

ICI VIEWPOINTS

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An Operations Issue to Watch: Shortening the Settlement Cycle

By Marty Burns

Should the time between the execution of securities trades and settling payment be reduced in U.S. markets? The Depository Trust & Clearing Corporation (DTCC)—the financial industry utility that processes securities transactions, including those for the fund industry—has recently delved into this question, aided by a [study](#) from the Boston Consulting Group (BCG). The study examines the costs of moving to a shortened settlement cycle and the time it would take to pay off those costs given the potential savings from operational and efficiency gains.

This is an issue that ICI, through its Securities Operations Advisory Group and other committees, is closely monitoring.

Background

Since 1995, markets have operated on a “T+3” settlement cycle, meaning that a trade must be completed three business days after the trade is done. In other words, the seller of the securities must receive payment, and the buyer must receive the securities.

In the wake of the recent financial crisis, regulators and the financial industry have contemplated whether the rules on the settlement cycle should move from T+3 to T+2. One reason for making this move is that systems for post-trade processes have improved since 1995. Another reason is that shortening the cycle could also reduce risks in the marketplace and eliminate loss exposure.

At this point, DTCC is gathering information and exploring the issues. Are the costs of shortening the cycle worth the benefits? How long would it take?

The BCG Study

To address these and other questions, DTCC hired BCG to do a preliminary cost-benefit analysis. BCG surveyed a range of industry participants, including broker-dealer firms, buy-side asset managers, and custodian banks.

Based on this survey, BCG estimates that moving to T+2 would involve incremental industry costs of \$550 million. A move to T+1 would cost \$1.8 billion.

What about the time needed to recoup these costs from savings and efficiencies? Benefits from reduced loss exposure aside, the payback period for asset managers would be slightly more than five years for a move to T+2. For T+1, the period would be nearly 11 years.

However, factoring in estimated benefits for reduced loss exposure in significant default scenarios decreases the payback periods dramatically. By assigning a dollar value to the probability of an institutional broker-dealer’s failure, or a major market failure, BCG’s study estimates the payback period for the buy side to be less than one year for both T+1 and T+2.

An Issue to Watch

A move to a shortened settlement cycle is by no means imminent. BCG concludes that a transition to a settlement cycle of T+2 could be accomplished in approximately three years after the industry achieves consensus for the move.

Such consensus might not be easy to realize, however. As the study notes, competing priorities and other regulatory initiatives could be obstacles in the near term. Participants in the study also cited impediments such as settlement of physical securities, challenges

with securities lending, and foreign exchange transactions as other issues that must be addressed when considering a shortened settlement cycle.

As this issue evolves, ICI will be an active participant, consulting with members and sharing fund industry perspective with regulators and the DTCC.

Marty Burns is ICI's chief industry operations officer.

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