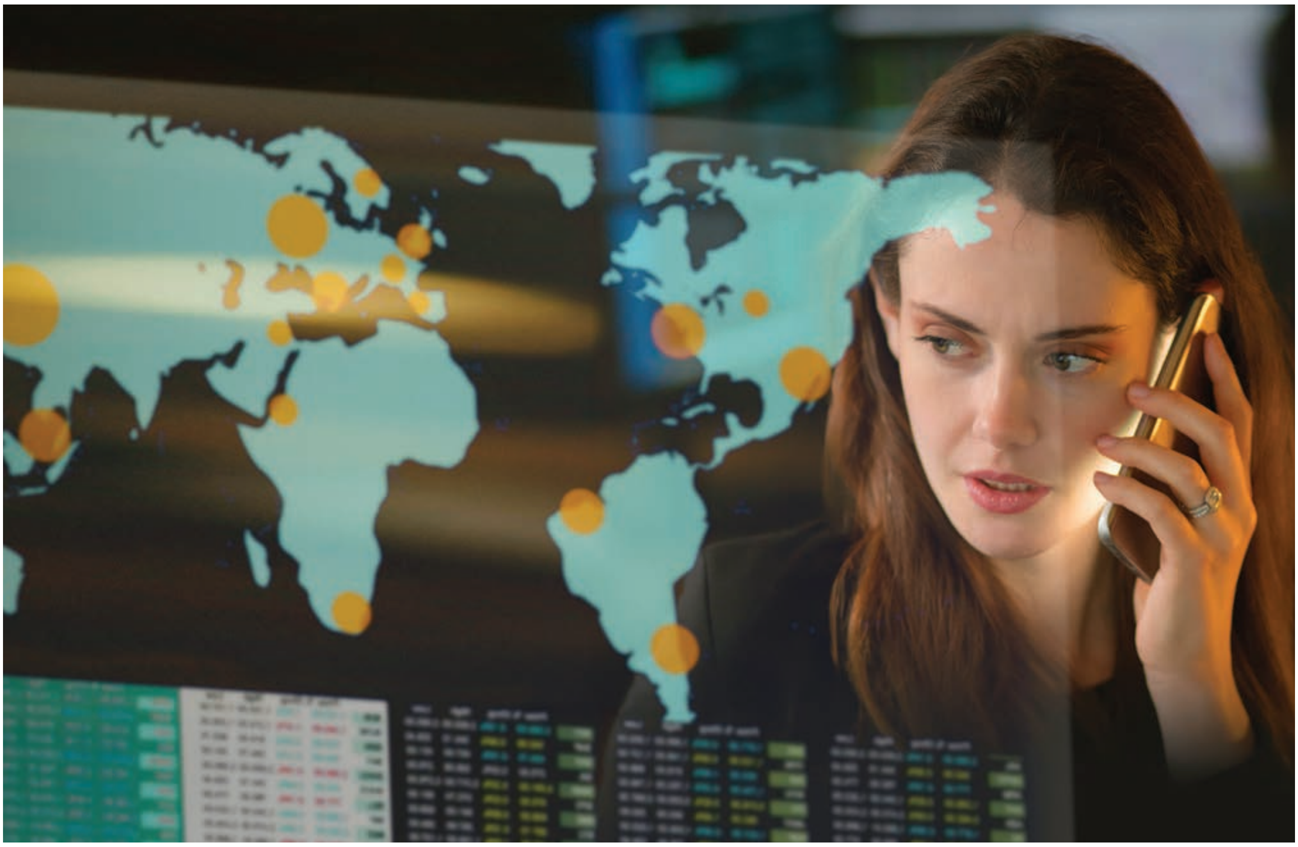


POV

US Accelerated Settlement to T+1 –

An opportunity or a hitch?

Contents

Abstract

The US securities market is moving to a shorter settlement cycle. In 2024, all U.S. trades will need to settle on T+1. That's one day after they're traded. The move from the current T+2 cycle aims to reduce settlement risk, reduce liquidity margin, and collateral requirements. It also compresses timelines in seven key areas. These areas include trade allocations, affirmations, and turnaround times; pre-funding and operations in foreign exchange trades; compressed timing for securities lending, loan recalls, and reallocations; shortened timeframe between ex-date and record date for corporate actions; the impact on cross-currency transactions with cash and liquidity management, batch processing, and their reporting, and time zone implications, especially for counterparties based in Asia. The change will have an influence on various processes throughout the securities trading lifecycle in addition to improving custody and settlements, affecting all global asset managers and financial institutions. Additionally, it will present a chance to automate and improve earlier manual or ineffective procedures to handle the increased demands and time constraints brought on by the shift to shorter settlement cycles.

Introduction

The US Securities and Exchange Commission has proposed rule changes to accelerate the settlement cycle to T+1. The US securities industry believes switching to a T+1 settlement cycle will improve overall market efficiency, mitigate risk, improve capital allocation, and promote financial stability, provided that the right balance between increasing efficiencies and risk mitigation is struck. T+1 cycle for US equities transactions could be implemented as soon as March 31, 2024.

Key advantages and considerations

Advantages

- Reduced counterparty risk
- Enhanced risk management
- Improved capital utilization
- Increased liquidity
- Enhanced investor confidence
- Lower financing costs
- Enhanced market stability

Considerations/Challenges

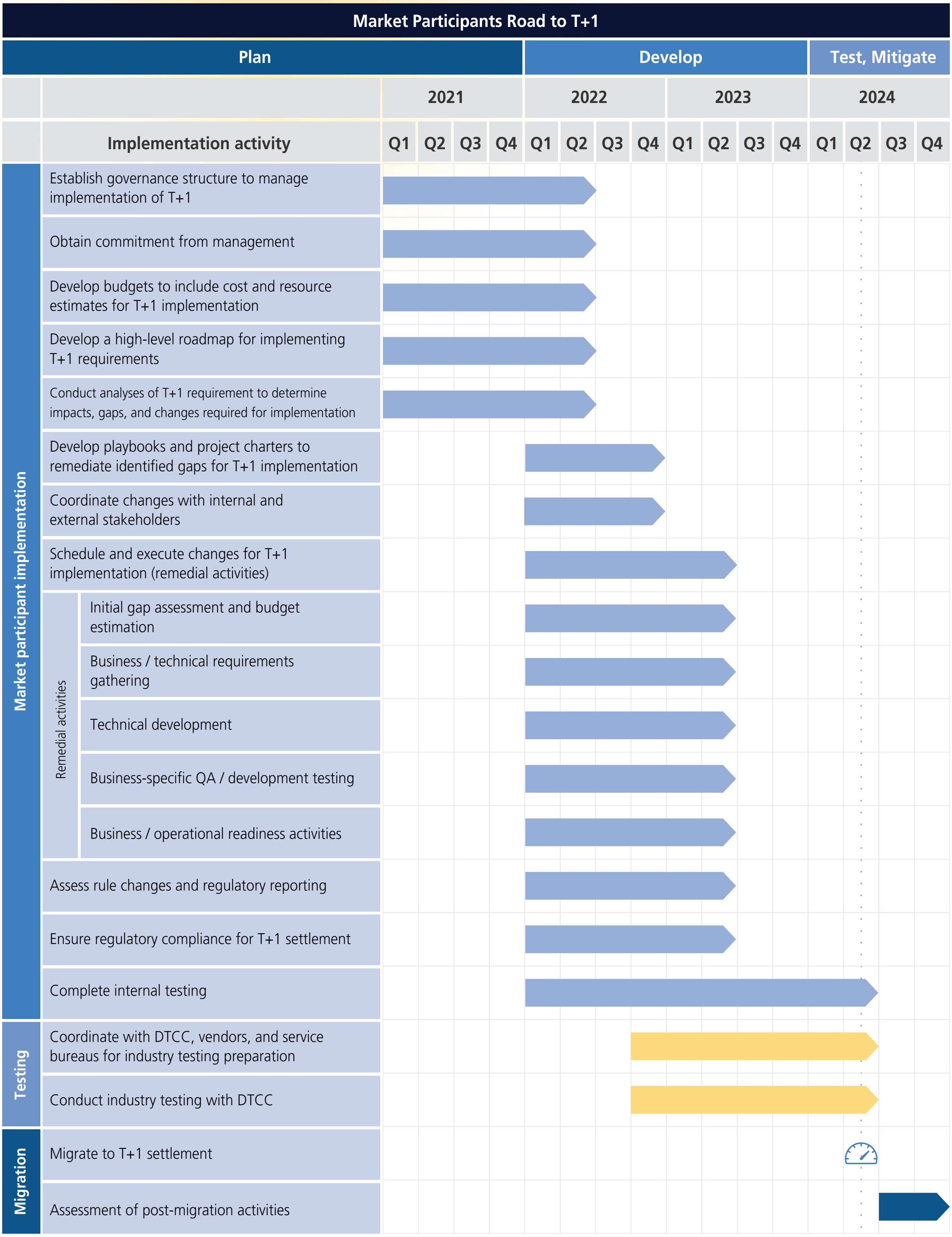
- Operational complexity
- Increased operational risk
- Liquidity management challenges
- Increased trade failures, disputes and penalties
- Market participant preparedness
- Significant investment to upgrade tech infra
- Predictive financing
- Real-time reconciliations

Key asset classes in scope for T+1

1. Equities
2. Bonds
    - Corporate bonds
    - Municipal bonds
    - Medium term notes
3. Mutual funds
4. Unit investment trusts
5. Exchange traded funds
6. Securitized products
    - ABS
    - MBS
    - ADRs
    - REITs
7. Warrants

Key timelines to the initiative:

The timeline below outlines the path for market participants in transitioning to T+1 with activities organized across market participant implementation, industry testing and migration.

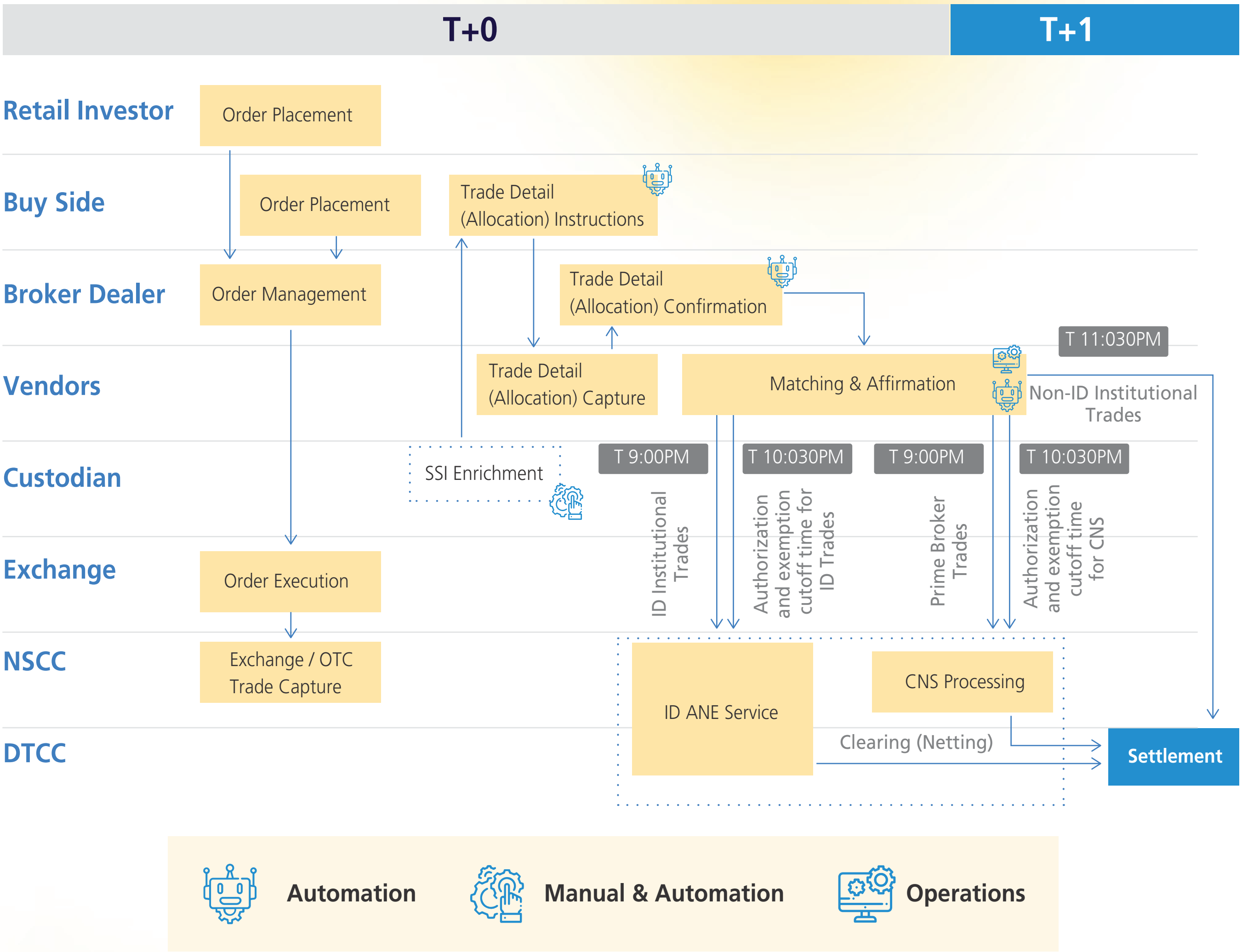


Source: DTCC T+1 SECURITIES SETTLEMENT INDUSTRY IMPLEMENTATION PLAYBOOK

Proposed Go Live

T+1 Ecosystem and key impacted areas:

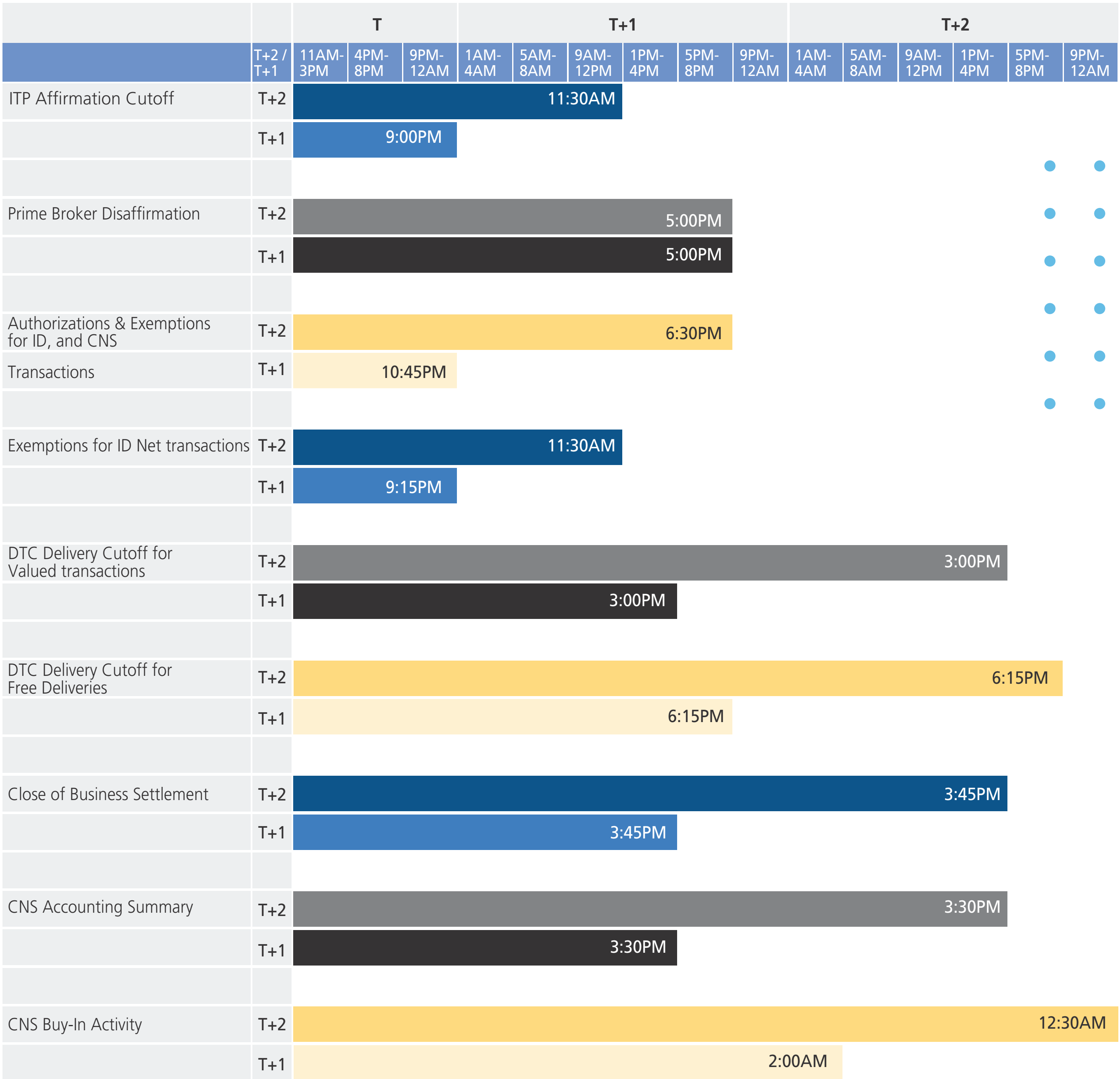
The figure below illustrates the T+1 settlement trade flow, including participants and proposed changes for the 24-hour cycle:



Source: SIFMA

In the space of trade allocation and trade confirmations, there is a ton of room for automation, whereas SSI enrichment and trade matching really benefit from quick manual activities paired with automation. Operations teams should make changes to their target operating model to encourage clients, particularly those trading outside of Asia, to provide their allocations and affirmations by the deadline.

Key activities timing changes from T+2 to T+1

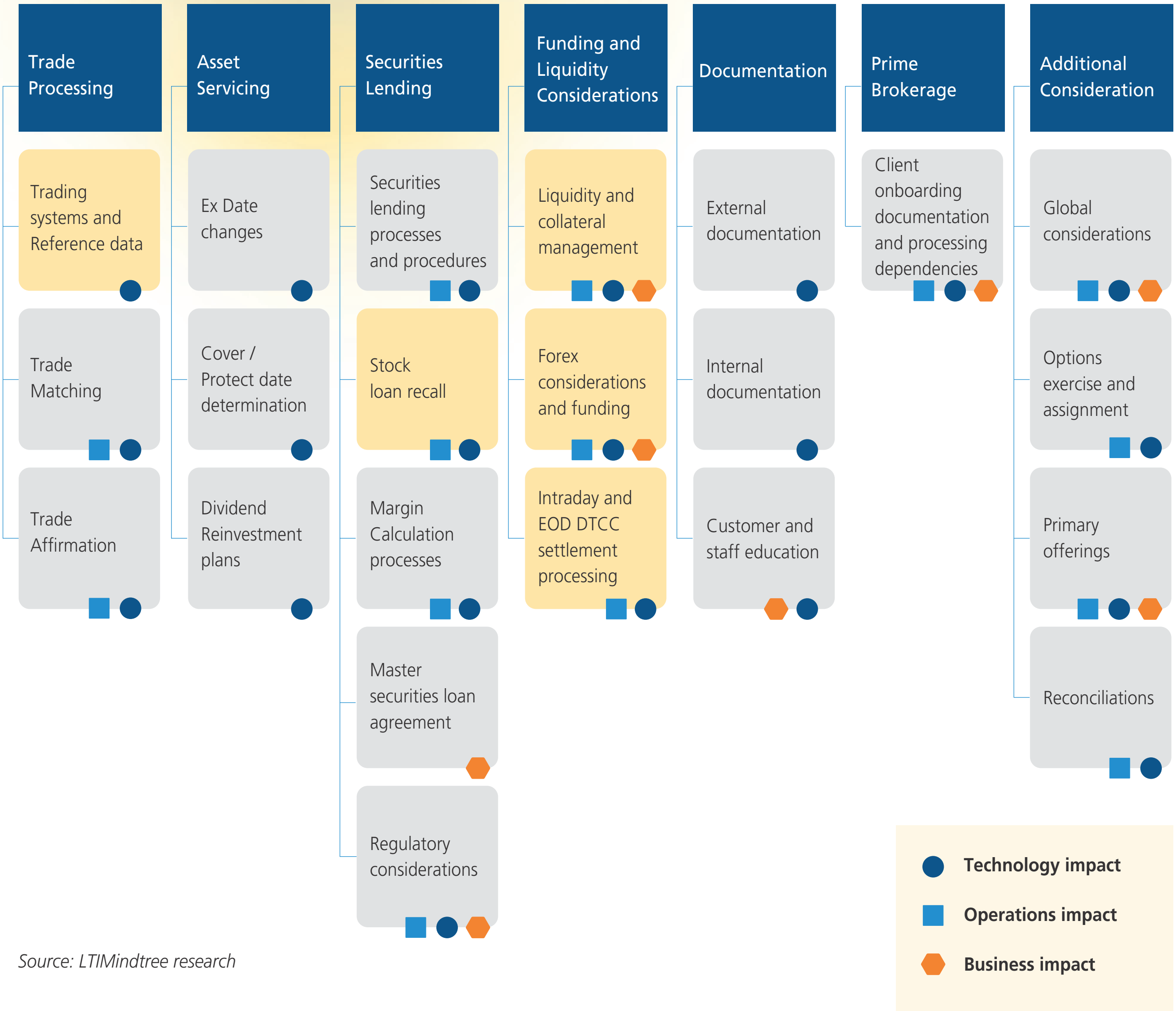


Source: LTIMindtree research

Preparing for impact

- The move to T+1 further compresses the settlement cycle by 50%, presenting unique challenges; firms operating in a legacy environment and industry standards must act now.
- Firms should begin to analyze which processes are manual or have multiple touchpoints and what tech stack changes need to be made to enable an automated end-to-end process.
- Not all jurisdictions are moving to T+1, and global trades will add to the complexity of issues due to a lack of harmonization, making it even more critical for trades to be confirmed and matched on trade date.

Figure: Process and subprocess level impact across business functions



Source: LTIMindtree research

Challenges of T+1 transition

System and operational readiness

- Multiple points of reconciliation throughout the trade lifecycle both within organizations and between organizations leading to expensive exception management processes and technology.
- Lack of comprehensive and real-time trade lifecycle view leads to inefficient post-trade process, wasted resources, and costly exception processing and fails management.
- The persistence of manual processes at each step in the post-trade process and in pockets of the industry drives up operational cost for all actors in the post-trade process.
- Multiple solutions with different data formats, messaging, communication methods, and platforms require sell-side and custodians to have multiple complex systems to support their buy-side clients.

T+1 is designed to reduce risk and increase profitability. Operationally, it will be an uphill battle to seize those advantages, if not prepared. With industry testing of T+1 settlement scheduled to begin in the US and Canada in Q3 of 2023, market participants have less than a year to prepare for the new trading cycle. On the surface, optimism reigns. Five years ago, the reasoning goes, the challenges of the T+3 to T+2 transition were overhyped. Surely, the transition to T+1 will be similarly seamless.

What many market participants are starting to realize, as they drill down into the operational details of T+1, is that the shift to T+1 will place fundamentally new strains on their operations. While the overarching industry frameworks for T+1 are falling into place, neither the dealers and asset managers nor the buy-side firms nor the custodial banks know precisely how they will achieve a seamless transition to T+1 on an operational level.

Overall, T+1 will clearly be a good thing for the industry, significantly reducing margin requirements and lowering market risk. However, not all market participants will benefit equally, and the companies that are truly unprepared will experience serious impacts to their operational efficiency and their bottom line.

Testing impact before go-live:

- Impacted firms like broker dealers, custodians, clearing houses, service bureaus, trading venues, and data vendors should not only understand their systems holistically but must alsoprepare relevant and valid test scenarios across participants and DTCC.
- Firms need to identify impacted and dependent applications, processes, and data.
- Firms need to have a dedicated bandwidth of SMEs who understand the middle and back office for testing which may in turn impact BAU.
- Strict and bounded Testing timelines require diligent program management.
- Intense management oversight is required to prevent regulatory consequences.

T+1 Operational impediments

To achieve all necessary duties on trading date, it is necessary to transition all processes and technical support for settling common stocks, corporate and municipal bonds, UITs, ETFs, depository receipts, security-based swaps, and options from T+2 to T+1. Overall, more than 80% of the current T+1 activities will need to shift to T+0. All files must be provided to DTCC by the depository cut-off time of about 10:45 US ET on trade date for submission of trades for settlement.

Employees in the companies' New York-based operations will have to work from 8 a.m. to 10 p.m. ET to accommodate the new schedule if they do not fundamentally rethink their trading procedures. Business operations won't be able to sustain possible 14-hour workdays on a daily basis without failing. Some businesses are thinking of moving their back-office operations westward, although doing so would only advance the start and end of the day and not address the problem of the overall burden.

Even routine and straightforward activities like allocations will be severely impacted by the switch to T+1. Custodian banks will now be required to finish all allocations late on the transaction date itself, as opposed to breaking batched deals into allocations on T+1 as is the existing practice.

The more complex the trades in question, the more difficult it will be to accommodate them in a T+1 world. The process of recalling an asset out on loan, for example, will be hastened, and T+1 may have an influence on the overall profitability of securities lending if it becomes more costly to carry off. Another conundrum is cross-border trades of US securities, which necessitate a separate foreign exchange settlement in addition to the securities settlement. Although digital currency is being presented as a mechanism for settling both trades on the same day, such a solution has yet to be tested and is unlikely to be in place by late 2023. And when it comes to back-to-back deals, current technology suffers even in a T+2 environment, let alone a T+3 future.

How are market participants approaching T+1?

- **88%** of market participants stated that their organizations are either actively participating in, or exploring use cases for digital assets, blockchain or distributed ledger technology (DLT).
- **54%** said a DLT-based market infrastructure could cut post-trade processing costs by **10-30%.**
- **79%** believe that atomic settlement is achievable in less than 10 years.
- **92%** see the value and benefits of tokenization to market liquidity, and variety of tradeable assets.

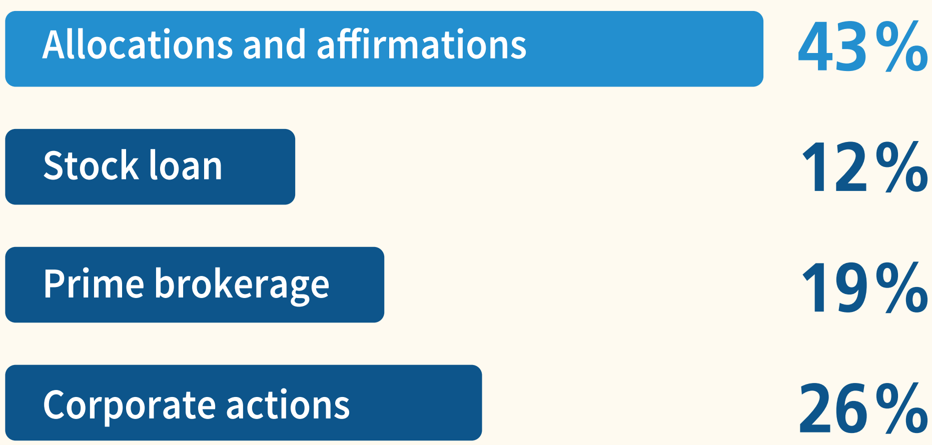
(Source: Citi Group:
https://www.citigroup.com/global/news/press-release/2022/market-participants-believe-shorter-settlement-cycles-are-on-the-horion-citi-survey-shows)

Businesses should view the T+1 transition as a chance to strengthen their existing automation and AI capabilities. This improves operational efficiency and eliminates manual labor throughout the trade lifetime. Many firms believe that transitioning to T+1 will necessitate automation and artificial intelligence.

What legacy post-trade business requires the most effort in the move to T+1?

In the poll conducted by DTCC, the greatest number of respondents (43%) voted "allocations and affirmations" as the process area that would require the most transformation as firms begin to prepare for a move to T+1.

Market participants poll: Key areas of T+1 impact



Source: DTCC Poll on February 23, 2022.

Is T+0 the next stop?

T+0 might still be years away. But we believe there are steps firms could take today as part of the T+1 transition to lay the basis for real-time settlement in the future with looking at data being the most important one.

Many firms think that blockchain or distributed ledger technology will play an important role in settlements and as per the survey conducted by DTCC firms are also considering settlement on T+0 (intraday, same day) in their current T+1 efforts.

Conclusion

For US securities that are cleared and settled through DTC, the industry was able to reduce post-trade settlement processing time by around one-third by switching from T+3 to T+2. It is estimated that the proposed switch to T+1 will cut the present T+2 processing time in half.

The change in settlement cycle from T+2 to T+1 will have an influence on various processes throughout the securities trading lifecycle in addition to improving custody and settlements, affecting all global asset managers and financial institutions. Additionally, it will present a chance to automate and improve earlier manual or ineffective procedures to handle the increased demands and time constraints brought on by the shift to shorter settlement cycles.

Welcoming change:

- For investors or traders who have sufficient money or shares in their trading accounts, this won't be a problem. In fact, since their possessions (shares/money) will arrive sooner, they are welcoming the move.
- Both investment managers and brokers will have to invest in technology/operations initially to do same day affirmations/confirmations but eventually that will improve the liquidity of the brokers and portfolio managers.
- Treasury teams will be able to see near real-time cash and securities positions which will improve their planning process.

How LTIMindtree can help?

- Holistic impact analysis
- Trade processing and settlement accelerators powered by our partner Latent Bridge
- Comprehensive technology assessments with
- Capital Markets technology modernization
- Top-down evaluation of operational processes
- Middle to back-office transformation
- Identify opportunities for automation
- Data-led business transformation
- Recommend process improvements
- Digital asset ecosystem enablement
- Testing: Market testing, participant testing, system testing, system integration testing and functional testing

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