DTCC

Don’t Delay The Inevitable: T+1 Settlement is Imminent

Val Wotton

MANAGING DIRECTOR AND GENERAL MANAGER, INSTITUTIONAL TRADE PROCESSING, DTCC

As the 28 May 2024 implementation date for T+1 settlement in the US approaches, Michael Altshuler's popular quote immediately comes to my mind, "The bad news is time flies. The good news is you're the pilot."

Time has certainly flown since the US Securities and Exchange Commission (SEC) announced the T+1 implementation date, but as the quote suggests, the good news is firms still can take concrete action to ensure a smooth transition to T+1. For firms in Asia and Europe, time is of the essence but rest assured it is not too late!

UNDERSTANDING NEW RULES AND IMPLICATIONS

Just like the prior accelerations of the settlement cycle, shrinking the cycle by one business day to T+1 is an extensive endeavor with extraterritorial impact. Therefore, it is critical that firms adopt a readiness mindset. Firms that are investing internationally must comprehend the new rules, how they will affect counterparties and the actions they need to take. It is also important to recognize that T+1 will touch every aspect of the trade lifecycle – therefore, each activity should be clearly defined, understood, and agreed upon by all parties to a trade.

As is the case with sell-side firms, there are actions in the post-trade processing workflow that must be undertaken by buy-side firms in the new U.S. T+1 regime. To meet the tight settlement window, the industry is recommending that trade allocations be completed by 7 PM Eastern Time. Trade confirmation and affirmation – a U.S. post-trade processing requirement – will have to be conducted by the parties to the trade and completed by the recommended cut-off time of 9 PM Eastern Time on trade date.

The SEC highlighted that institutional trades must be allocated, confirmed, and affirmed as soon as it is technologically possible and no later than end of trade-date. While trade affirmation can be outsourced or delegated to custodians, the responsibility of ensuring it's happening in a timely manner and in accordance with the new rules, sits with buy-side firms.

NAVIGATING REGIONAL CHALLENGES

Given that market participants are operating across different continents, trading counterparties outside of the U.S. Eastern time zone will have less than one business day for post-trade processing and any potential issue resolution. While this time zone constraint is less pronounced for Europe, Asian market participants will be significantly impacted as they will have to contend with a more compressed timeline as well as time-zone gaps.

That said, firms across all regions have been studying options to plot their T+1 route. Larger international firms may mobilize their international team to implement a 24/7 post-trade support model, regardless of the geographic location where the trade was executed. Firms may convert from batch processing to intraday processing – although the operating hours may not be ideal on Fridays where post-trade and settlement activities will have to be managed on Saturday mornings of the domestic country.

Other firms might adopt a shift roster to support U.S. business hours and there are others – such as the smaller buy-side firms – that will depend on their global custodians to manage post-trade processing, including trade affirmation. As affirmation may not automatically happen due to intricacies in processing and communications systems, buy-side firms should conduct a thorough review of third-party systems readiness levels before outsourcing any actions where they will be held responsible.

Regardless of the chosen route, leveraging manual processes or outdated technology to manage post-trade processes will no longer be an option. Every human intervention in the workflow could bring about settlement delay due to manual errors, and there is limited room for remediation in a T+1 environment.

As a result, increased operational efficiency and end-to-end automation are pre-requisites to achieving a T+1 settlement cycle. Specifically, critical activities that follow upon a trade match between an investment manager and the broker/dealer – allocation, confirmation, and affirmation – should be automated. Aside from meeting the tight settlement deadline, a zero-touch workflow where trade affirmations are automatically triggered to enable settlement will help to reduce trade fails and cope with sudden increases in trade volumes during market volatility.

FACILITATING CROSS-BORDER TRADES

With any cross-border trades, international investors must contend with the added complexity of foreign exchange (FX) funding. With one fewer business day available, international investors should streamline the process for managing FX trades with their custodians and counterparties to ensure there are sufficient funds to meet the T+1 settlement deadline, and not resort to pre-funding.

LEVERAGING DATA TO SAY IT ALL

The demands of T+1 will also necessitate operating at top efficiency where accurate population of trade data upstream will reduce exception management downstream. Aside from maintaining a central database of standing settlement instructions (SSIs) as the golden source of truth, institutional investors need to access the right data from the onset – using diagnostic tools to draw actionable insights and help uncover obstacles and complexity in the process.

These tools can provide dedicated metrics and data points to inform institutional firms on risk areas and opportunities for improvement to achieve higher operational and settlement efficiency. Although there are currently no penalties for not meeting the affirmation deadline or for failed trades in a U.S. T+1 world, there are tangible and intangible implications such as higher cost, non-compliance with the U.S. SEC requirements, and potential reputational impacts.

TRANSITIONING TO T+1

As the window for implementing changes to support T+1 closes, it is vital that firms accelerate preparations now. Conversations with counterparty brokers, custodians, and service providers should have commenced, enabling counterparties to flesh out operational and system details and ensure alignment among stakeholders.

At the same time, firms should ensure they have started to focus on the technological aspect of change management. By, modernizing, enhancing, or replacing existing technology to achieve higher levels of straight through processing, firms can help to ensure a smooth transition to T+1 within a short amount of time.

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