T+1 Settlement Forum Briefing: A race against time- in more than one sense

Date: Wednesday July 19, 2023

Venue: 20th Floor Auditorium, 25 Churchill Place, London E14 5EY

Event Notes provided by T+1 Settlement Forum Secretariat EY

Background

The SWIFT Institute commissioned ISITC Europe to conduct independent research to highlight the key areas impacted by the accelerated settlement. EY partnered with ISITC Europe and hosted an event to launch the report from the research.

Key Points

The following reflect the key points made by a mix of keynote speakers, moderators, panellists, and participants during the event:

- 65 organisations and trade associations have been in touch with the UK HMT T+1 taskforce and have had great support and collaboration in preparing for a potential UK accelerated settlement transition.
- Research in the US has identified 12 post-trade activities that occur prior to settlement.
- The taskforce report due at the end of the year will set out all the post-trade processes in scope, broadly cover the CSDR article 5, and look at trades in existing venues in the UK irrespective of the location of issuer and the place of settlement. OTC markets are expected to follow the lead of regulated trading venues.
- Direction of travel is broadly clear, since CREST setup in 1995, settlement cycle has gone from T+10 to T+2, clearly the UK cannot stay on T+2 indefinitely. Fundamental concerns need to be addressed prior to the move to T+1 taking place.
- Existing back-office processes will need to be modernised and updated, as post trade costs are too high for firms. This may lead to risk reduction, lower margin requirements, and quicker access to proceeds.
- The transition will be a catalyst for firms to modernise systems.
- The UK can learn a lot from the US when it goes live in May 2024.
- There is ongoing lobbying by some US firms to get the date pushed back but the consensus is that the date will not move. There may be some exemptions from the SEC for some securities.
- The HMT UK Accelerated Settlement Taskforce have intentions of publishing a report in Q4 2023 with a roadmap and solutions.
- ESMA has confirmed that they intend to publish a report in 2024 once they have considered the behavioural changes in the market.
- There are discussions on the possibility of a phased transition by asset class.
- On FX, major currencies should be able to cope, but challenges remain for APAC / EM currencies.
- European ETFs invested in the S&P would mean the ETF will settle on T+2 but the underlying securities will settle on T+1. This creates unknown issues.
- Corporate actions will be manageable since there was little friction from the T+3 to T+2 move.
- System infrastructure – there will need to be significant investment and adjustment.
- T+0 settlement is something to be explored after T+1 is achieved.
- Cannot get to T+0 without dematerialisation.
- Though there is strong consensus that the T+1 route is inevitable, there is significant anxiety amongst market participants on the pace of change.
- The ISITC Europe research was approached from the perspective of understanding the ramifications for investors and firms on moving to T+1.
- There are no benefits from an investor perspective, though it allows investors to get proceeds of sale faster, but they must pay faster too.
- Forces players in capital markets to modernise systems and allows for technology innovation.
- Reduced counterparty risk.
- The US represents 46% of global equities, but in terms of active trading it is probably much higher.
- Most portfolios will have exposure to US markets in some way, so most firms are impacted by this.
- Most small buy-side firms like this tend to outsource to custodians, but very few firms have actively engaged with the custodian on T+1 settlement.

- Many firms have not set budget aside this year to understand the impact of T+1 – they are awaiting direction from leadership.
- Some problems are not technical; however, time is the major issue given we are not all in the same time zone.
- There will be IT costs, business restructuring, and an increase in trade failures.
- In the UK 68-70% unmatched transactions on trade date. 10% of transactions not settled after T+1.
- FX and prefunding will need to change especially if firms do not operate an in-house treasury function. Anecdotal reports do not suggest what the impact is of the T+1 move to FX. Some firms are looking to move their FX functions to US time zones.
- For securities lending, problems arise for lending of more illiquid securities. Some firms will also withdraw from lending stock if the operational costs become too high.
- Moving away from any manual process seems to be the solution – how long this will it take to implement needs to be defined.
- Market resiliency is another concern with real time processing.
- Impact on investors would be that they will need to pay for the securities earlier with T + 1.

Risks

- Poorly designed, nonstandard processes
- Non-standardised ad hoc communications with clients and custodians
- Lack of standards, breaking STP chains
- Internal IT availability
- Third party IT and network capability.
- Lack of recovery time
- Market resilience – if we end up making the industry worse, then T+1 has not worked.

What can firms do?

- Do not wait for regulatory change to assign budget.
- Engineer operational failure points
- Analyse existing operations and processes for errors and delays
- Examine current processes on trade date plus one, can these be completed on trade date?
- Ask custodians or settlement agents questions about t+1.

Q & A

1. In terms of failed settlement, how will penalties be applied?
    - Europe – CSDR penalty mechanism. US – have not decided to introduce penalty. But there is a need for broker dealers to know that their clients are following the rules, so that they can be compliant.
    - Some sell-side participants have plans to monitor market participants they interact with to make sure they are compliant using a timestamp system. Firms are taking a proactive approach to build reporting to see when allocations and affirmations are coming in; counterpart data is being reviewed to see compare rates; reaching out to clients in efforts to continuously improve the service being provided. They are also reaching out to clients, educating them, helping them comply and looking at US and international product crossover and analysing the impact on CSDR.
    - For UK, not sure if fine is sufficient.
    - Buy side firms well prepared for the US transition are either an important client to broker dealers (and will receive sufficient support from them) or are already running an efficient operation.

- The move to T+1 has not been discussed in the context of improving settlement efficiencies and it is not one of the aims of the transition. This is why US has not introduced penalty for non-compliance.

2. Should there be a regulatory requirement for affirmation and allocation to be sent through on trade day?
    - Agree that it must come in on trade day, regardless of the method by which the instructions come in. The question is how practical this is for non-US firms. US clients' trade are usually already allocated on T, it is in APAC EMEA where this is more challenging.
    - There is no mandate that the affirmation and the allocation will have to come in automatically but it will need to come in on the trade date but there is discretion on what method will be used. There is a question around practicality, but it should be noted that EMEA and APAC regions may be outliers when it comes to counterpart follow up.

3. On the ISITC research presented earlier
    - During interviews with buy side for the research, buy side appear not very prepared and have not yet started thinking about preparation. The transition can come as a shock to them.
    - Investment associations in the UK are contributing to the various taskforces – they have been more involved than when CSDR went live. So, there is confidence that buy side will somehow manage the transition.
    - There is mixed reaction and mixed levels of preparedness on buy side. Citi is currently assessing which of their clients is struggling w the transition and which is doing okay.
    - The Buy side generally, expect some support for them in making the transition.

4. Do you think it would be better if there is more collaboration with global CSDs? Would the coordination of the transition be better? Or would that be unrealistic?
    - Does not see CSDs as a big problem, booking and allocation and their timing do not have much to do with CSDs.

5. Affirmation rate for European and APAC firms are significantly lower than for US firms. Why is that and what can be done?
    - 90%+ for US, 60-70% for Europe
    - There is no incentive for European and APAC firms to affirm, trades still settle without affirmation.

6. FX: is there a solution out there?
    - Not sure if there is a solution. But confident that buy side can adapt and match the future FX requirement. Breaks are a rarer occurrence so there should not be an issue with trading earlier to meet the requirements. This can involve improvement in data (i.e., getting it to fund manager faster), so that they can trade FX earlier - even before the corresponding securities trade is matched.
    - Expect cost to go up in the initial phase of transition. Cost may then go down as liquidity increases.
    - Buy side clients often ask them for prefunding advice.

7. Do you see UK aligning as fast as possible with US? Or aligning with EU instead?
    - Too late to align with US anyway. UK should understand the implication of moving to T+1 first before deciding on when to make the move.
    - Agree too late to align w US, but to align w EU would take a long time so this is also unlikely. But the preparations are required regardless of UK or EU transition.
    - Not sure if there will be an alignment of timing. But is certain the transition will come, so make sense to prepare sooner rather than later.
    - Prevailing impression is that there is no pressure from UK gov to rush into T+1. EU would want UK to publicly commit to T+1 before report is published next year.
    - UK transitioning ahead of EU gives no apparent competitive advantage to UK.

8. How about phased implementation?
    - Would be harder. Prefer all or nothing. Phased would be harder implement on system.
    - Not sure how to implement it in phases – would be difficult to pick apart equity flows, prefer to avoid this.
    - India did it phased based on size of stock.

9. Guidance for UK move to T+1.
    - If you have not engaged with interfacing participant, should start now.
    - Looking at post trade processing. This process is archaic. Need to switch up processing so that it is done on trade day.
    - Market participants should commit capital and resources to look at the impact of T+1 and how to implement the transition. Systemic approach to review is preferable over piecemeal.
    - This is an opportunity to introduce more STP in operations.