THE INVESTMENT ASSOCIATION

# A Transition to T+1 Settlement in the UK, EU and Switzerland

## IA position paper
**October 2024**

## About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.1 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 48% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

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## Executive Summary

This paper outlines the Investment Association's views on a potential move to a T+1 settlement cycle in the UK, EU and Swiss markets.

With the transition to T+1 settlement cycle in North America now complete, transitioning to a T+1 settlement cycle in the UK, EU and Switzerland is a crucial step towards enhancing the efficiency of those markets.

Global alignment will foster a more robust financial ecosystem, will increase investor confidence and will ensure that the UK and European markets remain competitive and attractive to all investors.

Crucially, a UK, EU and Swiss transition to T+1 settlement will see greater alignment and harmonisation of settlement cycles globally, thereby reducing trading friction and costs to the benefit of the end investor.

The IA is a member of the UK's Accelerated Settlement Taskforce, which published its initial recommendations on March 28th, 2024. We are also a steering committee member of the subsequent technical group, led by Andrew Douglas. The technical group published its interim report along with a short consultation on September 28th. The report contains 43 principal recommendations and 14 additional recommendations, and we expect this publication followed by a subsequent and final report in December 2024 outlining a path to the UK's transition.

The views expressed in this paper are our own and are based on the average positioning of IA member firms' views, which we surveyed in July 2024 following the North American transition. Based on this comprehensive engagement, our recommendations are as follows:

- **Supervisory bodies and policymakers in the UK, EU and Switzerland should work on a shared timeline with respect to moving their respective markets to a standard T+1 settlement cycle.**

- **The UK, EU and Switzerland should transition to T+1 settlement on a date in Autumn 2026.**

- **Should one or more jurisdictions listed above only be able to transition at a later date before the end of 2027, and can commit to this before the end of 2025, the other jurisdiction(s) should move their transition date back to align.**

- **In the event the UK opts to move to a T+1 security settlement cycle ahead of Europe, there should be a "safe-harbour" exemption on UK traded and settled exchange traded products (ETPs – including ETFs, ETNs and ETCs), which should remain on a T+2 secondary market settlement cycle until the EU transitions, at which point the exemption should expire. Should the EU transition first, a similar "safe harbour" should apply. This should also apply to Eurobonds.**

- **There should be a recommendation, but not a regulatory requirement, to transition the mutual fund subscription and redemption settlement cycle to T+2 from the common T+3/4 in the UK and other popular EEA fund jurisdictions to coincide with the UK, EU and Swiss transition to T+1 in capital markets.**

## IA Member Firms Considerations around a transition date

There is an array of views across representatives of the UK investment management industry on a desired timeline for the UK, EU and Swiss markets to transition to T+1 settlement. Thoughts around a potential transition date largely centre around:

1. **Global Market Realignment** and the desire to see alignment across capital markets globally to reduce friction and reduce funding costs.

2. **European Markets Alignment** and the desire to avoid the creation of new frictions across pan-European portfolios and products.

3. **Transferable solutions from the North American transition** that can be used for a swifter UK/European move.

4. **Further Areas that need to be considered** by investment managers across the UK and Europe in adopting T+1 settlement, such as a quickening of the fund settlement cycle.

5. **Investor impact and market competitiveness**, ensuring sure that the transition does not negatively impact investors and that UK, EU and Swiss markets remain competitive.

We explore these topics in greater detail below.

Autumn 2026 represents a broad compromise of our membership's views, and we acknowledge that there are investment managers who prefer to either transition on an accelerated or slower timeline to this.

We acknowledge, too, concerns around misalignment between the UK, EU, and Switzerland and a desire to avoid creating misalignment across these jurisdictions have also influenced thoughts on a transition timeline.

There is also a recognition that other industry sectors may need a longer time to prepare for the transition, and that the political and regulatory timelines of the UK and Europe may make a 2026 transition challenging.

Our membership strongly prefers that EMEA markets transition at the same time and consequently prefer that any future moves in the settlement cycle be conducted and co-ordinated globally with the end investor in mind.

Concurrently, there is also a desire amongst IA members to regain global alignment of settlement cycles to ease funding challenges.

## 1. Global market realignment

With the US, Canada and other markets transitioning from a T+2 to T+1 settlement cycle in May 2024, it has created a large misalignment between some of the large, developed capital markets. Whilst some misalignment was already present prior to this go-live (e.g. India and China at T+1 and T+0 respectively), the North American markets represent a much greater proportion of market capitalisation globally (e.g. the US is commonly around 65% of market-cap weighting to global indices).

Misalignment across major capital markets jurisdictions creates additional friction by way of funding costs, which are seen through the cost of extended settlement transactions, custodian overdrafts and failing trades. This is particularly prevalent for those invested in global portfolios, an increasingly popular strategy in recent years.

Funding costs may manifest through:

**The gap between mutual fund subscription/redemption settlement and capital markets settlement**

A subscription into a mutual fund will commonly settle T+3 in the UK and in much of Europe, though shorter & longer cycles are seen. Concurrent to an investor subscription, the underlying capital market securities are purchased (currently at T+1 in North America, T+2 in EMEA, etc), such that the investor benefits from fund performance from the time of subscription. This creates a challenge which predates, but is exacerbated by, the North American transition to T+1 settlement, where cash is received after the settlement date of underlying securities.

Split capital market settlement cycles further exacerbate this issue by necessitating split funding durations for the underlying stocks.

Additionally, an array of settlement cycles globally makes it more difficult for a fund to shorten the subscription/redemption settlement cycle across the full fund umbrella, as flexibility may be necessary to meet liabilities. Should the majority of capital markets be at T+1, the industry can more easily pivot their fund range to a shorter cycle.

Global alignment for capital markets at T+1 will reduce friction in funds and funding costs, and ultimately benefit investors.

**Friction in exchange-traded product (ETP) management**

ETPs, notably ETFs but also ETCs and ETNs, play an important role across the global capital markets landscape. In Europe, these instruments have seen rapid growth in recent years. A key benefit of European ETPs is that they allow all investors access to a wide pool of local and international markets. Prior to the North American transition to T+1 settlement, European ETFs benefited from aligned settlement cycles across:

- Primary market creation/redemption at T+2 between Authorised Participants (APs) and Issuers
- Secondary market trading of ETFs at T+2
- Settlement of most underlying securities at T+2

In response to North American markets' May 2024 transition to T+1 settlement, European ETP issuers have amended the settlement of primary market transactions (creates and redeems of new ETP shares between the issuer and authorised participant) to a T+1 basis for ETPs with North American equity exposure. However, settlement of such ETPs by the end-investor (aka secondary market) remains on a T+2 settlement cycle.

This misalignment between primary and secondary market settlement has resulted in additional funding requirements for authorised participants (APs) and may be ultimately passed on to end-investors. This is particularly pronounced where the gap straddles a weekend, with APs pricing in additional funding to cover the weekend period.

Realignment of markets would mitigate these issues and make ETPs more efficient, improving EU ETP's competitiveness globally and delivering a better outcome for the investor through ETP pricing tracking closer to its constituent securities.

**Asset swaps**

Selling a North American asset at T+1 to purchase a European stock at T+2 now creates a funding gap. This friction will reduce once European markets move to T+1.

With the North America transition, the majority of capital markets globally in terms of market capitalisation are now settling T+1. Aligning the UK, EU and Swiss markets onto T+1 settlement will bring a greater proportion of global market securities within the same settlement cycle, decreasing friction. This will reduce funding costs for popular cross-border products, such as global focus mutual funds and ETPs.

## 2. European market alignment

Concurrent with a strong IA member drive towards achieving global capital market realignment on settlement cycles, the IA's members would also strongly prefer to retain European alignment, both between the UK, EU and Switzerland and also between the EU's constituent countries.

Despite a preference to retain European market alignment, there is a split view amongst our membership on whether one of the jurisdictions should transition if the other jurisdictions need a longer transition period (for example, the UK announces a 2026 date, but the EU looks to transition in 2029 or beyond). A small majority think that the more ready jurisdictions should transition ahead of the others to join North America in such a scenario, though there will be a further spread of thought in defining what constitutes a sufficiently far-apart timeline.

Overall, there is a strong consensus to retain UK, EU and Swiss alignment where possible, and a preference that the above question is avoided by adopting a cross-UK, EU and Swiss transition date in either Autumn 2026 or 2027.

Potential challenges of misalignment between the UK, EU and Switzerland include:

**A new funding gap for EU focus funds**

Whilst global or North America focused funds will have been impacted by the increased funding gap for North American underlying securities, a piecemeal UK/EU move will bring a further number of funds in scope for this misalignment issue creating additional funding challenges.

Data from the Investment Association's Investment Management Survey (IMS)[1] outlines that, of equities held by member firms and managed in the UK, 35% is allocated to North America, 20% to the UK and 19% to Europe excl. UK.

**The cost of multiple transition programmes**

It is the preference of firms to prepare a "big bang" approach to a shorter settlement cycle, rather than multiple programmes with different transition dates. This allows firms to more efficiently put in place scalable solutions that work across all regions, rather than "sticking plaster" manual fixes put in place until other jurisdictions transition.

**Multi-listed exchange-traded products (ETPs)**

ETPs may already be accommodating misalignment between underlying security settlement cycles and the primary market creation/redemption, as elaborated in the previous section. However, this 'primary market' workflow constitutes a small proportion of the overall liquidity pool of ETFs.

Most ETF trading and settlement happens directly amongst end-investors at the ETF-listing level, on public venues such as exchanges and regulated multi-lateral trading

[1] Investment Management Survey – Investment Association (October 2024)

facilities, across Europe. This market is commonly referred as 'secondary market'. For European ETFs, secondary markets can be three times bigger than primary market.

For secondary market trading, ETPs are listed and traded across European venues and it's common to see ETPs listed in the UK, Germany, Italy, Switzerland and more. A key advantage for the European ETF ecosystem is the commonality of settlement cycles across all of these jurisdictions, currently at T+2. As such, it should be evident that any misalignment between the UK, EU and Switzerland may cause a significant disruption in the cross-border secondary market trading of these ETPs. For example, should the UK transition to T+1 settlement ahead of EU, ETF market-makers will not be able to leverage the combined pool of Europe-wide ETF secondary market liquidity whilst APs will be forced to manage T+1 create/redeems for one market and T+2 create/redeems for the rest of Europe. This is likely to have severe negative impact on liquidity and transaction costs incurred by the end investor.

For this reason it's important that, should the UK, EU or Switzerland not transition at the same time, a "safe harbour" exists for all ETPs until a majority of these jurisdictions have transitioned to T+1.

## 3. Transferable Solutions from the Americans T+1 Transition

Many investment managers across Europe will have had to put in place measures to adapt to the North American transition, with the US often making up the biggest geographic investment weighting of an investment manager's fund(s). These system improvements and process changes should leave the industry in a good place to adapt to considerations necessary for a UK, EU and Swiss transition, including:

**Trade matching & settlement –** Given the high allocation, confirmation and affirmation rates achieved by European based investment managers for US securities, this should put them in a good place for a UK/EU transition to T+1. If an investment manager can affirm US transactions by 9PM ET (2AM UK time), it should be easier to achieve this in the UK/EU, with much of the infrastructure in communicating allocations/confirmations across both continents being similar (e.g. use of a tool such as CTM or in directly communicating with a custodian).

**Foreign exchange –** Measures put in place for the US will carry over well to the UK, EU and Switzerland. The main challenges for the North American T+1 transition were around CLSSettlement's[2] cut-off proximity to the US market close, the deadline of custodians to access CLSSettlement and tight liquidity in the FX markets around US market close. In the European time zone, firms will have an additional 5 hours prior to CLSSettlement cut-off and occur at a time when there is considered to be greater liquidity in the FX markets.

**Funding –** Firms have adapted to the increased funding requirement of T+1 settlement well, with solutions such as an overdraft facility, extended settlement and more forming part of a toolkit to address funding gaps. These will convert well to an EMEA transition to T+1 settlement and in the medium term, an EMEA transition to T+1 will ease this challenge as fund settlement cycles will likely be shortened alongside the transition.

Lessons learnt from a successful 15-month US implementation period should be carried over into considerations on transitions within Europe. Whilst there is greater complexity within these markets, much of the work can be leveraged from existing transitions or from work carried out since late 2022/early 2023 where the UK and EU industry taskforces started collaborating on potential transitions in those markets.

[2] CLSSettlement is a key PvP netting tool for FX transactions, netting payments of $6.5 trillion daily and playing a role in mitigating counterparty and settlement risk

## 4. Further areas that need to be considered

Whilst solutions for the Americas T+1 transitions will assist in go-live preparedness, there will still be areas that require more work ahead of any potential EMEA T+1 transitions.

**A shortening of the fund settlement cycle**

Whilst some mutual funds within the UK and EU already had a T+2 or shorter mutual fund subscription and redemption settlement cycle, feedback from UK investment managers suggest that ~75% or more of funds (either UK or Luxembourg/Ireland domiciled) remain at a T+3 subscription/redemption settlement cycle or longer.

Challenges remain in shortening this to T+2 or faster, which include:

- In the UK – a more effective cash transfer model. Bacs offers the most scalable and cost-effective model but has a 3-day clearing period.
- The capability of intermediaries within the fund settlement cycle chain to achieve T+2 or faster.
- A preference to keep a fund umbrella with multiple funds and fund strategies at the same fund settlement cycle. Flexibility in a longer fund settlement cycle provides time for a global investor base to provide funding and to purchase a range of underlying securities. This will ease with convergence towards global alignment.
- Retaining the flexibility for distribution to international investors who may hold different currencies, particularly for those in the APAC region.

Given the array of products a fund may invest in, it's important that firms retain the flexibility of setting a fund settlement cycle. Accordingly, a change to the fund settlement cycle to T+2 concurrent to the capital markets transition should be recommended, but not mandated.

**Securities lending and sale notifications**

Investment managers may either choose to engage in a stock lending programme for their own funds or may have clients who elect to employ one. For the latter, the lending programme is often "invisible" to the investment manager, with the firm not always aware of stocks on loan. In theory, this shouldn't impact them or the asset owner, as mechanisms are in place to recall stock in time if it's sold. This becomes much more challenging where securities settle T+1.

In the US, a deadline of 23:59 was originally touted as a recall notice cut-off, before industry bodies subsequently recommended a best practice of one hour before market close on trade date in line with master agreement legal templates. From an investment manager perspective, this is seen as a "best efforts" cut-off, as many investment strategies revolve around end of day pricing, making it impossible to send a sale notification prior to the cut-off.

It remains to be seen how many issues this will cause in the US, and work will have to be done to find a solution across lenders, borrowers, asset owners and investment managers within EMEA.

**Potential unintended short-term risks**

While there is confidence that a UK, EU and Swiss transition to T+1 settlement can be achieved within the timeline we have outlined, we encourage regulators and market participants to monitor settlement rates in and around the transition date.

**The impact to overseas investors**

We anticipate that the same transferable solutions for the North American transition to T+1 applied amongst investment firms based in EMEA should also work to the benefit of overseas investors, with a particular focus on APAC, where standard working hours finish before markets close in EMEA.

Firms from APAC should be able to leverage solutions in trade matching, FX and funding across both the Americas and EMEA.

Nevertheless, further work must be done to ensure that overseas investors are able to mitigate any challenges in accessing UK, EU and Swiss markets, whether direct capital market instruments or fund products.

**CSDR cash penalties**

A facet of the European market that introduces further complexity are CSDR cash penalties.

Although buy-side firms are largely net receivers of cash penalties[3], firms cannot assume that this will remain the same with a transition to T+1 Settlement.

Even if the buy-side navigate a T+1 transition successfully, a spike in cash penalty debits for counterparties could have a negative impact on asset pricing and liquidity.

Additionally, we understand that ESMA and the Commission are considering an increase in cash penalty rates and the introduction of mechanisms that may make the regime more complicated, such as progressive penalty rates. The IA amongst other consultation respondents have advocated for the cash penalty regime process to be as operationally simple as possible.

ESMA and the European Commission should carefully consider the impact of cash penalties in conjunction with a transition to T+1 settlement.

[3] Anecdotal feedback from several member firms post cash penalty go-live was that around 80% of cash penalties were credits

## 5. Investor impact and market competitiveness

**Putting the investor first**

Misalignment across global capital markets has created additional frictions which then causes onward costs. This may manifest through global basket products such as ETFs pricing slightly above the underlying value of their constituent securities, or costs for mutual funds as they manage funding gaps and misalignments. This is especially prevalent for funding over a weekend. Though these costs may be relatively small at fractions of basis points, when set against the volumes and values in global basket products they represent a much larger value. Global alignment will ease these funding costs and should make global basket EU product pricing more efficient, to the benefit of the investor.

Additionally, a shortening of the capital markets settlement cycle will allow an investor to receive proceeds from sold capital markets products one day faster, to their benefit. This is a benefit championed in the US without the same due consideration within Europe.

End investors should not be disadvantaged by a market jurisdiction moving where it is not ready, but equally they should not be facing additional market costs or delays in receiving proceeds where this is avoidable.

**Market competitiveness**

A faster move from one of the UK, EU or Switzerland ahead of the others is not seen by our members as a competitive advantage, with a strong desire to see all markets move in tandem.

A longer transition period, however, in 2028 or beyond may be seen as a disadvantage to the capital market(s) of those jurisdictions as a whole when compared against other international regimes.

With 2028 occurring 4 years past the US go-live, the US and other large capital markets may be considering a transition to same-day settlement at a time when the UK, EU and Switzerland are considering a transition to T+1 settlement.

In order to demonstrate competitiveness, those markets must show the ability to adapt their markets safely, but at pace, with an eye on future developments such as a transition to same-day settlement.

## Conclusion

The transition to a T+1 settlement cycle of the North American markets in May 2024, was considered a success by investment managers, with the majority perceiving that the go-live transition went well and those highlighting issues noting that they were minor rather than major. This is a testament to the work put in by industry to prepare for all aspects of the transition.

Whilst fund managers have adapted well to the challenges of misaligned settlement cycles globally, it is our view that it will be to the benefit of investors and securities markets to align settlement cycles as much as possible across jurisdictions.

In the US, the 15 months set out in February 2023 for a May 2024 go-live was sufficient, with settlement rates achieved by the broader market being higher than prior to the transition. Whilst the UK, EU and Swiss market infrastructure may be more complicated, it is our view that many of the lessons learnt, system upgrades and process changes that firms undertook for the US transition can be applied in a UK, EU and Swiss context, making T+1 transition achievable by Autumn 2026, 24 months from now.

We note, however, that some market sectors may need a longer transition period to prepare, and that the political and regulatory timelines of both the UK and EU may make Autumn 2026 challenging. Should this be the case, we believe the UK, EU and Swiss regulatory bodies should collaborate to set a later date, but one that is before the end of 2027.

In a period when jurisdictions are aiming to demonstrate and boost the competitiveness of their capital markets, the ecosystem's ability to enact a fast but orderly transition to T+1 Settlement is crucial.