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Accelerating the settlement cycle: An opportunity to modernize across the industry

On February 9, 2021, the Securities and Exchange Commission (SEC) issued a proposal to shorten the securities settlement cycle from T+2 to T+1 in a document titled Shortening the Securities Transaction Settlement Cycle, Exchange Act Release No. 94196[1]. In response, Depository Trust & Clearing Corporation (DTCC) published a whitepaper "Advancing Together: Leading the Industry to Accelerated Settlement"[2] in February 2021 highlighting the benefits of moving to a T+1 settlement cycle.

The Industry Steering Committee (ISC) determined in its December 2021 report, "Accelerating the U.S. Securities Settlement Cycle to T+1"[3], that moving to a T+1 settlement cycle will increase the overall efficiency of the securities markets, mitigate risk, create better use of capital, and promote financial stability, provided that the appropriate balance is achieved between increasing efficiencies and mitigating risk. Below is a summary of the primary benefits anticipated by adopting T+1 settlement as referenced in the ISC report:

Reduction of risk, particularly during periods of high volume and volatility: As the volume of unsettled trades over a single trading day and the time between trade and settlement are reduced, there will be a reduction in systemic, counterparty, and operational risk across the settlement ecosystem, particularly in periods of market volatility. Furthermore, T+1 settlement preserves the benefits of settlement netting at National Securities Clearing Corporation (NSCC). This would significantly reduce the volume of securities and money required to be moved across markets on any given trading day.

Reduction in liquidity requirements: With firms' market and counterparty exposure over the settlement period reduced, NSCC participants could see a reduction in margin requirements related to NSCC's Value-at Risk (VaR) Component and ultimately posted to NSCC by its participants. This reduction would allow broker-dealers to better manage their capital and liquidity risks and better utilize their available capital. For investment funds, T+1 will align the settlement cycle of registered US mutual fund shares with the portfolio securities settlement cycle, thus improving liquidity management.

Capital and operational efficiencies: Capital and operational efficiencies can be grouped into three categories: infrastructure modernization, standardization of industry processes, and reduction in costs:

Infrastructure modernization: Technology adoption and automation of manual processes would significantly reduce operational risk, increase productivity, and reduce friction for market participants.

Standardization of industry processes: By adopting recommended leading practices and implementing behavioral changes across the industry, market participants have an opportunity to standardize and synchronize processes in order to facilitate greater transparency, and approach real-time/near-time access to critical data across the financial ecosystem. The migration provides opportunities to coordinate processing timelines, formalize service level agreements (SLAs) between counterparties, standardize processes for prime broker customer onboarding, and develop an automated straight-through settlement processing path for unaffirmed and disaffirmed institutional transactions based on regulator guidance.

Reduction in costs: The industry foresees long-term cost reduction for market participants and end investors due to the benefits of T+1 settlement.

The T+1 Playbook

[1]SEC rule proposal, *Proposed rule: Shortening the Securities Transaction Settlement Cycle*, February 2022.
[2]DTCC whitepaper, *Advancing Together: Leading the Industry to Accelerated Settlement*, February 2021.
[3]ISC Report, *Accelerating the U.S. Securities Settlement Cycle to T+1*, December 2021.

In August 2022, the Securities Industry and Financial Markets Association (SIFMA) and the Investment Company Institute (ICI) commissioned Deloitte & Touche LLP (Deloitte) to prepare the [T+1 Securities Settlement Industry Implementation Playbook][4], which outlined a detailed approach to identifying the potential impacts, implementation activities, timelines, dependencies, and risk impacts, that market participants should consider in order to prepare for the impending transition to a T+1 Settlement Cycle. Firms can use the playbook as a guide to identify the areas impacted by shortening the settlement cycle and the various considerations. Every firm has a different infrastructure, businesses, clients, operations and geographies that all need to be taken into consideration. The timeline considers a possible transition to T+1 in the third quarter of 2024; however, the actual T+1 transition date will be subject to regulatory approval, including final SEC rules concerning the shortening of the securities settlement cycle.

The Playbook consists of 14 sections. The first two sections provide overviews of previous settlement cycle initiatives and the approach taken for the remainder of the Playbook. The next eight sections describe Trade Processing, Asset Servicing, Documentation, Securities Lending, Prime Brokerage, and Funding and Liquidity Considerations. The remaining sections describe considerations for Regulatory Changes, Additional Considerations (i.e., Global Considerations, Primary Offerings, Buy-Side Considerations, etc.), Industry Testing and Migration Plans, and associated resources for market participants to prepare for the transition to T+1.

The rule proposal adds several new requirements, including: (1) same-day affirmation; (2) a new record-keeping requirement for Registered Investment Advisors (RIAs) of timestamped receipts of confirmation by the broker; and (3) mandates that clearing agencies adopt policies and procedures to transition clearing and settlement functions to straight-through processing.

The below heatmap from the Playbook shows the widespread impacts across the post-trade ecosystem, market participants, and legacy technologies that are batch cycle-oriented.

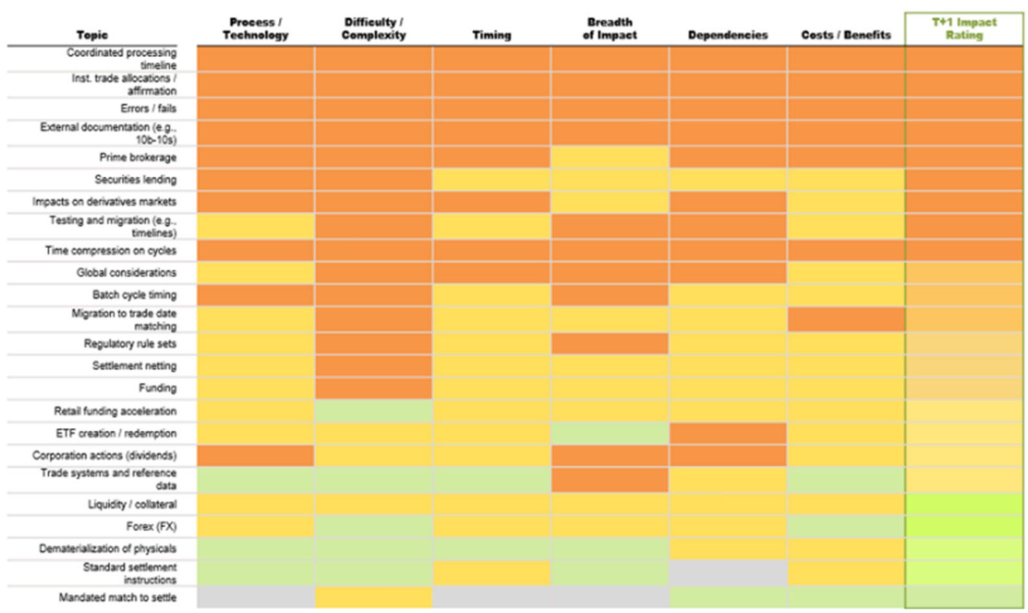

Figure 1: T+1 Industry Impact Heatmap, T+1 Industry Implementation Playbook, *[T+1 Securities Settlement Industry Implementation Playbook](),* August 2022.

This visual is intended to differentiate topics with a higher degree of impact (in orange coloring) from areas with a minimal impact (in light green and grey). The topics are listed in descending order of priority, with the overall T+1 Impact Rating collated on the right.

Global Markets

The Canadian Capital Markets Association (CCMA) announced plans to move Canadian markets to a T+1 settlement cycle by 3rd quarter of 2024 to coincide with the US T+1 migration currently regulatory approval.

In the Asian markets, the Securities and Exchange Board of India (SEBI) has introduced T+1 rolling settlement cycle for stocks on an optional basis. This optional transition was intended to provide flexibility to stock exchanges to offer either T+1 or T+2 settlement cycle while satisfying requests from market stakeholders to shorten the cycle. Indian stock exchanges started a phased transition to a T+1 settlement cycle on February 25, 2022. Other Asian markets, however, have not indicated such a transition.

[4] T+1 Industry Implementation Playbook, *T+1 Securities Settlement Industry Implementation Playbook,* August 2022.

European and South American markets have indicated that they will continue to study the impacts of a T+1 settlement cycle but do not have current plans to facilitate such a transition prior to a US transition.

Market Participant Scope

The move to a T+1 settlement cycle will impact organizations across the financial services industry and throughout the trade lifecycle. Impacted market participants include issuers; asset managers ('40 Act and non-'40 Act funds); broker-dealers (retail, institutional, and prime brokerage); global custodians; vendors; service bureaus; transfer agents; exchanges; clearing firms; buy-side firms; and depositories.

Product Scope

The products subject to the T+1 standard settlement cycle include the "securities" defined in Section 3(a)(10) of the Exchange Act[5] covers—among others—equities, corporate bonds, UITs, mutual funds, ETFs, ADRs, security-based swaps, and options. With regard to limited partnership interests, the SEC excluded non-listed limited partnerships due to complexities related to processing the trades in these securities and the lack of an active secondary market. In contrast, the SEC included listed limited partnerships primarily to ensure exclusion of these securities would not unnecessarily contribute to the bifurcation of the settlement cycle for listed securities generally.

Lessons Learned from T+2 Migration

The move to the T+2 settlement cycle in 2017 yielded benefits for the industry and market participants, including reduced credit and counterparty risk, operational process improvements, cash deployment efficiencies, increased market liquidity, lower collateral requirements, and enhanced global settlement harmonization. The implementation required coordinated changes between market participants across a broad range of functions, including trade processing, asset servicing, legal, compliance, and technology. The same industry consensus, strong organizational leadership, and communication and coordination among industry participants will once again be required to successfully migrate US securities settlement from T+2 to T+1.

Five Actions You Can Take:

1. Establish a governance structure to manage implementation of T+1.
2. Obtain commitment from management to dedicate resources to the implementation effort.
3. Develop a roadmap for implementing T+1 requirements.
4. Conduct analyses to determine impacts, gaps and changes required for implementation.
5. Develop budgets and project charters to remediate identified gaps for implementation

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[5] Section 3(a)(10) of the Securities Act, *https://www.sec.gov/interps/legal/cfslb3r.htm#FOOTNOTE_2*, October 1999.