

T+2 Settlement in the USA



Are you ready?

The move to T+2 in the U.S. has the potential to reshape not just settlement, but also corporate actions, financing and collateral management. It's even a prerequisite for cross-border market harmonization.

Interview with **Andrew Zelenka**, Principal Consultant, TCS Financial Solutions

Q: What is T+2?

It's a rule change that speeds up settlement in the US financial markets from three days to two days. Current practice allows three days ("T+3") between the *trade date* when an order is executed, and the *settlement date* when the securities are typically exchanged for payment. The proposed implementation moves that up a full day, to "T+2."

Q: Which entities and financial instruments are covered by T+2?

The shorter settlement cycle will affect any entity that facilitates trading, including retail clients, investment managers, hedge funds, custodians, broker dealers and markets/depositories. Financial instruments covered by T+3 settlement include equities, corporates, municipal bonds and unit investment trusts (UITs) in the U.S. market.

Q: When will T+2 implementation occur?

Industry testing is scheduled to occur in the first half of 2017, with the implementation scheduled for September 5, 2017. The go/no-go decision will be made in August 2017.

Q: What needs to change to achieve T+2 settlement?

Many market practices will have to occur earlier, ideally on the trade date. The industry will have to sequence deliveries to maximize matching and settlement efficiency, and work to manage the possibilities for settlement failure or late settlements.

Q: Which settlement processes need to be re-engineered?

A good place to start would be to affirm trades on the trade date.

Proper settlement instructions must be included along with each trade. Without complete instructions, the risk of settlement failure increases, as does the need for unwieldy workarounds such as suspense accounts with internal transfers handled post-settlement.

Messaging is also critical. In the T+3 world, some market participants exchange files at set times, but such an approach creates artificial delays. Under T+2, trading and settlement systems should use event-based messages, triggered automatically upon the completion of the prior process.

Market participants will have to process higher volumes in a compressed timeframe. As such, technology infrastructures, including chipsets, databases, applications and web servers, will need to be tested and optimized for high availability processing. It will also be necessary to ensure that the higher volumes are supported by real-time data backup and disaster recovery mechanisms that support redundant processing with no single point of failure, along with the ability to quickly switch to backup systems with no loss of transactional data.

Q. How will T+2 affect corporate actions processing ?

Banks, depositories and data vendors will need to ensure that dates and remittances are properly calculated and communicated. There will be adjustments for how organizations calculate the ex-date [the cut-off point for entitlements] for regular-way trades, and the due bill period [when remittances to investors are due] for both regular and irregular trades. These adjustments affect processing for both announcements and remittances. Additionally, the cover/protect period must be reduced by one business day after the offer expiration date.

The required changes will ripple throughout the marketplace. DTCC will be making several changes to properly process ex-date notifications, and to the DTC interim accounting process, including bond interest. Firms with proprietary processing systems will have to check the way that they derive ex-dates. Exchanges will need to account for the shortening of the ex-date period and any associated downstream processing of that information.

Also, any firms that trade around expiration dates of voluntary reorganization offers will have to review their processes for claiming failed deliveries, recalling securities and tracking trades pending settlement.

Q. How will T+2 affect financial firms in other regions outside the U.S.?

Many other markets have already shortened settlement times, and much of Europe and Asia is already on a settlement cycle shorter than T+3.

“Firms must look beyond short-term goals and evaluate options to re-engineer their business processes and enhance the IT infrastructures of the affected businesses processes before transitioning to a reduced settlement cycle. They must view this as an opportunity to invest in their technology infrastructure, to achieve the end objective of decreasing risk while enhancing business efficiency.”

Ganesh Padmanabhan and Ramakoteswara Roa T., "Shortening the Securities and Cash Settlement Cycle from T+3 to T+2." *TCS BaNCS Research Journal* 2:5, 44-51 (Tata Consultancy Services, 2014).

Aligning settlement cycles across geographies could help promote harmonization of markets, enabling global financial firms to better manage cash flows and simplify financing and collateral needs. However, global harmonization may be more challenging to achieve than moving to T+2 in the domestic market.

Q. How will T+2 affect financing and collateral management?

Both will have to become much faster. Trade execution is measured in sub-seconds, while financing and collateral management are measured in hours or days. That mismatch won't work.

It's a complicated problem. These transactions involve multiple financial intermediaries representing multiple parties, and often use the same position as collateral. Furthermore, clients may operate across multiple time zones, and key participants can be on the other side of the world from the settlement location. Nevertheless, financing and collateral management transactions are expected to occur close to the settlement date of an underlying trade.

For T+2 to be effective, the technology and business processes that support financing and collateral management have to be fully updated and rebuilt for speed. ■