

# The Importance of Getting T+1 Right

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**When stock exchanges were first established, the typical trade settlement period was 14 days. It wasn't until the 1970s that required settlement times began shrinking; first dropping to seven days, then five, and then to three days during the 1990s. The current requirement of two-day settlement has been around since 2017.**

## Moving to T+1 involves major adjustments across the entire financial ecosystem. And that has implications for the rest of the world as well.



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The US Securities and Exchange Commission (SEC) is now proposing to shorten the settlement cycle in the United States from two business days (T+2) to one (T+1) by March 2024. While that sounds simple enough, it actually involves major adjustments across the entire financial ecosystem. And that has implications for the rest of the world as well. So far only India has moved to T+1 and that happened earlier in 2022.



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Additionally, the SEC's proposal has raised questions about whether T+0 would be the next logical step after T+1. In this article, the first in a series on the impact of impending settlement cycle changes, we explore the SEC's proposal and look at what's involved in accelerating the settlement process. We then lay out the challenges and show what's needed to get to T+1 and beyond.

# Trade Settlement Periods in the United States

**14 Days**

was the typical settlement period up to the 1970s.

**7 Days**

First dropping to 7 days, then 5 days and then to 3 days in 1993

**2 Days**

Current settlement period since 2017

1970

1990

2017

## What does moving to T+1 involve?

The SEC has proposed to amend Rule 15c6-1a which governs the settlement cycle for most broker-dealer transactions by prohibiting brokers or dealers from entering into a contract for the purchase or sale of a security that provides for payment of funds and delivery of securities later than the second business day after the date of the contract. The cornerstone of the proposal is to shorten the settlement cycle for securities transactions to trade date plus one business day. The proposed change is accompanied by various additional measures to streamline and enhance the efficiency of institutional post-trade processes.

These measures include new requirements for the same-day affirmation of securities transactions, amendments to the recordkeeping obligations for investment advisors relative to trade allocations, confirmations and affirmations, and obligations for central matching service providers to facilitate the adoption by their customers of straight-through processing.

The SEC has proposed an implementation date for T+1 of March 31, 2024. In view of the importance of this matter, State Street submitted a formal response to the SEC on April 11, 2022 which supports the benefits of moving to T+1 but also raises concerns about timelines.

There is widespread recognition of the benefits T+1 can offer. By removing one day of the settlement cycle, there is a corresponding reduction in risk. This includes a decline in the length of exposure to trading counterparties, lower margin requirements for clearing members,

and a lowering of both market and liquidity risk. The Depository Trust and Clearing Corporation (DTCC) estimates that a move to T+1 could reduce the \$13.4 billion held by its members on average in margin each day by 41 percent.

There is also greater funding efficiency as investors benefit from operational efficiencies and gain quicker access to their funds.

A US move to T+1 will likely put pressure on other major markets in Europe, the UK, and Asia to follow suit. Canada has already announced that it will adopt the same timeline as the US for T+1.

Asia is likely to be the most impacted by the move to T+1 in the US market due to time zone differences. All post-trade activity there would need to be done in two hours.

And there are costs associated with moving to T+1. The SEC has estimated that the change will cost the industry \$3.5 billion to \$4.95 billion to implement and it further estimates compliance costs of \$5.5 million per institution.

# \$13.4B

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## What about T+0?

Given the costs and benefits of going to T+1, some may wonder if same-day settlement (T+0) is the next logical step. Unfortunately, it's not that simple.

The first thing to understand about T+0 is that zero doesn't really mean zero. Instantaneous settlement is not possible in today's financial environment. That's because the settlement of securities trades is a multi-step process that involves coordination and communication among a wide variety of parties. The process must allow sufficient time after a trade is agreed upon for the underlying securities to "move" and for the appropriate transfers of funds. Underpinning the settlement process, time must be allowed to assure legitimacy, accuracy and regulatory compliance. Processing of securities transactions takes place in batches, which takes time to pass the batch information down to the depository level where netting of securities and cash occurs. You can compress the timing, but you can't make it zero.

The fundamental issue in getting to T+0, though, is that next-business-day settlement still fits conceptually and operationally into the current post-trade framework, while same-day settlement does not. Remember that securities trading takes place across geographic boundaries and time zones; a mismatch in settlement will have acute impacts for international investors, particularly enormous funding challenges. International banking and money transfer protocols would have to speed up. Services like FedWire would have to

operate around the clock or be fully replaced. And foreign exchange transactions would have to adjust as well.

While conceptual problems can potentially be resolved by agreement among the many players, the breadth and complexity involved with same-day settlement has wide ranging implications for the entire financial system. This includes, for instance, the organization of the US payment system, as well as the structure of key banking functions, including the provision of deposit accounts and the extension of credit. Furthermore, while it is certainly possible for the industry to achieve greater efficiencies in some post-trade processes, getting to same-day settlement will require a fundamental overhaul of the existing clearing, payment and settlement ecosystem for the US market.

This will require, in our view, the broad use of emerging technologies, such as digital ledger technology, tokenized assets, and instantaneous or near-instantaneous payment functionality, to drive further automation and efficiencies. We think a move to T+0 might not make sense on a cost benefit basis for some years to come, especially given the lack of widespread adoption to date of technologies to facilitate same day settlement such as distributed ledger technology. While the move to T+1 is not without its challenges, it won't require a complete re-engineering of our post-trade financial system.

## Overcoming the challenges of moving to T+1

# T+3

**We can look back at the move from T+3 to T+2 to better understand the challenges.**

# T+2

**After seeking industry-wide input, the SEC formally kicked off T+2 in September, 2015 with a target date of Q3 2017.**

# T+1

**The SEC proposed target date for T+1 to go live is now less than two years away.**

Perhaps the biggest challenge with the SEC's T+1 proposal is the timeline. We can look back at the move from T+3 to T+2 to better understand that challenge. Industry discussions for T+2 settlement started in 2012, well before any SEC rule was set in motion. After seeking industry-wide input, the SEC formally kicked off T+2 in September, 2015 with a target date of Q3 2017.

To be sure, the SEC and the industry can draw on that experience to make the move to T+1 more efficient, but the SEC's timeline for T+1 is more aggressive than was the case with T+2. The SEC proposed target date for T+1 to go live is now less than two years away.

We believe a longer timeline will result in a more comprehensive review to assess impacts and design development plans to ensure complete remediation. Specifically, we recommended in our response to the SEC a revised implementation deadline of two-years from the publication of a final rule in the Federal Register.

The planning and coordination by market participants, in conjunction with regulators, central securities depositories, and other financial market infrastructure systems required to achieve T+1 settlement should not be underestimated.

Engagement with industry groups such as DTCC, the Securities Industry and Financial Markets Association (SIFMA), and the Investment Company Institute (ICI) are key as tremendous dialogue across the industry will be needed to understand challenges and craft solutions.

Among the considerations that the industry will need to address in its planning efforts are changes to trade matching systems and processes, tighter deadlines for the receipt of client trade instructions and the resolution of pre-trade problems. DTCC participants are being encouraged to review and leverage industry solutions, such as Institutional Trade Processing's Central Trade Matching platform, if possible.

Then there are the implications of T+1 for various asset servicing functions, such as the processing of corporate action events, income distribution and cash funding requirements. Many of these critical trade functions, including allocations, confirmations and affirmations, begin after the end of the trading day. Ensuring that there is ample time for these functions to occur before starting the next business day will impact existing processing schedules.

The implementation of T+1 settlement will also require a reassessment of existing industry processes in the foreign exchange and securities lending markets, and the operational model for exchange traded funds (ETFs).

The challenges of T+1 settlement are particularly acute for non-US investors, due to the greater complexity of trade processing flows and the need to convert base currency into USD.

Foreign investors may be required to pre-fund cash positions and deposit securities prior to trading. This could result in cash being underinvested, make the delivery securities more complicated and also riskier, and could make the US markets less attractive to international investors.

One proposal on the table from the DTCC is to move processes to later in the day, with Depository Trust Company (DTC) night cycle processing three hours later at 11:30 p.m. on trade date and DTC affirmation cutoff times at 9 p.m. on trade date. This will require careful consideration by the industry, including the exploration of potential unintended consequences.



## What happens next

The journey to T+1 has begun, and it is one that has wide-ranging impacts globally. While we believe T+1 will deliver benefits for the industry, we believe it must be done carefully and in consultation with all participants. Now that the industry has responded to the SEC's proposal, the next step is to await the publication of a final rule. In our next article in this series, we'll dive deeper into the implications for various market participants and examine how T+1 may change the way they do business in the US market.

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