COMPRESSION UNDER THE SPOTLIGHT:

Navigating the complexities of the global shift to reduce settlement times

The impact of the move to T+1 for equities in North America reaches far beyond the region and into adjacent asset classes and functions. Meanwhile the rest of the global markets are being forced to consider their own settlement cycles. Here, a panel of industry experts look at market readiness for May 2024, discuss the unique difficulties across timezones, and the notion of fragmented settlement cycles between major markets.

S&P Global
Market Intelligence

How do you think the industry – overall – has dealt with preparations and changing processes in the build-up to the shift to T+1 in North America?

Kamala Kannan: The industry is now mobilising towards T+1 but there does appear to be a few participants still in the discovery/research stage due to their lack of awareness or internal technology debt. For these firms those challenges need to be addressed soon or else they will face high costs with respect to settlement failures. The time until go-live is now under five months and there is an immediate need for all participants to understand the holistic impact of shorter settlement cycle on their business, such as cut offs, auto affirmation, internal process/system change, FX, recalls, corporate actions.

Eivind Lysaker Almaas: From a European participant`s perspective, the T+1 switch in India for example, is easier due to the time zone difference. Volumes in the North American markets are likely much higher than in Asia, so there is still a high focus on preparedness. Shortening of settlement chains/reducing the number of intermediaries along with eliminating manual processes to settle a trade is key for the industry, and still some mid-tier participants seem to struggle in this regard. The actual direct impact of the changes to non-US market participants could have been communicated better by US custodians – several of the key changes in the SEC rules do not actually apply to non-US participants.

Haroun Boucheta: In the US, overall industry preparations are going well in the sense that industry testing is well under way and there is a clear intent from the regulator to meet the go-live date. On the other hand, this happening under a very short implementation timeframe for such a major market change (16 months from rule publication to go live). Hence, there are several industry issues which still need to be worked out (CLS, multi-listed securities etc.). The time zone effect for foreign investors (non-US) also remains an issue, meaning that costs for non-US investors are likely to go up overall.

As we move into the home stretch, what are the main areas which clients are asking you about?

HB: The US move to T+1 is happening under a rather tight schedule. Our clients are mostly asking about/interested by: the affirmation process - what it is, how does it work and the related record keeping; the FX management especially in cases of bank holidays in the country of the original currency; and whether the US T+1 comes with a penalty mechanism such as in the European CSDR.

ELA: Firstly, consequences of missing the affirmation deadline on 21:00 EST on T. Secondly, how the change will impact FX and funding processes and deadlines. And last but not least, how we will handle misalignment in settlement cycle with EU markets (especially concerning dual listed securities, CSDR penalties and corporate actions).

KK: S&P Global Market Intelligence clients utilising our post-trade back-office solution are predominantly focused on FX handling and processing, the real time inventory management of loan recalls, and the Ex/Record/Cover Protect date issues of corporate actions.

What are some of the unique difficulties of participants in Europe and Asia adapting to the new US T+1 cycle?

KK: Time zone and funding are two major issues buy-side firms in Europe and Asia will face.

Due to time zone differences, the time available for firms to resolve any issues in allocation (mismatch, invalid account, invalid SSIs) will be significantly reduced and also the ability to initiate/track affirmations. With respect to funding, the need of the hour will be to prefund the trade (if selling the existing position is an option to fund the entire US trade, then this has to be initiated a day before as other markets would still be in T+2 settlement) or perform FX in T+0/T+1 value date.

Currently FX transactions are performed T+2 and to achieve T+0/T+1, the FX transaction will need to be settled bilateral (resulting in counterparty risk) or submit to CLS (not all currencies are supported) before their cut off time (00:00 CET) for payment vs payment FX settlement. This issue is further exacerbated for trades executed at the end of day, as liquidity for FX will be reduced at that time, as will the time available to send allocation/confirmation/affirmation.

HB: From the go-live date in the US set for 28 May 2024, the DTC affirmation cut-off for night settlement cycle will be 9pm EST on trade date. For cross-border trades, especially when investors are located in Europe and Asia, this critical processing will be exacerbated by time zone differences (9PM EST means 3am Paris time and 10am Singapore time). While the US market attracts foreign investors (the US Treasury Report shows that 19.6% of all securities and 16% of equities are held by investors outside the US), the SEC rules do not include any exemption for them.

SPEAKERS:

Kamala Kannan
Director, Securities Services
S&P Global Market Intelligence

Eivind Lysaker Almaas
Head of Settlement, SVP
DNB Markets

Haroun Boucheta
BNP Paribas
Head of Public Affairs, Securities Services
Co-Chair of the T+1 Global Impacts Working Group of ISSA

Do you think Europe could benefit from moving straight to T+0, assuming a potential T+1 switch would still be some years away?

ELA: European infrastructure is, unfortunately, still far more complex that the US, T+0 seems unrealistic given the current environment. T+1 is possible but will require a significant efficiency lift from the industry to work in practice. If regulators were to see whether EU is ready for T+0, it can impose hefty "late matching fines" on T+0 to assess how the industry adapts over a period – when a high enough matching rate on T+0 is achieved, EU markets can perhaps be ready for a T+0 cycle.

HB: First, we have to underline that no decision has been taken by European public authorities. ESMA is currently working on a cost-benefit analysis to assess whether shortening the settlement cycle would make sense having in mind that the market structure is much more complex and fragmented in Europe than in the US. We expect that responses to the ESMA call for evidence generally focus on T+1 taking the view that T+0 (and in particular in the sense of "atomic" trade settlement, i.e. settlement basically occurring simultaneously with the execution of a trade) is not considered by market participants as a plausible scenario over a foreseeable horizon of time. Such a move to atomic settlement could lead, as it is the case in some jurisdictions (e.g., China), to the need to prefund each individual trade and result in significantly higher liquidity and funding costs, negatively impacting the economics of the securities industry. Even an end of day T+0 model does not appear to offer any advantages over T+1 settlement and has a major disadvantage: the lack of a back-up, namely, the lack of the ability to settle in the real-time process on T+1 without suffering a settlement fail.

Do you foresee any issues with fragmented settlement cycles between major markets?

KK: For market participants trading securities across multiple jurisdictions and markets, the time difference in settlement cycles between T+2 markets and T+1 will inevitably lead to increased settlement risk. The time differences will introduce potential risks related to counterparty exposure, liquidity mismatch and tighter deadlines in trade capturing, matching and reconciliation. This will be further increased on multi-listed securities, ETFs, ADR/GDRs and corporate actions with different Ex dates and the same Record date (multi listed instruments). Volatility may move to more efficient markets, where participants can close their open positions, one day less than other market.

ELA: Out of sync settlement cycles will lead to both higher funding costs and CSDR penalties for cross border/multi listed securities. Corporate action dates will also be an issue.