in risk and cost savings.

The US has committed to move to T+1 in May 2024 and the EU is consulting on a move to T+1 with ***ESMA***'s report expected in the third quarter of 2024.

In public remarks at a roundtable in January 2024 EU Commissioner McGuiness said that the key question is not if the EU makes the move to T+1 but when and how it does so[3].

So the discussion for the UK needs to shift to how it moves to T+1 rather than whether it should do so.

Second is that a move to T+1 would impact almost every department of fund managers, brokers and ***Custodians*** from front office trading to back office processing. It will inevitably trigger significant investments into greater automation and standardisation of core back office and post trade processes which would have a material market benefit.

Accordingly we have identified a number of operational and behavioural changes that should proceed in advance of the move to T+1.

Third is the need for continuing engagement with stakeholders on the issues that will arise during the transition. The opportunity to learn from the US move to T+1 in May 2024 is particularly important.

That is why I am recommending the establishment of a Technical Group to look at the operational issues that will need to be resolved and to help agree market standards to ensure a smooth transition.

It is fair to say that the consensus to move to T+1 takes the form more of acceptance than enthusiasm, but this is to be expected

[3] Source: https://europa.eu/newsroom/ecpc-failover/pdf/speech-24-422_en.pdf

when significant and disruptive change is required for the greater good.

The benefits and costs will also, at least initially, fall unevenly between stakeholders.

And there are differences in preference over shortening the period of misalignment with the US or waiting for alignment with the EU.

This is illustrated by the IA's annual survey[4] which shows that of the £8.8 trillion managed by its members 42% is invested in equities of which 32% is in North America and 19% in Europe.

Inevitably these differences of view make it harder to achieve the necessary co-ordinated commitments that are required to make the change. And is why mandating a change will be necessary.

We have sought to identify the major issues that will need to be resolved together with some suggestions as to how that might happen.

It is not however practical at this stage to identify every issue or suggest solutions to every problem which will, in any event, vary between institutions and stakeholders.

There also remains uncertainty as to how markets will react when the US moves to T+1 in May 2024. Misalignment between the US and the UK will give investors a choice as to which settlement regime they wish to trade for certain transactions.

This will present challenges for overseas participants in distant time zones who will have to manage shortened deadlines and FX trades to settle their transactions.

ETFs and other mutual funds can also be impacted by any misalignment between their basket of securities and their own settlement cycle.

As will the significant number of securities that trade on UK venues but settle outside the UK.

The consequences of misalignment with the EU and the possible mitigations that can be put in place should this occur are identified in this report.

The next phase of work on how the UK transitions to T+1 needs to be led by a more technical and operationally focused group.

[4] Source: Investment Management in the UK 2022-2023, The Investment Association Annual Survey October 2023

They can carry out further consultation to ensure that the challenges of a transition are fully understood and solutions identified.

That group can also convene stakeholders to facilitate the planning for a move to T+1 and help establish consistent standards and processes so that capex spending can be budgeted for 2025.

Accordingly a key recommendation of this report is the immediate creation of a government sponsored Technical Group. Its recommended mandate is set out in the recommendations below.

Choosing the Date for Transition

Inevitably much discussion has been focused on the date for transition.

There are different preferences between quicker alignment with the US or alignment with the EU and the cost and burden of implementation lies unevenly with the benefits. This has meant that it has been difficult to achieve consensus over the pace at which the UK should move.

My view is that the advantages of a clear timetable to transition outweigh the disadvantages.

All projects need a deadline to incentivise the effort that will be required and create the sense of urgency to do the detailed work for a smooth transition.

It is also important to create the right dynamic for the Technical Group to carry out its work. It needs to focus exclusively on the practical issues that this report identifies and which need to be resolved before a move can take place.

A number of factors influence the timing.

First is the general consensus that implementing the necessary changes is a two year project – one year for planning and one year for investment and implementation. It is worth noting that the ***SEC*** gave fifteen months formal notice for the US move to T+1 in May 2024.

Second the UK should have the opportunity to learn any lessons from the US move.

Third the Technical Group needs to complete its work. It will report by the end of this year by which time ***ESMA*** should have published their report.

Fourth stakeholders will need to make provision in their 2025 capex budgets.

Finally it makes sense to allow a period after the operational changes are mandated in 2025 for participants to adapt to the changes in market processes before the formal move to T+1.

A date before the end of 2027 chosen by the Technical Group fits in with those requirements.

The relevant authorities should take the necessary steps to formally mandate a move to T+1 once the Technical Group reports by the end of the year.

Phasing Operational Changes

There is considerable support for a two step approach to the transition to T+1.

This means mandating appropriate operational tasks to be completed by the end of ***Trade Date*** together with certain behavioural changes. These changes should take place in advance of the move to T+1.

Most obviously these would include requiring ***Allocations***, ***Confirmations*** and trade level ***Matching*** to take place by the end of ***Trade Date***.

Electronic ***SSIs*** should also be mandated and market standards established relating to ***Trade Date*** settlement instructions and for onboarding new accounts.

These changes will increase automation and take effect from a date in 2025 determined by the Technical Group.

And enable new systems to bed in while taking a pragmatic approach that allows the UK to adapt to global developments.

Finally

I would like to emphasise the integrity and professionalism of those involved in post trade activities which has been a striking feature of the work of this Taskforce. They have shown an admirable commitment to the changes that will be required provided sufficient time and investment is made available.

It is important that market innovation finds the solutions to the issues that have been identified and I am confident that will happen.

2.2. Recommendations

1. **The UK should commit to move to a T+1 settlement cycle.**

2. **The date for the move to T+1 should, subject to Recommendation 3, be selected by the Technical Group established under Recommendation 6 and should be no later than 31st December 2027.**

3. **The UK, EU and other European jurisdictions should continue to explore opportunities for close collaboration to see if they can align their moves to T+1. If the EU or other European jurisdictions commit to a transition date to T+1 the UK should consider whether it wishes to align with that timeline. However if that cannot be achieved within a suitable timescale the UK should proceed in any event.**

4. **The scope of the move to T+1 should be finalised by the Technical Group and could include an appropriate safe harbour mechanism for ETFs and certain other securities that trade in the UK but settle outside the UK.**

5. **Irrespective of the migration date to T+1 appropriate operational changes should be mandated with effect from a date in 2025 determined by the Technical Group including the following:**

   (i) market standards for onboarding all new accounts to include all data necessary to settle a trade;

   (ii) electronic processes for sharing *SSIs*;

   (iii) market standards for *Allocations, Confirmations* and trade level *Matching* to take place on *Trade Date;*

   (iv) market standards to be established for *Settlement* instructions to be sent on *Trade Date*;

   (v) market standards for securities lending recalls

   (vi) *CREST* to remain open beyond 8pm for transaction input until a time agreed with the Technical Group; and

(vii) the UK time at which the *Trade Date* should be deemed to end.

6. The government should immediately establish a Technical Group comprising operational and market experts to:

(i) identify and suggest solutions to the technical and operating challenges of a transition to T+1;

(ii) identify the lessons to be learned from the US move to T+1;

(iii) agree common operational standards, processes and systems for the industry to adopt;

(iv) satisfy itself that there are workable solutions for the issues described in section 5 of this report and any other issues it identifies;

(v) determine the scope and safe harbour arrangements described in Recommendation 4;

(vi) select the date in 2025 for the operational changes referred to in Recommendation 5 to be mandated before the formal move to T+1;

(vii) select a date before the end of 2027 for the UK's transition to T+1; and

(viii) publish its findings by the end of 2024.

7. The relevant authorities should take the necessary steps to mandate the dates selected by the Technical Group for the operational changes in 2025 and the transition to T+1. Further suggested regulatory changes are set out in section 7.5 of this report.

8. Mutual and other open ended funds which currently operate redemptions and subscriptions on a range between T+3 and T+4 should be encouraged to transition to T+2 to align with the wider capital markets.

9. The focus should now shift to how the UK moves to T+1 rather than whether or when it should do so.

10. A move to T+0 or Atomic Settlement should not take place until after the move to T+1.

3. PROCESS TODAY

3.1. Introduction

Settlement is a crucial step in the trading lifecycle – whereby the buyer receives the purchased securities and the seller receives the corresponding cash in exchange for those securities.

The settlement process does not occur simultaneously with the execution of the trade. There is a window between trade and settlement during which a number of post trade processes take place to facilitate settlement of large volumes of securities transactions in a standardised, safe and efficient manner. Figure 1 below identifies ten such processes.

This window which is known as the "settlement cycle" is currently two business days for most, but not all, securities transactions.

The UK has followed a T+2 settlement cycle since 2014 in compliance with Article 5 of ***CSDR*** which mandated a maximum of two business days for settlement of transactions executed at a trading exchange.

Prior to the electronification of UK securities and the creation of ***CREST*** as the UK's securities settlement system, settlement took place on a fortnightly, account-based cycle. This changed first to ten business days, then T+5 and T+3 shortly thereafter.

Although most types of UK instrument settle on T+2, there are some notable exceptions.

- Settlement of Gilts takes place on T+1.
- Settlement of physical certificates follow a different process to electronic securities and typically use a longer settlement cycle.
- Primary issues such as IPOs, rights issues and syndicated bond issues follow a separate regime.
- UK mutual funds subscription and redemption cycles range between T+1 and T+4 with most at T+3 or T+4.
- Repos are not generally subject to any standard settlement cycle.

There is an important global context to the potential move to T+1. Several key global jurisdictions have implemented or announced their intention to migrate to T+1 settlement.

Most significantly, the US, Canadian and Mexican securities markets will make the transition to a T+1 settlement cycle in May 2024. India has already completed its transition to T+1 settlement for equities through a phased implementation process where securities were migrated in tranches according to their liquidity. China already operates on a T+0 settlement cycle. The EU has begun to consider its own move to T+1 with ***ESMA*** expected to produce its report in the third quarter of 2024.

And in a recent Citi white paper (Securities Services Evolution 2023) a survey showed that 89% of market participants now expect their own markets to move to T+1 within five years.

3.2. Key Participants

There are a variety of participants in the post trade process.

These include asset managers and other investors on the buy side.

Intermediaries include broker-dealers who arrange transactions, market makers and dealers that provide liquidity and take principal positions and prime brokers who provide a suite of services principally to hedge funds and investment managers.

The key market infrastructure includes regulated exchanges such as the London Stock Exchange, Aquis and others and multilateral trading facilities such as Bloomberg, MarketAccess and Tradeweb.

High volume order-driven trading is commonly used for liquid equities and ETFs. Quote-driven trading is used on the multilateral platforms for less liquid bond trading.

For some transactions ***CCPs*** stand between buyers and sellers following the execution of a trade and prior to its settlement.

Custodians, who can be local or global, provide settlement, safekeeping and administration of securities services as well as offering intraday liquidity, collateral management, FX and securities lending.

Central securities depositories (***CSDs***) such as ***EUI***, the UK's ***CSD***, and the two international ***CSDs***, ***Euroclear Bank*** and ***Clearstream*** are responsible for notary, settlement and safekeeping functions on behalf of ***Custodians*** and others. ***Settlement Agents*** provide access to ***CSDs***.

Finally Registrars are responsible for maintaining an accurate register of the holders of an issuer's securities.

3.3. Summary of Settlement Process

It was clear from our work that there would be benefit in setting out a summary of the post trade process as it operates today.

There are variations in the process for different types of security but they are not so significant as to have an impact on our recommendations in this report.

Generally the post-trade lifecycle can be broken down into two main flows of information.

First there is a "horizontal flow" between the buyer and seller. These two principals to the transaction must agree on all information relevant to facilitate the settlement of the trade. This includes both economic data (such as the quantity and price, as well as any additional fees or charges to be included in the settlement amount) and non-economic data (such as the details of the accounts at the ***CSD*** between which the transaction should be settled).

Secondly there is a "vertical flow" in which information is cascaded through the lengthy ***Custody*** chain to the ***CSD***. Settlement intermediaries acting on behalf of the buyer and seller will place equal and offsetting instructions at the ***CSD***. Provided the economic and non-economic data is correct the instruction will match. And provided the buyer has placed sufficient cash in its required cash account and the seller's securities account holds sufficient securities the instruction will settle.

It can be seen from the table below that many activities are already expected to take place on ***Trade Date*** although that depends on the time of day the trade takes place.

So T+1 is currently often used to conclude allocation, confirmation and matching, resolve exceptions and act as a period to reduce the risk of failed settlements as well as providing more time to process trades that take place late on ***Trade Date***.

That is not to diminish the current importance of T+1 but it does suggest that with better processes and technology upgrades it should be possible to ensure that the activities that need to happen on ***Trade Date*** do so.

Figure 1 - Overview of Key Actions/Actors in securities trade lifecycle

Action	Description	Current (ideal) Time	Actors
Trade Execution	A transaction is agreed by two trading counterparties (buyer and seller). This may be done on a trading venue or “***OTC***”. Investors and asset managers typically access markets through a broker, who helps buyers find sellers and sellers find buyers.	T+0	Asset managers/other investors Broker-dealers Trading venues
Allocation	A single block transaction may be split across several different accounts. The asset manager/investor informs their counterparty of the details of the split.	T+0	Asset managers/other investors Broker-dealers
Confirmation	Key economic and non-economic data relating to the trade is finalised.	T+0	Asset managers/other investors Broker-dealers
Trade-level ***Matching***	Trading parties may make use of third-party systems, which allow both sides of the transaction to enter the trade details. If the details are the same, the trade is ‘matched’.	T+0	Asset managers/other investors Broker-dealers ***Matching*** platforms

Action	**Description**	**Current (ideal) Time**	**Actors**
Clearing	Clearing is an optional process for securities transactions, whereby a central counterparty (***CCP***) becomes the buyer to any seller and the seller to any buyer, so the counterparty risk is transferred to the ***CCP*** from the actual parties to the trade. This also allows for transactions to be settled on a netted basis.	T+0	***CCP*** Clearing members
Instruction to ***CSD***	Following the ***Allocation/ Confirmation*** process, the details of the transaction are propagated through the ***Custody*** chain and input to the ***CSD*** for settlement.	T+0	Asset managers/other investors Broker-dealers Global custodians Sub-custodians ***CSDs***

Action	Description	Current (ideal) Time	Actors
Settlement-level ***Matching***	Once both sides of the instruction are entered correctly, the ***CSD*** will attempt to match them in the settlement system. If an equal and offsetting instruction cannot be found, the instruction will remain unmatched and not be put forward for settlement. Details of the status of the instruction should feed back up the ***Custody*** chain to the trading parties.	T+0 – T+1	***CSD***, Asset Managers, Brokers, ***Custodians***
Securities position management	Trading parties and intermediaries ensure that securities that have been sold are ready and available for settlement on the intended settlement date. This may involve borrowing or recalling securities or entering into a repo transaction	T+0 – T+1	Asset managers/other investors Broker-dealers Global custodians Sub-custodians

Action	Description	Current (ideal) Time	Actors
Cash position management (inc FX)	Trading parties and intermediaries ensure that for securities purchases, the relevant cash amount is ready and available for settlement on intended settlement date. This may involve executing an FX transaction to ensure funds in the appropriate settlement currency.	T+0, T+1, T+2	Asset managers/other investors Broker-dealers Global custodians Sub-custodians
Reconciliation and exception management	All parties involved in the settlement chain will need to investigate any breaks or exceptions.	T+0 onwards	Asset managers/other investors Broker-dealers Global custodians Sub-custodians

If for any reason the purchase and sale instructions cannot be matched, for example due to an error in the cash amount, the ***Settlement Agent*** or ***Custodian*** cannot apply its own discretion and amend its client's instruction unless expressly delegated by the client in the ***Custody*** agreement.

Instead the ***Settlement Agent*** or ***Custodian*** will need to advise the trading party of the discrepancy. The trading party will then need to make the required amendments or discuss the ***Matching*** issue with its trading counterparty.

If any details in the settlement instruction need to be amended the trading party will need to send a new instruction to the

Settlement Agent or ***Custodian*** or ***CSD*** for onward instruction to the ***CSD*** or directly to the ***CSD*** itself.

When a trade fails to settle on time cash penalties apply in the EU. In other markets claims may arise to cover the costs resulting from the failure to settle including the cost of buying replacement securities and funding costs for financing long or short positions.

In the UK there is a fining regime operated by the ***CSD*** which fines for general poor settlement performance rather than individual failed transactions.

3.4. Specific Activities

Specific issues arise in relation to a number of activities or asset classes which are discussed in more detail in Section 5.

Multi-settlement instruments

Pooled investment funds operate solely on a subscription and redemption basis and so there is no secondary trading. Commonly UK funds will settle their subscriptions and redemptions on a T+3 or T+4 basis.

Cashflow issues arise for those funds that hold a mix of securities that settle on T+1 and T+2. This arises where the settlement times for the underlying securities differ from the fund's subscription and redemption timelines.

Nevertheless unlisted funds mostly have the freedom to change their contractual redemption and subscription arrangements.

Additional issues arise for secondary trading in ETFs described in more detail in Section 5.

Issues also arise in relation to dual listed securities where there will be separate liquidity pools operating under different settlement regimes – IAG which trades in London and Madrid is an oft quoted example.

Securities lending

Securities lending is critical to the operation of financial markets. Transactions are typically initiated by a borrower, with negotiation and lifecycle maintenance occurring through a mixture of automated functions provided by vendor platforms and manual interventions.

Once the borrower and lender agree commercial terms a contract is agreed under the terms of a master agreement, typically a ***GMSLA***.

The terms of the loan will detail the type of collateral to be exchanged, the rate, the term date and the settlement details.

Borrower and lender pass the transaction to their operations team for collateralisation, ***Matching*** and settlement at the ***CSD*** on the Settlement Date.

After settlement of the securities loan a daily mark to market is applied to the contract. The borrower and lender agree and exchange margin daily in line with the price of the loan and collateral.

On the term or recall date the borrower and lender arrange for the return of lent securities which on settlement trigger the return of any related collateral.

The majority of large institutional investors, such as pension funds, ***UCITS***, Central Banks and Sovereign Wealth Funds participate in securities lending from which they generate an additional portfolio income.

Central Banks are also active users of securities lending as part of their market operation transactions, to ensure market liquidity for example through the Public Sector Purchase Programme.

Securities lending occurs on a continuous basis all year round and facilitates:

- The provision of secondary market liquidity of securities;
- Increasing long-term investor returns on security portfolios;
- Raising finance against long term investments;
- Meeting prudential regulatory obligations such as the Liquidity Coverage Ratio and Net Stable Funding Ratio under the Capital Requirements Regulation, helping to both manage and reduce systemic risk;
- Sourcing and delivering collateral for regulatory margin requirements under the EU's recently implemented BCBS Uncleared Margin Rules;
- Market making activities of financial institutions, giving them ready access to securities that they may not be holding;

- Settlement obligations and increasing operational efficiency, particularly in light that CSDR penalises late settlement of securities; and
- Short selling, which improves price discovery for institutional investors and improves market efficiency, mitigating price volatility.

The move to T+1 presents different challenges for each party to a securities lending transaction.

For borrowers the ability to identify a borrowing requirement and manage sufficient inventory to collateralise a trade, happens over a close of business cycle resulting in a stock loan the following day. T+1 significantly compresses this process.

For lenders the ability to receive notification from the beneficial owner and pass that on to a borrower, who then has to source replacement securities is similarly a significant challenge.

A move to T+1 will need planning and investment to find solutions to these issues.

Repo

Repo is a generic name for both repurchase transactions and buy or sell-backs. It plays a central role in the modern financial ecosystem, facilitating a number of functions and interacting with a variety of different financial markets.

Repo markets help fund the market-making books of broker-dealers for both sovereign and corporate debt supporting secondary market liquidity for global cash bond markets.

An active repo market is a prerequisite for liquid markets in derivative instruments, in particular exchange-traded bond futures and options.

Repo markets are also where collateral is priced and sourced allowing financial and corporate institutions to meet the margining requirements that increasingly underpin today's financial markets.

Finally, repo markets are the primary channel through which Central Banks manage bank reserves and monetary policy.

The principal users of repo on the sell side are market-makers and leveraged and other bond investors seeking funding.

On the buy side, the principal users are risk averse investors seeking secure short-term investments.

These include large commercial banks, Central Banks investing foreign currency reserves, international financial institutions, money market mutual funds, agents investing cash collateral received by their securities lending clients, asset managers with temporary cash surpluses and the treasuries of large non-financial corporates.

Financial market infrastructures such ***CCPs*** and ***CSDs*** are also regular users.

More recently repo has been attracting smaller commercial banks as well as a number of non-bank financials such as sovereign wealth funds.

The European repo markets represent around EUR 10 trillion in terms of the value of outstanding transactions.[5]

Traditionally repo has tended to settle one business day earlier than the respective settlement period for the same security.

This is because net cash and securities positions that need to be covered in the repo market are only known after close of business on the cash market transaction date.

A move to T+1 shortens the time available for repos to settle.

Repos are not subject to a standard settlement cycle and the Technical Group will need to establish that the repo market can continue to operate in a satisfactory manner following a move to T+1.

Corporate actions

The two basic categories of corporate action are:

- Distributions: whereby proceeds (either cash or securities) are delivered by the issuer to the holders of a security without affecting the underlying security itself such as the payment of a dividend; and
- Reorganisations: whereby the underlying security is replaced by new proceeds (either cash or securities) such as a stock split.

Corporate actions can also be divided into:

- Mandatory or voluntary events: whether or not the holders of the security have a choice to participate in the event; and

[5] Source: ICMA's European Repo Market Survey in December 2022

- With options or without options: whether or not the holders of the security have a choice of proceeds (e.g. can decide whether to receive cash or stock).

The issuer determines who is entitled to the proceeds of the corporate action based on the positions at the issuer ***CSD*** at the end of the "record date".

Buyers and sellers must determine when executing a transaction whether or not the entitlement to the corporate action is transferred with the ownership of the securities.

Industry standards have been developed to ensure consistency as to how corporate actions are announced and processed and how entitlements are determined. These standards set out the sequencing of key dates that must be adhered to. This includes the concepts of "ex-date" and "last trading date" which define the cut-offs after which the entitlements to distribution and reorganisation events are not attached to new transactions.

Key dates are sequenced so that securities traded with the entitlements attached are able to be settled by the record date ensuring that the issuer identifies the new holder of the securities as the holder of the entitlements as well.

This means that a move to T+1 would require changes to the sequencing of these key dates.

If a transaction is executed on or before the ex-date/last trading date but does not settle before record date, further action will be required to ensure that the proceeds of the corporate action are correctly distributed to the holder of the entitlement.

These actions can be:

- Market claims: the process to reallocate the proceeds of a distribution to the contractually entitled party.
- Transformations: the process by which unsettled transactions over the record date are cancelled and replaced by new transactions in accordance with the terms of the reorganisation.

3.5. Out of Scope Matters

Physical Certificates

These fall within the scope of The Digitisation Taskforce, chaired by Sir Douglas Flint, whose interim report was published on 10th July 2023 to drive forward the digitisation of shareholdings. They operate on a separate settlement cycle and accordingly they are not dealt with in this Report. Nevertheless we identified considerable support for the recommendations in Sir Douglas Flint's report.

Primary markets

Primary markets are where securities are created and issued for the first time such as where companies or public authorities are seeking to raise capital and sell stocks or bonds to investors. This can take the form of initial public offerings, private placements, or rights issues etc.

The issue of new securities operates on a timetable set out in the relevant offering documentation such as a prospectus.

As a result the settlement cycle relating to secondary trading does not apply and primary issues are not within the scope of this report.

4. REASONS FOR MOVING TO T+1

4.1. Summary

The principal reasons for the UK to move to T+1 are:

- harmonisation with international markets;
- improving market resilience and reliability;
- reduction in risk; and
- cost savings.

Consensus also exists over the need to automate more post trade processes. Incentivising this investment is an important additional benefit.

Given progress in other jurisdictions and the fact that many securities already settle on T+1 there should be no technology bar to making the move.

4.2. International harmonisation

The North American markets will move to T+1 in May 2024 and China and India are already operating in a T+0 / T+1 settlement environment. These jurisdictions represent over 55% of global equity markets (SIFMA).

The EU, Australia and a number of LATAM countries are also considering the move, which would significantly further increase the proportion of the global equity market operating on T+1.

And according to the survey by Citi, 89% of market participants now expect their own equities markets to move to T+1 (or T+0) in the next five years.

In the UK nearly two thirds (62%) of institutional investors holding shares in the FTSE All Share on the LSE are non-UK investors. And 40% of institutional investors are from North America with 14% from Europe (excluding the UK).[6]

The IA's annual survey[7] shows that of the £8.8 trillion managed by its members 42% is invested in equities of which 32% is in North America and 19% in Europe.

[6] Source: LSEG January 2024

[7] Source: Investment Management in the UK 2022-2023, The Investment Association Annual Survey October 2023

The benefits of international alignment include an increase in efficiency for cross border trades and avoiding the additional cost of misalignment as other jurisdictions move to T+1.

4.3. Market resilience and reliability

T+1 settlement allows holders of securities to realise cash more rapidly.

In a stressed market participants may need to raise cash rapidly by selling securities.[8]

The ability to receive cash on T+1 is a benefit during such periods thereby improving the resilience of markets and participants.

These benefits are of course dependent on the transition to T+1 being implemented effectively and minimising the risk of increased settlement fails.

4.4. Reduction in market and credit risk and associated costs

Another key benefit will be the overall reduction of risk.

In the time between a trade being executed and settled there is risk that the parties to the trade may not fulfil their obligations.

There is also a risk of heightened volatility especially in stressed market conditions that may impact the transfer of cash or ownership of securities.

The longer the time to settle, the greater the risks.

In a T+1 settlement environment there will be 24 hours less exposure and so counterparty and market risks will be significantly reduced.

In turn this reduces the number of unsettled trades at any point in time. By way of example a major element of the Lehman insolvency (when the settlement cycle was T+3) was resolving three days of unsettled trades.

Operational risk will also be reduced by implementing automation and ***STP*** across post-trade operations, decreasing the manual errors in ***Allocation*** and ***Matching*** that may cause trades to fail.

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[8] See generally: Seven Moments in Spring: Covid-19, financial markets and the Bank of England's balance Sheet operations Speech by Andrew Hauser 4th June 2020

Reducing the settlement cycle should have a knock-on impact of reducing margin and collateral requirements for clearing members on transactions clearing through a ***CCP***.

This is cited as one of the major benefits expected by the US as it prepares for its move to T+1.

Risk model simulations in the US have shown that volatility margins could be reduced by up to 41%, as a shorter settlement cycle helps with balancing risk-based margining and reduced pro-cyclical impacts (DTCC).

4.5. Incentive for investment in automation

An important benefit to the broader post trade ecosystem of moving to a T+1 settlement cycle is that market participants across all sectors of the industry will need to upgrade their technology and operational infrastructure, increasing automation and exploring new collaborative solutions offered by industry vendors.

Increasing the number of processes that are automated will not only reduce manual errors in ***Matching*** and processing of ***Trade instructions*** but will also reduce the time taken to process trades. Increasing efficiency of processing will deliver operational cost savings.

It can be difficult for back offices to attract investment in post-trade processing and the presence of a market imperative to act will accelerate the industry's modernisation trajectory.

In other jurisdictions investments have included:

- re-engineering of settlement system architecture to bring process steps from overnight batch mode into intraday processing or to bring batches earlier in the settlement period;
- use of process mining and interrogation tools to build greater understanding of inefficiency in settlement processes and to identify the causes and location of friction and delay such as client or product data issues, client communication weaknesses and workflow delays;
- incentivising clients to change behaviours that delay settlement such as the use of faxes, emails and PDFs to communicate ***SSI***s, ***Allocations*** and settlement instructions; and
- driving the adoption of pre-***Matching*** solutions to increase speed and reliability of settlement processes.

5. KEY CHALLENGES AND COSTS

5.1. Alignment with other markets

The US and Canadian move to T+1 will take place in May 2024.

This will allow the UK to learn from the US experience particularly as to how overseas investors respond to shortened deadlines.

The EU has begun to consider its own move to T+1 although the timing of such a move might differ from the UK.

There remains therefore the possibility of misalignment between the UK and the EU for a period.

A number of issues arise from misalignment with the US and the EU and these are described below.

1. XS ISIN securities

Background

ISIN is the unique identification code assigned to securities to facilitate their identification and trading. The XS prefix indicates the security is issued outside of the country where it is traded.

Euromarket Securities with XS ISINs are settled through the *ICSDs* of Euroclear Bank (Belgium) and Clearstream Banking (Luxembourg) and are capable of being traded and listed on both UK and EU trading venues.

This is in contrast to domestic market securities which tend to be traded solely by participants in the local market, generally settled through local ***CSDs*** and are assigned a local ISIN prefix (e.g. 'GB' for the UK domestic market, 'US' for the US domestic market, etc).

Transactions in XS ISIN securities tend to be executed by UK market participants on UK trading venues and by EU market participants on EU trading venues.

Following Brexit, many of the largest UK venue providers (including Bloomberg, MarketAxess and Tradeweb) established separate EU venues to be able to continue to provide services to UK and EU clients, respectively. This gives participants a choice as to whether to trade on a UK or EU venue.

These venues mainly operate a buyside to sellside "Request for Quote" ("RFQ") process by which the buyside solicits buy or sell prices from dealers. They only offer limited matching of buy and sell open interest.

This means that the opposite side of a trade will always be on the same venue (EU or UK) as the buyside participant initiating the trade. The sell side counterparty will generally sell from inventory, borrow or buy without a matching sale.

As a result EU/UK liquidity is managed either within a dealer group (with the EU/UK trading entities managing their inventory between themselves) or via the interdealer market.

Issue

A move to T+1 in the UK ahead of the EU would not of itself present a material alignment issue as trades are not being matched across markets with different settlement cycles.

However the same security could be traded on either T+1 or T+2 depending upon whether it is traded on an EU or UK trading venue.

If the UK moves ahead of the EU this would result in two settlement cycle options for the inter-dealer market and non-EU/UK market participants who would be free to choose whether to trade on an EU or UK trading venue.

The effect of this would be to split the liquidity of the relevant security into two separate pools.

There are three potential solutions.

(i) Mandate T+1 for trades on UK venues and accept fragmentation of settlement cycles. Although having the same ISINs, additional identifiers would enable participants to distinguish between trades on UK and EU trading venues.

    The advantages of this approach are:

    - It would align trading of XS ISINs on UK trading venues with domestic securities traded on trading venues; and

- If XS ISINs are illiquid, a reduction in liquidity may not impact the trading significantly.

The disadvantages of this approach are:

- There would be fragmented settlement cycles between UK venues and EU venues that might drive non-EU/UK business to EU venues;
- For liquid securities it would lead to a difference in spreads between EU and UK venues as dealers incorporated the extra funding costs in their spread; and
- EU ***CSDR*** settlement discipline rules would apply to the shorter settlement cycle (because the securities would remain subject to EU ***CSDR*** on the assumption that they are settled through ***Euroclear Bank*** and ***Clearstream***), which could make such a move unattractive.

(ii) Trading venue providers which operate venues in both jurisdictions could voluntarily implement T+1 for their EU venues.

The advantages of this approach are:

- It would preserve the single T+1 settlement cycle for those venues, without having to mandate a phased implementation for XS ISINs; and
- Providers might implement T+1 across all of their venues as part of the US move to T+1 in May 2024 and so this approach may not require any additional work on their part.

The disadvantages of this approach are:

- It relies on voluntary compliance by the trading venue operators;
- There is still a risk of fragmented settlement cycles between UK venues and EU-only venues that do not require T+1 settlement; and
- EU ***CSDR*** settlement discipline rules would apply to the shorter settlement cycle, which could make such a move unattractive.

(iii) The UK could move to T+1 at the same time as the EU for transactions in XS ISINs.

The advantages of this approach are:

- All venues across the UK and EU would be implementing T+1 at once, meaning there would be no issues with fragmented settlement cycles across the two markets; and
- There would be no need to rely on voluntary compliance by the trading venue operators.

The disadvantages of this approach are:

- The EU's move to T+1 is still in its early stages, with ***ESMA*** not due to complete a feasibility report until the third quarter of 2024, meaning that there is uncertainty as to implementation timing.

Proposal

It is difficult to predict how non-EU/UK participants would react if faced with a choice between a T+2 settlement cycle on an EU venue or a faster T+1 settlement on a UK venue with the consequential need for additional processes.

Although the relatively low liquidity in XS ISINs is facilitated by an RFQ process the creation of a settlement cycle mismatch would split the liquidity pool for individual XS ISIN securities.

The market will continue to evolve as participants adapt both in response to the US move to T+1 and a commitment by the UK to move to T+1 and this is something the Technical Group needs to consider when it finalises scope including a safe harbour mechanism.

Similar issues will arise in relation to EU government bonds that trade in the UK.

2. ETFs

Background

Many Exchange Traded Funds ("ETFs") and other open-ended funds (e.g. other ***UCITS*** funds, Open Ended

Investment Companies ("OEICs"), unit trusts) invest in securities across a number of different jurisdictions. Currently, the settlement cycles are aligned in most major jurisdictions.

Secondary market liquidity in ETFs is provided through two mechanisms. First traditional transactions between market participants via a designated market-maker. Second via an Authorised Participant ("***AP***") through the creation or redemption of ETF shares.

In the latter case, the investor would enter into a normal secondary market transaction with the market-maker or ***AP*** to buy or sell ETF shares. Unless the market-maker or ***AP*** can match a buy or sell order, the ***AP*** would effect a creation or redemption of new units with the ETF issuer itself.

Currently, the settlement deadline for the creation and redemption process is commonly T+2 and is therefore aligned with the settlement cycle for the secondary market trade and the underlying securities of the fund.

Secondary market trading

Where an ETF is traded on both UK and EU exchanges, as is commonly the case, this may create separate liquidity pools and pricing misalignment.

The nature of this misalignment would depend upon whether the trading venues offer an integrated order book across the EU and UK or whether the misalignment is as described above in relation to XS ISINs.

Creations and Redemptions

Mismatches between the settlement cycle of the ETF shares and any of the underlying securities of the fund could impact an ***AP***'s ***Inventory Management***, performance and the cost to the investor, particularly where the ETF has significant cross-border exposure.

For example, on a creation where the ETF share has remained on a T+2 settlement cycle (because it is traded on an EU exchange) but some of the underlying securities have moved to T+1 settlement, the ***AP*** would receive cash from the investor too late to be able to settle the purchase of those underlying securities (in the case of an in-kind creation) or pay the ETF issuer (in the case of a cash creation).

It would therefore need to borrow overnight to fund this shortfall, or delay purchasing the underlying securities / submitting its creation order by a day which in either case would incur additional borrowing or hedging costs that would be passed on to the investor.

Alternatively, on a creation where the ETF share has moved to T+1 settlement but some of the underlying securities have remained on T+2, the ***AP*** would be unable to deliver those underlying securities to the ETF issuer in time (in the case of an in-kind creation), which would result in a settlement failure on the secondary ETF share trade with the investor.

Or, in the case of a cash creation, the fund would be left holding excess cash for a day following settlement of the secondary ETF share trade, which would be a drag on performance.

Market-makers and ***APs*** could respond by holding more ETF shares in inventory, but this would also come at a cost to investors.

The converse to the above applies to sales/redemptions.

Where an ETF is a ***UCITS***, it will currently need to ensure that any additional borrowing does not exceed the 10% limit mandated by the ***UCITS*** rules.

Proposal

Potential approaches to address the creation/redemption issue are:

- Implement T+1 for all ETF shares: This would be beneficial for funds with portfolios mainly invested in UK, US or other securities trading on a T+1 cycle, as there would be alignment between the settlement cycle of the fund's shares and the majority of its underlying securities. Funds with a significant proportion of EU or other underlying securities operating on a T+2 cycle would be impacted. They would suffer a cash drag and borrowing issues for settlement on creations or redemptions respectively.

- Delay implementation of T+1 for ETF shares until the EU implements T+1. This would benefit funds with portfolios of mainly EU and other assets on a T+2 cycle. There would then likely be cash drag for settlement of T+1 underlying securities on a creation or redemption. It would particularly impact funds with a significant proportion of UK, US or other securities traded on a T+1 cycle.
- Consideration could be given to amending the ***UCITS*** rules to relax the 10% borrowing cap to mitigate these issues. However many ETFs are domiciled in the EU and so outside the remit of UK regulation. Where issues arise it may be necessary for ETFs to operate ***OTC*** to manage the risk of breaching the ***UCITS*** rules.

As with XS ISINs the market will continue to evolve and the Technical Group will need to make recommendations in relation to ETFs in the light of the circumstances in due course.

3. Other Mutual and Open Ended Funds

There are two issues for mutual funds.

First is the fact that some funds will have a cashflow cost, like ETFs, where they instruct an asset switch from T+2 securities to T+1 securities. That is because the sale proceeds on T+2 securities will not be received until after the obligation to settle a T+1 trade arises.

The reverse transaction will result in surplus cash pending settlement of the T+2 transaction.

As with ETFs these mutual funds may need to transact some trades ***OTC*** and continue to settle on T+2 where it is necessary to do so.

Separately there is no secondary market trading in open-ended funds that are not ETFs, so liquidity is provided solely through subscriptions and redemptions directly with the fund.

As with ETFs, misalignment between the settlement cycle of some of the underlying securities and the fund subscription/redemption deadline results in cash drag and the need to borrow.

This is an issue that will exist for all open-ended funds regardless of location and arises whenever such funds invest in securities with different settlement cycles.

As with ETFs the 10% ***UCITS*** borrowing limit will apply. And again where these funds are domiciled within the EU they will be outside the jurisdiction of the UK. It may be that where needed mutual funds will need to trade ***OTC*** on T+2 to mitigate this issue.

Equally the current practice of UK mutual funds operating redemptions and subscriptions on a range between T+1 and T+4 also needs to be considered.

It would make sense for the UK mutual fund industry to accelerate their fund settlement cycle to T+2 in line with the shortening of the securities settlement cycle to T+1.

There will be some challenges that will need to be worked through. These include the BACs payment model which settles on T+3 and ensuring the needs of investors are met.

Some UK trade bodies are recommending a shortening of the mutual fund settlement cycle to T+2 in preparation for the US and Canadian move to T+1 in May 2024.

Should the UK move to T+1 ahead of the EU there may be an increase in friction and costs for funds containing a mix of UK and European securities given the different settlement cycles. There is a concern that this may encourage investment into EU excluding UK indices.

4. CREST Depository Receipts

Background

CREST depository interests (***CDIs***) are UK securities representing an overseas domestic equity on a one to one basis. The underlying share is delivered to a ***CREST*** account at the local ***CSD***, and ***CREST*** in turn issues a ***CDI*** representing those shares to the relevant investor.

A ***CDI*** will have the same ISIN as its underlying security and is settled through ***CREST***.

CDIs are typically unlisted and trade off-exchange through market-makers, although there are a number of listed ***CDIs*** in respect of UK listed international securities.

Issue

As many ***CDIs*** do not have GB ISINs and are not traded on a UK trading venue they would not be caught by any UK regulatory requirement for listed securities to move to T+1.

However, those ***CDIs*** that are traded on a UK trading venue face similar issues to ETFs.

For some ***CDIs***, such as ***CDIs*** in highly liquid US equities, trades on a UK trading venue would likely be accompanied by movements of inventory to and from the US market and the contemporaneous issue or redemption of the ***CDI*** for the underlying security.

Issues and redemptions of ***CDIs*** are an automated process which occurs when the security is received or delivered from or to the home market. As a result they can be effected on a T+0 basis and it would make sense for those ***CDIs*** to have the same settlement cycle. The move to T+1 in the US is likely to incentivise such a change.

For other ***CDIs***, such as ***CDIs*** over FTSE listed non-UK equities, trades on a UK trading venue are not necessarily accompanied by a contemporaneous issue or redemption of the ***CDI*** for the underlying security and there is a significant pool of liquidity held in the UK.

For these ***CDIs***, a move to T+1 might not present an issue except where a trade needs to be accompanied by a contemporaneous issue or redemption of the ***CDI*** for an underlying with a different settlement cycle.

Where a ***CDI*** is traded in both the UK and the EU, similar liquidity fragmentation issues may arise as with ETFs.

Proposal

As with ETFs the question of whether ***CDIs*** and other Depository Interests should be exempt from a move should be looked at in more detail by the Technical Group.

5.2. Foreign Exchange

1. Background

Nearly two-thirds (62%) of shares traded on the LSE are held by non UK institutional investors.[9]

In addition some 25% of government debt is owned by private overseas investors, the second highest in the G7.[10]

The UK Office for National Statistics calculates that investors from outside the UK hold £2trn of UK assets.[11]

These statistics confirm the extent to which London is a significant global market with a higher proportion of overseas investors than the US.

The FX market is a global market with no official opening hours although in practice operating hours are Monday 8am Sydney – Friday 5pm New York.

It operates as an ***OTC*** market with many trading platforms. The FX Global Code July 2021 acts as an informal rulebook.

There are no exchanges, ***CSDs*** or other central market infrastructure apart from CLS Bank.

CLS Bank operates CLSSettlement a global multicurrency cash settlement system with a payment versus payment system. It does not wholly eliminate FX settlement risk but reduces it considerably among the currencies that it encompasses.

The deadline to enter ***CLS*** for next day settlement is 11pm GMT for direct CLSSettlement members. However ***Custodians*** will typically add 1-2 hours for onward ***CLS*** users, such as asset managers and hedge funds, looking to utilise netting.

The standard settlement cycle for FX transactions is T+2. However this is a long-standing market convention, which is not mandated by law or regulation.

[9] Source: LSEG January 2024

[10] Source: Office for Budget Responsibility, Fiscal Risks and Sustainability July 2023

[11] Source: Census 2021

It is therefore possible to settle on a T+1/T+0 basis but this will generally incur a higher cost either via higher fees or a wider spread.

Unless institutions in London provide FX liquidity after UK markets close FX transactions may migrate to the US.

2. *Issue*

Under the current T+2 securities settlement cycle investors prefer to enter into any related FX transactions once the underlying security trade is matched after the market closes so that the economics of the securities trade is confirmed.

This allows the FX trade to be executed on a T+1 basis and settle in time to complete the underlying securities trade.

The FX trade settlement occurs either through CLS Bank to take advantage of cross-party netting and reduce the settlement and operating risk or as a bilateral exchange between the transacting parties.

At present and because there is lower FX liquidity available for some currency pairs at the end of the securities ***Trade Date***, the FX trade may need to be executed on a T+1 basis on the following day (ie T+1 of the securities trade). This means that both the FX and securities trade settle on the same day (ie on T+2 securities trade).

A move to T+1 for UK securities would reduce the time for a related T+1 FX trade to a few hours post the securities market close on the ***Trade Date***. The lower liquidity at that time of day could lead to increased costs.

The FX trade could be executed on a T+0 basis on the day the securities are due to settle. The disadvantage is that the deadline for submitting trades into ***CLS*** is midnight CET of the day preceding the value date so these FX trades would not be eligible for netting.

If that is missed the FX trade will have to settle on a gross bilateral basis increasing the operational cost for the parties involved and introducing counterparty risk.

In a T+1 settlement cycle overseas investors need to consider the FX cut-offs across their various FX providers and adjust their processes accordingly.

Weekends and bank holidays will pose a particular challenge where FX markets are closed in the base currency. Either the securities trade will fail or it will need to be prefunded, an extended settlement sought or a local currency facility will be required.

We have heard that there should be adequate liquidity at the end of ***Trade Date*** for major currencies. However concerns have been raised in relation to secondary currencies where there is less liquidity.

Further complications arise because of the interdependency of final FX calculations on the results of trading in markets outside of the UK, some of which such as the US do not close until many hours later. This may increase bilateral settlement, increasing cost and risk for the end investor.

3. Proposals

There are a number of choices available to deal with the FX challenge for non-UK participants.

Participants could move operational working hours in line with the UK working day to access market liquidity in the correct time-zone. This is costly and not available to all.

A third party provider such as a ***Custodian*** could execute FX locally in the UK. Investors tend not to favour this option due to higher costs although more efficient solutions may be considered.

Investors may decide to enter into the FX trade when the underlying security trade is unconfirmed. This carries an economic risk as pricing may change between the two trades.

Investors looking to instruct a T+0 FX transaction could accept the risk of executing their FX trade bilaterally. As a result fewer FX trades may flow through ***CLS*** increasing liquidity and settlement risk across the market.

Pre-funding is a technically viable option. This is not a preferred option because of the cost implications and challenges relating to portfolio management and compliance.

FX trading hours could also be extended to 6pm UK.

How international investors into the US respond to the move to T+1 in the US in May 2024 will provide useful lessons for a UK move.

Our expectation is that both the FX markets and the securities market will find solutions to the FX challenge and this is something the Technical Group will need to monitor.

5.3. Stock lending, recalls, collateral and inventory management

Securities financing such as repo, securities lending and collateral management are key ***Inventory Management*** functions. They are described in more detail in section 3.4 of this report.

These arrangements tend to settle on a shorter cycle than the underlying cash trades often already on a T+0 basis and sometimes recall notifications are transmitted late in the day.

Managers and asset owners engaging in stock lending programs need to ensure stock is available for delivery.

A move to T+1 will have a corresponding impact on these activities.

Market deadlines will be a key issue to address. They not only include the end of ***Trade Date*** but also earlier deadlines relating to DVP ("Delivery versus Payment") and FOP ("Free of Payment").

As with other aspects of a move to T+1 the challenge is compounded by the multiple stakeholders involved across different time zones.

Solutions will likely involve more automation and ***STP***.

The concern is to ensure that borrowed securities are delivered in time for settlement of the related trade.

A similar issue exists in relation to securities held by way of collateral.

The Bank of England Securities Lending Committee has established a Settlement Efficiency sub-group which is examining improvements in standards and ***Confirmation*** processes currently in use.

It will be important for the Technical Group to understand the impact of a move to T+1 on the supply and demand for UK stock borrowing and lending and repo.

5.4. Operational Deadlines

Allocation and ***Confirmation*** processing alongside settlement instruction, CSD-level ***Matching*** and settlement efficiency are critical to a smooth move to T+1.

Allocations and ***Confirmation*** processing and ***Matching*** on ***Trade Date*** is currently best practice for timely settlement on T+2.

The generation and cascade of settlement instructions typically commences on ***Trade Date*** and continues into T+1 at which point CSD level matching is performed and exceptions investigated.

Data from ***CREST*** shows that 67% of settlement instructions are matched on ***Trade Date*** compared to 97% on T+1 and this gap will need to be improved significantly with the loss of the middle day.

Issues arise where ***Allocations*** are provided late by the buyer, are incomplete or provided through non-standard channels. Similar issues arise with sellers on ***Confirmations.***

Incorrect ***SSIs*** and end-of-day bulk batches instead of intra-day batches also cause problems and with ***CREST*** currently closing for input of transactions at 8pm there is limited time to resolve exceptions and errors.

A move to T+1 would require ***Trade Date Matching*** to be close to 100% which will require new investment and updated processes as well as market standards across the industry.

I am recommending that new deadlines on ***Trade Date*** are mandated for ***Allocations, Confirmations*** and trade level ***Matching*** before the move to T+1 giving the market time to adjust to a new regime.

Similarly there should be a requirement for all ***SSIs*** to be in electronic format and for market standards to be established for ***Trade Date*** settlement instructions.

A move to T+1 and, in due course to T+0, will require ***CREST*** to operate beyond its existing hours. That will allow more time to conclude these processes which will benefit US and APAC investors in particular.

Given the market's reliance on this key infrastructure it will need to extend its operation beyond 8pm for the benefit of all market participants. This is something the Technical Group should agree with ***CREST***.

5.5. Corporate actions

The move from T+3 to T+2 did not give rise to material difficulties in relation to corporate actions.

The main concern on a move to T+1 will be the requirement to bring forward the date on which the buyer of securities ceases to be entitled to distributions known as the ex-date. This will result in it and the record date falling on the same day for cash distributions.

As such, systems will need to ensure this is possible so market claims are processed accordingly.

For stock distributions the ex-date and payment date will remain the business day after the record date.

There are differences between ***EUI*** and the ***ICSDs***, ***Euroclear Bank*** and ***Clearstream*** in the processing of claims, transformations and buyer protection.

The Technical Group will need to review the detailed arrangements, including the extent of automation required and agree any detailed processing changes needed to support a move to T+1.

Registrars will need to ascertain if the market deadline for all elective events needs to move from intra-day to close of business.

There will also need to be a review of the market practice rules that protect buyers. Issuers will need to update their event calendars and there will need to be co-ordination around the migration date.

5.6. Costs of Technology and Operational Change

Significant investment into technology upgrades and operational change will be required to move to T+1, including system reconfigurations, staff training, testing and transition costs, as well as any regulatory compliance and control costs.

The main areas of investment will be upgrading manual processes across the trade lifecycle, introducing real-time solutions to move away from batch processing, meet shorter deadlines, and speed up failure resolution processes.

Additionally, firms may face costs associated with moving staff or hiring new staff in new time zones in order to accommodate longer operating cycles.

In a survey carried out by Accenture ahead of the US move to T+1 (published in Oct 2022), 2 out of 5 respondents expected their function to spend between $6 and $10 million on the transition.

Accenture estimates that a total investment of $30-50million per year for 3 years would be required for a large financial institution.

5.7. Risk of increased fails and infrastructure resilience

Near term challenges of transitioning to a T+1 settlement cycle include an increased risk of settlement fails if market participants are not prepared to meet new deadlines.

The reduction in the window between the end of trading and the beginning of settlement in today's environment is from twelve to two hours. This may initially put stress on settlement processes and leave less time for exception management which could lead to an increase in settlement fail rates.

A material increase in fails over the initial migration period would incur cash penalties under ***CSDR*** for securities that settle in the EU and capital impacts under Basel III (AFME). Settlement discipline issues will also arise in ***CREST***.

However this should be a short term impact as seen when India moved and should improve once automated processes and new operating models are running smoothly.

The risk should be further mitigated on a UK move to T+1 by the preparation for the US move in May 2024.

The move to T+1 also reduces the time available to repair market infrastructure system failures. Testing the resilience of new systems will be a critical part of the transition process.

5.8. Impact on less liquid securities

More work needs to be done by the Technical Group to understand the impact on smaller capitalised equity securities and other illiquid instruments.

Stock lending may not be readily available for these securities which are dependent on market makers providing two way prices. Settlement can get extended with the result that the settlement date is missed while market makers source stock.

6. TIMING AND PHASING

6.1. Choosing the Date for Transition

There are a number of factors that need to be taken into account in determining the timetable for a UK move to T+1.

First is the scale of operational change that will be required to update systems and processes. That involves the need to design and agree new standards before they can be operationalised.

Second is the wider context of change that is already taking place to reflect the recent regulatory reforms the UK is making following Brexit. The issue is as much about capacity to implement change as it is about the cost of investment.

Third is the need to embed behavioural change. Much of this is identified in the ***Hudson Report*** and a number of changes should take place before the final step of mandating T+1 across all UK trading venues.

Fourth is whether the UK should align with the EU or go ahead in any event.

Lastly is the question of what, if any, exemptions should be permitted following the change to T+1.

There are clear benefits to the UK unequivocally committing to a move to T+1 within a specific timeframe. Without this it will be difficult to create the momentum across all relevant stakeholders to make the changes that will be required.

And whilst alignment with the EU would be preferable that may not be achievable within the UK's desired timescale.

The ***SEC*** confirmed the US move to T+1 with effect from May 2024 giving 15 months' formal notice.

That US commitment combined with the announcement of this Taskforce means that there has already been extensive consideration of the challenges of a move to T+1. The UK will also have the benefit of being able to learn from the US move.

Another factor is the need to allow participants to include the cost of transition in capex budgets so investment can be made in 2025.

The Technical Group should be able to coordinate with stakeholders so they can identify where costs will need to be incurred allowing budgets to provide for the necessary upgrades.

Nevertheless there remains the challenge that the cost and burden of a change to T+1 falls unevenly and there are different views over whether to wait for the EU or minimise the period of misalignment with the US.

This has meant it has been difficult to achieve consensus over the pace at which the UK should transition.

My view is that the advantages of a clear timeframe outweigh the disadvantages.

A date before the end of 2027 allows time for the new systems adopted in 2025 to bed in while taking a pragmatic approach that allows the UK to adapt to global developments.

The specific date should be confirmed by the Technical Group when it reports by the end of 2024.

6.2. Phased Operational Change

There is a clear view that appropriate operational changes should take place ahead of the move to T+1 to help the market adjust to the new market practices and standards which will be needed in a T+1 environment.

So appropriate operational changes, including the following, should be mandated from a date in 2025 determined by the Technical Group:

- market standards for onboarding all new accounts to include all data necessary to settle a trade;
- electronic processes for sharing ***SSIs***;
- market standards for ***Allocations***, ***Confirmations*** and trade level ***Matching*** to take place on ***Trade Date***;
- market standards to be established for settlement instructions to be sent on ***Trade Date***;
- market standards for securities lending recalls;
- ***CREST*** to remain open beyond 8pm for transaction input until a time agreed with the Technical Group; and
- the UK time at which the ***Trade Date*** should be deemed to end.

7. IMPLEMENTATION

7.1. Overall implementation planning considerations

Implementation of a UK move to T+1 will require a level of industry-wide coordinated change comparable to the introduction of a new regulation or other large scale market transition.

However the profile of the work is quite different.

In contrast to recent major transitions (e.g., the introduction of MiFID II, or the cessation of Libor) this does not require the introduction of wholly new processes or financial products.

A move to T+1 is largely a matter of performing existing activities in a faster and more efficient manner.

US market participants have estimated that moving from T+2 to T+1 involves a reduction in available time for key activities not of 50% as might be assumed, but of 83%, as activities which would be performed on the intervening 'middle day' need to be performed on ***Trade Date*** and potentially after market close.

So the challenge of a move to T+1 consists in achieving this step-change in process efficiency and in managing the impacts on related and adjacent processes.

7.2. Timing and dependency structure

The UK adoption of T+1 settlement would consist of approximately five main phases.

These are the required regulatory and rule changes, industry engagement, implementation, testing, and transition.

The regulatory and rule changes are discussed further below.

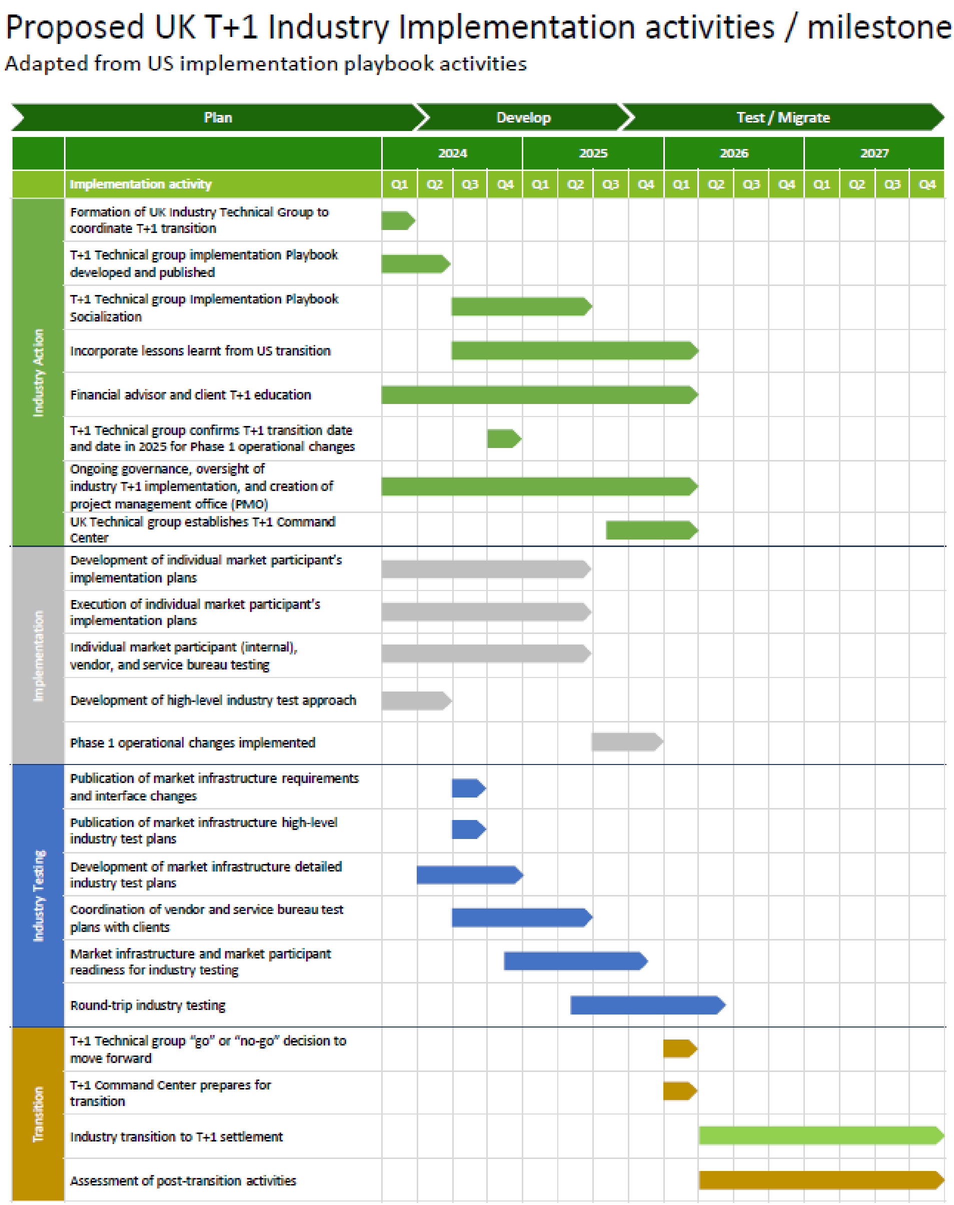
An industry engagement phase would involve the formation of the Technical Group as described earlier in this report. This would coordinate the transition, including the development and socialisation of a detailed transition "playbook" and the setup of ongoing governance to track transition across industry. It would also learn lessons from the US transition.

Implementation would involve the development and execution of individual market participant plans, including testing at an individual market level, and the development of a cross-industry testing approach.

Following implementation would be an intensive testing programme. This would encompass the development of detailed market infrastructure, industry test plans, coordination with vendor and service bureau test plans with clients and round-trip industry testing.

Finally, the industry would transition to T+1.

Figure 1 - Gantt chart indicating potential timeframes that may be followed for each phase and its underlying activities



7.3. Implementation Considerations

Section 5 provided analysis of the expected challenges, risks and costs that may arise from a UK transition to T+1.

The table below summarises the implementation considerations based on the challenges raised. They would need to be considered in more detail by the Technical Group.

Alignment with other markets

Issue / Challenge		Potential resolution / approach / considerations		Resolution owner
1	XS ISIN Securities can be traded on both EU and UK platforms, down to the choice of non-EU / UK investors	1a	Mandate T+1 for trades on UK venues (and accept fragmentation of settlement cycles)	Technical Group
		1b	Trading venues operating in both UK and EU could voluntarily implement T+1 for EU venues. This would require voluntary action from trading venues	EU / UK based Trading venues
		1c	Plan UK move to T+1 in alignment with EU transition for transactions in XS ISINs	Technical Group
2	ETFs will face an issue of mismatched settlement cycles of underlying shares if the UK moves to T+1 before the EU and other markets	2	Update procedures to ensure enough funds available for the purchase of securities / submission of creations orders, as well as the ability to deliver underlying securities to an ETF issuer on time e.g., by holding more ETF shares in inventory. For ***UCITS***, borrowing must remain in the 10% limit as per ***UCITS*** rules	Market Participants / ***APs***
3	Other mutual and open-ended funds will face similar issues as ETFs	3	Evaluate current settlement cycles of mutual funds which range between T+1 and T+4 to assess whether it would be pertinent to shorten to a	Technical Group/ Mutual fund providers

Issue / Challenge		Potential resolution / approach / considerations		Resolution owner
			standard settlement cycle for all UK Mutual Funds	
4	***CDIs*** do not have GB ISINs and are not traded on UK trading venues however would face similar issues as ETFs	4	Evaluation on whether ***CDIs*** should be exempt from a move to T+1 settlement	Technical Group

Foreign Exchange

Issue / Challenge		Potential resolution / approach / considerations		Resolution owner
1	The processing window for FX transactions will be smaller in a T+1 settlement environment	1a	Adjust FX cut-offs and processes to provide a longer window for FX transactions – FX trading hours could be extended to 6pm GMT	FX providers
		1b	Move operations close to the UK, allowing access to market liquidity in the correct time zone (costly)	FX providers
		1c	Use third party providers to execute FX locally in the UK (costly)	FX providers
		1d	Prefund transactions (costly)	FX providers

Issue / Challenge		Potential resolution / approach / considerations		Resolution owner
		1e	Apply lessons learned from US transition to UK FX processes	FX providers

Stock lending, recalls and inventory management

Issue / Challenge		Potential resolution / approach / considerations		Resolution owner
1	Key ***Inventory Management*** functions including repo, securities lending and collateral management will be impacted by a move to T+1	1a	Assess ***Inventory Management*** processes and procedures to ensure stock is available for delivery. Recall processes, triggered by lender sales, should support timely notification, sufficient for borrowers to source securities in the open market.	Market participants
		1b	Assess intraday liquidity costs, ***CCP*** margin calls and margin calculation processes	Market participants
		1c	Review of ***CREST*** deadlines, technology and internal communication systems	Market participants

Allocations and Operational Deadlines

Issue / Challenge		Potential resolution / approach / considerations		Resolution owner
1	T+1 settlement will require ***Matching, Allocation*** and ***Confirmation*** to take place on T+0	1	Mandate same day ***Allocations*** and ***Confirmations***, prior to the final T+1 transition date, giving time for market participants to adjust before the official settlement. A suitable timeline to conclude this process needs to be agreed.	Technical Group
2	Settlement instructions are currently processed manually and do not have a standardised format	2	Mandate a standardised, electronic format for ***SSIs*** to be transmitted across the UK market, to allow ***Allocations, Confirmations*** and settlement instructions to be processed without reliance on email, fax or other manual methods ensuring vendors use the same data fields to prevent fragmentation	Technical Group
				Market participants
3	***CREST*** input is currently disabled at 8pm, giving limited time to resolve exception and errors with 67% of trades matched on ***Trade Date***	3	Extend the ***CREST*** instruction input deadline to give a longer window for settlement instructions to be generated and transmitted through to ***CREST*** in order for exceptions to be identified and resolved and to achieve as close as possible 100% matching in ***CREST***	Technical Group and ***CREST***

Issue / Challenge		Potential resolution / approach / considerations		Resolution owner
4	There is currently a reliance on manual processes which are time-consuming and inefficient.	4a	Implement technology / system and process upgrades to ensure as close to 100% of trades are allocated/confirmed and matched on T+0 as possible	Technical Group
		4b	Perform comprehensive review of all ***Allocation, Confirmation*** and ***Matching*** processes, to assess where efficiencies can be made	Market participants

Other issues

Issue / Challenge		Potential resolution / approach / considerations		Resolution owner
1	Impact to corporate actions as ex-date will be changed to fall on the same day as record date	1	Review of internal processes and system functionality to make necessary upgrades to accommodate updated ex-date and ensure market claims can be processed properly	Market Participants
2	Deadline for elective events may not be suitable in a T+1 settlement environment	2	Assess whether market deadline for elective events should be moved from intra-day to close of business	Registrars

Issue / Challenge		Potential resolution / approach / considerations		Resolution owner
3	There will be an impact to liquidity requirements in a T+1 settlement environment	3	Perform impact assessment on liquidity and collateral management processes, including FX funding procedures, to make necessary operational / process / technological upgrades to ensure all funding requirements can be met	Market Participants
4	Current technology and operations may not be fit for purpose to complete settlement by T+1, which would result in an increase in late settlements / settlement fails post migration	4	Perform impact assessment of current operational processes and technology and develop plans for enhancements to ensure preparedness for T+1. Proper investment and preparation should be taken to minimise settlement fails, which may incur cash penalties under ***CSDR*** and Basel III	Market Participants

7.4. High level implementation recommendations

These include:

- Learn and leverage lessons from other jurisdictions

  Various jurisdictions (including India and China) have already moved to T+1 settlement, and the USA and Canada are in the process of this transition at time of writing. In order to maximise the efficiency of the transition for the UK market, mitigate risks, and optimise the ability of market stakeholders to extract benefits, the Technical Group will incorporate lessons and parallels from these jurisdictions.

- Create appropriate central steering and coordination capabilities

  Major transitions of this type require consistency of approach and action across the market. This will be important in a number of areas, including agreeing specifics of detailed interpretation, setting out and coordinating multilateral testing activities.

  A central governance function orchestrated by the Technical Group would be beneficial in providing detailed guidance to market participants on individual plans which can then be tailored by participants as required.

7.5. Regulatory and Legal

The key regulatory change would be to amend Article 5(2) of UK CSDR to mandate a maximum settlement cycle of one business day for settlement of transactions executed on a UK trading venue.

Certain other changes to UK CSDR would be required to, for example:

- mandate the ***Matching***, ***Allocation*** and ***Confirmation*** of transactions on the ***Trade Date***;
- mandate electronic ***SSIs***;
- provide for potential exemptions; and
- clarify that the T+1 obligation applies regardless of the location of the ***CSD*** through which the transaction is settled.

Consideration could be given to amending the ***UCITS*** rules to relax the 10% borrowing limit for UK ***UCITS*** and Non-***UCITS*** Retail Schemes to address the liquidity issues raised above in relation to ETF and other mutual and open ended funds. However it should be noted that many ETFs mutual funds that trade securities on UK trading venues are domiciled in the EU and so outside the remit of UK regulation.

In addition, a range of amendments would need to be made to participants' rulebooks, trading documentation and industry best practice guidelines to ensure the smooth and consistent implementation of the above proposals. For example:

- trading venues would need to amend their rulebooks to reflect the move to a T+1 settlement cycle and trade ***Matching***, ***Allocation*** and ***Confirmation*** deadlines mandated by regulation;

- ***CREST*** and other ***CSDs*** would need to amend their rulebooks to extend operating hours and market discipline regime;
- ***ETF*** documentation, including subscription and redemption deadlines and any contractual borrowing limits, may need to be amended to address the issues raised above; and
- Trade associations should consider collaborating to produce new best practice guidelines (or amending existing ones) to aid their members' transition to T+1 and, where appropriate, encourage migration of ***OTC*** trades on a voluntary basis.

The Technical Group and relevant stakeholders will need to consider these issues in more detail and identify further areas for change.

This will include mandating behavioural changes before the final move to T+1.

8. T+0 AND ATOMIC SETTLEMENT

The direction of travel to faster settlement times will continue with the advent of blockchain and other technology.

A move to T+0 or atomic/instantaneous settlement is technically possible today. However there is clear consensus that it is neither practical nor sensible to seek to move from T+2 to T+0 in one step.

Investment in systems and processes to move to T+1 will need to have in mind a subsequent move to T+0 or ***Atomic Settlement***. This is something which should be considered by the Technical Group.

There will also be consequences for stakeholders who manage their balance sheets by netting at the end of each day.

Appendix 1
Glossary of terms

Allocations: where an investment manager sends instructions to the broker on how they wish to allocate a block trade to underlying accounts;

AP: Authorised Participant being a financial institution which has the authority to create and redeem shares in Exchange-Traded Funds known as ETFs,

Atomic Settlement: instantaneous settlement of security trades;

CCPs: Central Counterparties who stand between buyers and sellers facilitating the clearing and settlement of trades – DTCC, LCH, Euroclear and EuroCCP being examples;

CDIs: ***CREST*** Depository Interests which are UK securities representing an overseas domestic equity on a one to one basis;

Clearstream: an ***ICSD*** based in Luxembourg;

CLS: Continuous Linked Settlement which eliminates risk in FX trades using a "payment versus payment" system providing a simultaneous exchange of currencies through CLS Bank International;

Confirmations: the details provided by the broker that verifies trade information so the trade can be prepared for settlement;

CREST: the UK settlement system operated by ***EUI***;

CSDR: the EU Central Securities Depository Regulation regulating the legal aspects of securities settlement;

CSDs: Central Securities Depositories responsible for notary, settlement and safekeeping functions on behalf of ***Custodians***, trading parties such as banks / brokers and buy-side firms. "***ICSDs***" are international rather than local;

Custodians: Perform safekeeping and administration of securities on behalf of their clients and can facilitate settlement either through direct links to the ***CSDs*** or through ***Settlement Agents***. They also offer intraday liquidity services, collateral management, FX and securities lending. Custodians are either global or local;

Custody: The safekeeping and administration of securities on behalf of others;

ESMA: the European Securities and Markets Authority;

EUI: Euroclear UK & Ireland Limited the ***CSD*** established in the UK which operates the ***CREST*** system and a subsidiary of ***Euroclear SA/NV***;

Euroclear Bank: an ***ICSD*** based in Belgium and a subsidiary of ***Euroclear SA/NV;***

Euroclear SA/NV: the holding company of EUI and Euroclear Bank;

Euromarket Securities: securities which are issued and traded on the international capital markets and which are traditionally domiciled in a currency other than the issuers domestic currency, Eurobonds being a typical example;

Gilts: bonds issued by the UK Government;

GMSLA: Global Master Securities Lending Agreement the standard legal agreement used in securities lending;

Inventory Management: Sufficiency checks by the trading parties to ensure that the buyer has sufficient cash and the seller sufficient securities in place realigning from another account or arranging a borrowing securities or through credit facilities;

Matching: The comparison of the trade details and ***SSIs*** instructed to the ***CSD***. Discrepancies will need to be investigated by the trading parties and any amendments instructed;

OTC: over the counter markets where securities are traded directly between two parties rather than on regulated trading venue;

Reconciliation: From the broker to the intermediaries throughout the ***Custody*** chain there will be a series of controls: (i) Transaction level reconciliation between booking venues / front and back-office systems. (ii) Position level reconciliation between the actors in the ***Custody*** chain through to the ***CSD*** (iii) Beneficiary level reconciliation for ***Custodians*** to reconcile the positions held with the ***CSD*** against their own books and records. For ***CREST*** and the ***CSD*** participants (typically brokers / sub-custodians or global-custodians) there is a regulatory requirement under Article 37 of ***CSDR*** titled Integrity of the Issue;

SEC: the US Securities Exchange Commission;

Settlement Agent: Provides the trading party or other intermediaries such as ***Custodians*** / prime brokers with access to the ***CSD*** where it facilitates settlement;

SSI: Standing Settlement Instructions which contain standard key information required to be included in the settlement instruction such as bank, account number and account name;

STP: "Straight through processing" an automated end to end processing of transactions without the need for manual intervention or rekeying of data;

The Hudson Report: the April 2022 report "Charting the Future of Post Trade" by the Taskforce set up by the Bank of England and FCA;

Trade Date: the date on which the buyer and seller agree a transaction which for market purposes ends at a specific time which may or may not be on the calendar date of the trade;

Trade instruction: Both trading parties 'instruct' their appointed ***Settlement Agent***, ***Custodian*** or ***CSD*** with the details of the trade and the ***SSIs*** where it should settle. Each trading party is responsible to provide the correct information to its ***Custodian*** / ***Settlement Agent*** / ***CSD*** in a timely manner;

UCITS: ***"***Undertakings for the Collective Investment in Transferable Securities Directive" a regulatory framework which harmonises the rules for the management of investment funds.

Appendix 2
The July letter

UK Accelerated Settlement Taskforce

18 July 2023

Dear Taskforce Participant

Introduction

I want to update you on our work and progress since my note of 4th May 2023.

Since then there has been an uptick in industry papers and events. This has allowed us to engage more effectively with a wide group of stakeholders including many of you or your Trade Associations.

As a result, we have a clearer sense of direction and the emerging issues.

This letter provides an opportunity to share our latest thinking so that you can provide more input and help shape our direction of travel before we publish our interim report later in the year.

Whilst we of course welcome views on all areas of our Taskforce's work, in several key areas below we have noted particular points we would welcome views on.

Scope

The scope of the Taskforce's work covers all transactions executed on a UK trading venue regardless of the issuer's location or where those transactions settle.

As with the move to T+2 we expect OTC transactions to follow the lead of trading venues.

Direction of Travel

Since the introduction of CREST in 1995, the UK market has reduced its settlement cycle several times from T+10 to the current T+2 standard, a trend that is mirrored globally.

With many jurisdictions, most notably the US, adopting a T+1 default settlement cycle it is clear to us that the UK cannot practically remain on T+2 indefinitely.

In its Working Paper dated 30th May 2023 the Swift Institute supported this view also noting that there are some fundamental concerns that need to be addressed before a move occurs.

This means that we need to address the question of how and when the UK should move to T+1 rather than whether it should do so.

The longer-term benefits of a move to T+1 include a reduction in risk to all parties resulting from a shorter period when trades are “in flight”, lower margin requirements and quicker access to proceeds.

The other key benefit is that a move to T+1 would be a catalyst for the industry to invest in automation and to update systems and processes.

Many of these processes were identified by the Post Trade Taskforce which emerged from the Bank of England and FCA’s work through the Post Trade Technology Market Practitioner Panel and reported in April 2022.

It is clear that the existing frictional post-trade costs are too high and a move to T+1 will lead to an improvement in UK competitiveness by increasing efficiency in capital markets.

Key issues

The key issues that are emerging and our current thinking on them are set out below.

1. Alignment with the US/EU and FX markets

US Market

We expect the US move to T+1 will take place in May next year and will not be delayed.

This will give rise to practical challenges for non-US investors investing into the US, particularly given the time zone issues.

It will therefore provide an opportunity to learn how overseas investors respond to shortened deadlines.

EU Market

The EU has begun to consider its own move to T+1 although the timing of such a move might differ from the UK. There remains therefore the possibility of misalignment between the UK and the EU for a period.

The principal alignment issue with the EU would relate to international securities that can be traded on both UK and EU venues. That is those commonly referred to as Euromarket Securities which are traded or listed both in the UK and other markets and settled through Euroclear Bank in Belgium and/or Clearstream Banking in Luxemburg.

A move to T+1 in the UK but not in the EU would give markets a choice as to whether to take advantage of the shorter settlement time required by the UK.

Alternatively they may prefer to take the benefit of having an extra day thereby reducing, at least initially, the greater risk of failures which among other things would result in EU settlement penalties. Different settlement periods for the same security might also harm liquidity pools.

The issues relating to Euromarket Securities do not impact UK domestic securities which trade and settle in the UK.

This allows for UK domestic securities to move to T+1 ahead of other non-domestic securities subject to the other deadline challenges mentioned below.

FX Issues

There are separate concerns for participants who need to execute a related FX trade to fund the settlement of their securities trade.

We sense that major currencies should have sufficient liquidity to allow a T+0 or T+1 FX trade albeit there is concern that spreads may widen.

This challenge becomes more difficult for secondary currencies and presents particular issues for investors in APAC time zones.

Our sense is that the FX markets will resolve liquidity and spread concerns. However a consequence of an increase in T+0 settlement FX trading could be an increase in bilateral settlement, increasing operational risks, including settlement risk.

Mitigations suggested so far include moving operations closer to the UK to access market liquidity, using third-party providers, pre-funding and greater use of CLS.

We would welcome views on how markets might respond to the misalignment with the US, the possibility of misalignment with the EU and any misalignment with the FX market.

Will participants bear the cost or will trading move to an aligned market where trading, settlement and FX all operate on the same settlement cycle?

Could UK domestic securities move to T+1 ahead of other securities?

2. Allocations and Deadlines

Allocating and matching on trade date is currently best practice to achieve timely settlement on T+2 although this deadline is not always met.

Issues arise where allocations are not provided through standard channels or for time zone reasons.

Incorrect SSIs and end-of-day bulk batches (instead of intra-day batches) also cause problems and with CREST currently being disabled at 8pm there is limited time to resolve exceptions.

The shortened period for remediations on a move to T+1 would require trade date matching to be close to 100%. To achieve this new investment and updated processes will be needed.

One approach would be to mandate new deadlines for allocations and confirmations before the move to T+1 giving the market time to adjust to a new regime.

Allocations could take place intra-day or at the point of execution.

Similarly there could be a requirement before a move to T+1 for all SSIs to be in electronic format and a requirement for early use of LEIs in all trades.

Requiring information to be exchanged in a machine-readable format would also prevent the exchange of allocations via email, fax or other manual methods.

What views do participants have on these suggestions?

What other bottlenecks exist that could inhibit trade day allocation and matching?

3. ETFs and Mutual Funds

A misalignment between the settlement cycle for the creation and redemption processes for ETFs with the settlement cycle of the underlying securities is the most significant challenge for ETFs. Similar considerations apply to CDIs and other mutual funds.

The principal concern will be with cash management and the existing regulatory requirements. Either ETFs will be long on cash or will need to borrow to cover the mismatch between the different settlement cycles. Both will impact performance.

ETFs holding a majority of securities trading on T+1 will be impacted less than those with material holdings of securities trading on T+2.

European ETFs operating on T+2 invested in US securities trading on T+1 are an example of this issue. We will learn from the US move to T+1 how the market responds to that misalignment.

We welcome views on the impact of the additional frictional costs that might follow and the likely market response.

4. Inventory Management and Stock Lending

Securities financing such as repo, securities lending and collateral management are key inventory management functions.

These arrangements often settle on a shorter cycle than the underlying cash trades. This means a move to T+1 will strain these activities even more.

Managers and asset owners engaging in securities financing transactions must balance their operational timings to ensure securities are available for delivery with the risk of recalling securities too early and negatively impacting liquidity. There are also concerns around unintended disclosure of trading intentions.

Principal concerns include increased intra-day liquidity costs, central counterparties' margin calls and the broader challenge of updating technology and internal communication systems.

CREST deadlines and automation tools will need to be reviewed.

We would welcome views on these issues and the extent of investment in automation that would be required to mitigate them.

5. Systems and Processes

Considerable adjustments and investment will be needed to update legacy systems and work through the many challenges that will arise from a move to T+1. As well as those already identified, changes will need to be made to the processes for corporate actions and other post-trade activities.

Nevertheless, we sense that these challenges can all be met. But it will take time particularly given the current scale of back-office investment following recent regulatory changes and divergence.

Despite this we detect a clear acknowledgement that accelerated settlement has to come at some point and that the necessary investment will need to be made.

Timing

A clear commitment to make the move to T+1 will be required to encourage the necessary investment and provide sufficient time to make the transition.

The expectation is that ESMA will deliver its report on the potential for shortening settlement cycles in the third quarter of 2024.

And the experience of the US move to T+1 will help inform the timing of a UK move.

As already noted there may be scope as a first step to mandate some of the behavioural changes that will be required to enable an efficient move to T+1.

These could include establishing allocation and confirmation deadlines on T+0, mandating electronic SSIs, early use of LEIs and requiring information exchange in machine-readable format.

Others may include extending CREST's operating hours beyond 8pm.

Views are welcome on these ideas.

T+0

As I indicated in my last letter, our view remains that a move to T+0/atomic settlement should not be seriously considered before a move to T+1. We will not therefore seek to address the issues arising from such a move in our report.

Next Steps

I know many of you are already in contact with the various work streams we have established to examine these issues.

Please do continue to engage with them particularly given the approach we are taking set out in this letter.

Our report will need to set out a clear set of recommendations but it is not realistic to identify every operational issue and challenge.

Ultimately the market must commit to change and make the necessary investment over a sensible time scale.

I would also welcome any direct contact as well so you should feel free to contact me at [•].

I intend to publish an interim report in Q4 2023 so comments before the end of August would be most helpful.

Thank you for your continued support.

Kind regards

Charlie Geffen
Chair, UK Accelerated Settlement Taskforce

Appendix 3
The December letter

UK Accelerated Settlement Taskforce

18th December 2023

Dear Taskforce Participant

I want to update you on the work of the Taskforce since my letter of 18th July 2023, a copy of which is attached. As with that letter this is also being sent by the Trade Associations to their members.

Since then I have engaged with many of you either through the Taskforce, at one of the many industry events on accelerated settlement or directly.

The issues identified in my July letter have largely been confirmed including the broad consensus that the question is how and when the UK moves to T+1 and not whether it should do so.

And few question that a key benefit of a move to T+1 would be the catalyst for the industry to invest in automation and to update systems and processes.

It has also become clear that there is wide support for a two-phase approach to T+1.

Phase 1 would involve establishing market standards and ensuring that all the things that need to happen on Trade Date, such as allocations, confirmations and trade level matching do so.

Phase 2, the actual transition to T+1, would then take place at a later date.

The one issue on which there are differences of view is the date on which the transition to T+1 should take place.

That is not a surprise given the global nature of the UK market.

Some wish to minimise the period of misalignment with the US which moves to T+1 in May next year whilst others wish to align with the EU for which there is currently no time frame.

It is also the case that the costs and burden of implementing a transition lie unevenly with the benefits some of which relate to creating a more efficient ecosystem. Unsurprisingly that leads to different perspectives.

There is also the risk that nothing will happen unless there is a time frame.

It makes no sense to set a date in stone at this stage not least because we need to learn any lessons from the US move.

But there are benefits in having a proposed time frame which is subject to change as we learn more. It is also possible to take different approaches to Phase 1 and Phase 2.

I want to hear more views, including on the timing issue, so I will delay publishing my report to ensure that all those who want to contribute further can do so.

In the meantime it is important that a framework is established for the industry to get on with the necessary preparations for Phase 1 of the move.

So I am creating a Technical Group, under the auspices of this Taskforce, to work on establishing market standards where needed and find the solutions to enable a smooth transition to take place. It can also help identify the costs and benefits of a move, the downsides of not moving and the risks of misalignment with the US and the EU. This needs to be looked at from the perspective of the UK as a whole rather than individual stakeholders.

The next 12 months can therefore be spent planning the steps that will need to take place to enable Phase 1 to be completed. I did not want the delay in publishing my report to slow down that important preparatory work.

A suggested list of the key themes that the Technical Group will look at is set out at the end of this letter.

If you would like to contribute to this work please let me know with the area of focus that matches your expertise by 5th January 2024.

We will then create work streams and a Steering Committee to take that work forward.

My report, which will include my recommendations, will now be published in Q1 next year. It will be accompanied by a list of questions for further consultation which will be focused around the matters and recommendations set out in my report.

I want to thank all those who have contributed so much to the work of the Taskforce and to wish everyone a happy festive season.

Kind Regards

Charlie Geffen
Chair, UK Accelerated Settlement Taskforce

Technical Group Themes

- Scope, including the position of ETFs, mutual funds, less liquid securities, Euromarket Securities, non UK government bonds
- Operational Processes and Deadlines, including allocations, confirmations, trade level matching, CREST
- FX issues and impact on overseas investors
- Stock Lending and Recalls
- Repos
- Trading and liquidity issues, including funding implications
- Corporate Actions
- Infrastructure Resilience
- Alignment issues/risks with the US
- Alignment issues/risks with the EU
- Lessons from the US

Appendix 4
Terms of reference[12]

Context

When trades are made on financial markets, there is typically a time lag between 'trade date' – when a buyer and seller agree to the terms of the trade – and 'settlement date' – when the buyer receives the securities (such as shares or bonds) they have purchased and the seller receives the proceeds.

This lag is known as the 'settlement period', or 'settlement cycle'. During this time period a number of checks take place, such as confirming that the buyer has sufficient funds and that the seller has the securities to complete the trade, and details are exchanged between the parties to prepare for settlement. This aims to avoid the possibility that the trade could fail to settle. However, this time lag also exposes both parties to risk.

The settlement period has shortened in recent decades in line with the capabilities of modern technology. The most common standard at present is 'T+2' – which requires most trades to be settled two days after trade date, with some exceptions. This has been the case in the UK and the EU since 2014, and in the US since 2017.

Other jurisdictions have recently proposed a further acceleration of the settlement period. The US and Canada intend to move to a 'T+1' standard by 2024, which would require most trades to settle the day after trade date. India has already begun a gradual rollout of 'T+1' in the share trading market. There is also a live debate on whether a further shortening to 'T+0', or 'same day' settlement is possible or desirable in the future, perhaps using new innovations such as distributed ledger technology.

It is important that the UK also considers whether accelerated settlement would be beneficial, what challenges it would pose and how it could be implemented in the UK. This includes a potential move to a new standard 'T+1' settlement period and any other future developments to the settlement cycle, such as 'T+0', or the use of distributed ledger technology.

An exploration of these potential developments will also need to include an assessment of whether the UK's settlement discipline and efficiency arrangements are currently performing effectively and are suitable for accelerated settlement, as this will be an important factor

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[12] HM Treasury Policy paper: Accelerated Settlement Taskforce – Terms of Reference – Published 9 December 2022

in determining the success of any acceleration of the settlement cycle.

The government has appointed Charlie Geffen to lead an industry taskforce to examine these issues and recommend an approach that works for the UK. Charlie was previously Senior Partner at global law firm Ashurst and is currently a Senior Adviser at consultancy Flint Global. The Taskforce will be guided by the objectives below.

Objectives

1. **Explore the case for moving to an accelerated settlement cycle, such as 'T+1', in the UK, and outline how this could be implemented**

The Taskforce should weigh the benefits and costs to both UK and overseas market participants of a transition to an accelerated settlement cycle, including how this could promote UK competitiveness and growth.

It should assess the challenges of implementing such a change and how these could be overcome. This should include any preparations that UK firms need to make in the short to medium term in response to the planned moves by other jurisdictions.

It should examine the changes that would be necessary to facilitate accelerated settlement across the industry and consider how accelerated settlement could drive wider improvements and modernisation of practices in UK capital markets. This should include examining international best practice.

The Taskforce should consider whether there is likely to be a longer term move to 'T+0' and consider the implications of seeking to implement 'T+1' given this general trajectory.

Any recommendations should include the mechanism for implementation – for example, whether the changes would require legislation or regulator rules. This should also include recommendations on the scope of any changes, such as the types of trades that should be included and any exemptions.

2. **Evaluate current settlement performance across the UK sector and assess potential improvements and reforms**

This should include assessing the UK's settlement discipline and settlement efficiency arrangements, examining whether there is a need to improve settlement performance and recommending measures that could be implemented to do so.

The Taskforce should also look at whether current settlement discipline and efficiency arrangements need reform in order to facilitate an accelerated settlement cycle.

3. **Engage with the wider FS sector in undertaking the above work**

The Taskforce should identify and engage relevant stakeholders, both in the UK and overseas, which have an interest in these issues, particularly those likely to be affected by any recommended changes. It should communicate openly with these stakeholders and take on board their feedback.

The Taskforce should also engage with any related public bodies it deems would be appropriate for this work, such as the Digitisation Taskforce.

4. **Provide recommendations, including how any changes should be implemented by industry, regulators and government, and what the appropriate timetable should be**

This should include a suggested overall timescale as well as a plan for each stage of implementation. The timetable should balance an appropriate level of ambition with the need to provide the industry with adequate time to prepare for any changes.

Governance and timetable

The Taskforce will be chaired by Charlie Geffen. It will be for the Chair to decide the composition of the Taskforce and to determine the processes that will be followed in order to pursue the objectives above. The Chair is asked to provide an interim public report on the Taskforce's initial findings by December 2023, and a full report with recommendations by December 2024. These recommendations could include actions for government, the UK financial services regulators and industry participants.