US market participants and investors have reason to cheer, as the Securities and Exchange Commission (SEC) adopted a rule last month that clears a path for financial transactions to settle faster—the first such change in more than 20 years.

The rule advances a vital initiative—launched and led by the financial services industry—to shorten the settlement cycle for US stocks, most bonds, and unit investment trusts from trade date plus three days (T+3) to trade date plus two (T+2). When it goes into effect on September 5, 2017, the initiative will mark one of the most significant steps to strengthen the capital markets since the financial crisis in 2008.

Moving to T+2 will carve a great deal of risk out of US capital markets. By eliminating a day from the trading process, it will reduce the risk that counterparties or intermediaries will fail to live up to their settlement obligations.

Another anticipated benefit of moving to T+2 is the settlement efficiencies it will produce. Institutional investors, for example, will further strengthen their operational processes, resulting in more trades settled on time and fewer failed trades. Most trade allocations and confirmations will proceed on the day a trade is executed, leaving more time to identify and correct any errors in the terms of a trade. Given the lower levels of risk associated with a shorter settlement cycle, the Depository Trust & Clearing Corporation (DTCC) estimates it will reduce the daily average capital requirements for its equity clearing fund by 25 percent, or $1.36 billion.

But that's not all. Mutual funds—one of the main vehicles that retail investors use to trade securities—will be able to manage cash flows more efficiently because the settlement cycle of their shares (typically T+1) will edge closer to that of their portfolio securities.

So, why not just push the system to next-day or same-day settlement—T+1 or T+0—right now? The answer is that T+2 aligns the United States with dozens of major markets around the world, including nearly every country in Europe and key jurisdictions in Asia, such as Australia, Hong Kong, and South Korea. It also aligns with Canada and Mexico, economies linked closely with the United States that are also moving to T+2 this September. T+2 generally works within systems and procedures already in place, and it will be ready for prime time in a matter of months.

By contrast, moving directly from the current T+3 to T+1 would leave the United States just where it is today—out of sync with much of the world’s trading. Leapfrogging to T+1 also would require a wholesale re-engineering of internal systems and procedures to accommodate trades across significant time differences, which are happening more and more often.

For these reasons and others, the T+2 initiative has earned universal support from both the buyside and sellside, and a wide range of stakeholders can claim ownership of its success so far. A steering committee co-chaired by DTCC, ICI and SIFMA has led the effort. And fund companies, broker-dealers, custodians, and service providers all over the country have contributed valuable insight and perspective.

Regulatory groups have been essential as well. The SEC deserves ample credit for providing a solid framework for the industry to implement T+2. So too do a number of self-regulatory organizations (SROs)—including the Financial Industry Regulatory Authority, the New York Stock Exchange, the Municipal Securities Rulemaking Board, and others—for ensuring their settlement rules are in line with the Commission’s.

Now that the SEC has acted, only a few steps remain ahead of the September 5 target date for implementation. Banking regulators—the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation—must amend their settlement rules, just as the SROs have done already. The financial services industry, for its part, must continue testing T+2 settlement, to ensure that
every market participant is prepared.

With all the competing priorities that the industry is dealing with these days, getting the T+2 initiative to this point has been no easy task. Yet it’s easy to see why we must finish the job. Moving to T+2 will make the financial system safer and our capital markets more efficient—both big wins for market participants and the individual investors we serve.

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