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## European Securities Settlement: Steps Toward Harmonization

By Jim Cecere

The evolution of the European Union (EU) has meant rapid integration across its member nations to form a more cohesive governance model. Much of this transformation has occurred in the financial markets, from the creation of the European Central Bank to the adoption of a common currency. As a way to bring about further harmonization among its various financial markets, European leaders have agreed that a uniform schedule must be implemented for trade settlement across the different EU nations.

There are many reasons for the securities settlement harmonization initiative. First, the TARGET-2 Securities (T2S) platform is being developed as a single technology platform for the settlement of all EU securities. It has been decided that all EU financial markets will use the T2S platform by 2014. Since all of these financial markets currently have different settlement cycles, there must be an integrated approach to securities settlement upon the transition to one platform, or the new system will not work efficiently. Second, the European Commission has recently adopted new standards for corporate actions processing so that they will be handled in the same way across all EU nations. In order for the corporate actions in flux (i.e. pending transactions) to be processed efficiently, though, settlement cycles must be harmonized as well.

The European Commission created a task force to determine the best course of action. After reviewing all of its options, the task force decided that it would be best for all EU members to settle securities by “T+2,” or two days after the trade date, and the decision was discussed among other major financial markets around the world. The European Commission has expressed its intention to issue a directive this summer to mandate that all European markets move to this settlement schedule by 2013 so that there is adequate time to prepare for an organized implementation.

There are many benefits to having a shorter settlement cycle. Margin and collateral requirements would potentially decrease, which would lead to an overall reduction in transaction costs. Systemic risk would be mitigated through faster trade completion, which hopefully would lead to fewer defaults. The move is expected to result in more efficient European capital markets, but the proposal has sparked many questions about the overall outcome, including the impact on financial firms and the costs that will be incurred. If the settlement schedule shortens, it would potentially mean that certain smaller and mid-sized firms would need to invest in upgraded technology so that trades would be more fully automated.

Many market participants agree that the increased use of same-day affirmation (SDA), or the verification of a trade on the day the trade is executed, would go a long way in helping to move toward T+2 and limit trade failures. In short, using SDA may increase the chances of whether or not a trade will settle on time. While SDA may be done manually, an automated process is undoubtedly faster and also limits the instances of human error. In addition, automation facilitates the retrieval of information by having the information available in an electronic database as opposed to a hard-copy fax.

While advances in automation might not be as necessary for larger financial firms, certain smaller firms may need to invest in upgraded trading technology to prepare for a move towards T+2 settlement. Processes surrounding securities lending, transfer agency and Treasury services will all need to be tightened so that settlement would happen within the expected timeframe. All of this will require a commitment on the part of financial service providers to improve existing procedures and develop more efficient ways of settling trades.

All in all, EU securities settlement harmonization is an evolving process, and it will take time to implement among member nations. Progress continues to be made on this front, with task-force members working to ensure that back-office operations run smoothly for countries that would need to move to T+2 securities settlement. As the harmonization process continues to take shape, it should ultimately result in a stronger financial system for the EU, which should benefit market participants worldwide.



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