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A Shorter Settlement Cycle: T+1 Will Benefit Investors and Market Participant Firms by Reducing Systemic and Operational Risks

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Last week, the Investment Company Institute (ICI), the Securities Industry and Financial Markets Association (SIFMA), and the Depository Trust & Clearing Corporation (DTCC) **announced** that our organizations are collaborating on efforts to accelerate the US securities settlement cycle from two business days after a trade is executed (T+2) to one business day after a trade is executed (T+1). We've been discussing this effort with our members since last year and are now advancing an in-depth analysis on the next steps to achieving T+1, with expected completion by the end of 2021:Q3. Shortly after that work, we will develop a definitive time frame for moving to T+1. In addition, we will assess what it may take to further accelerate the settlement cycle beyond T+1.

Q: Why ICI, SIFMA, and the DTCC?

A: Our organizations are proud to once again partner on accelerating the settlement cycle, building on our successful effort in 2017 to move from T+3 to T+2. Our knowledge from that multiyear initiative will be invaluable as we undertake this important work, which will require significant coordination across the industry and will span multiple operations, functions, and regulations. While we recognize the inherent complexities of this effort, we also know that further shortening the settlement cycle will deliver greater operational efficiencies, substantially lower capital requirements, and reduce risk in the financial system—all critical goals we are committed to achieving with the industry.

Q: What is the settlement cycle?

A: The settlement cycle refers to the time between the trade date, when an order is executed in the market, and the settlement date, when participants exchange cash for securities and a trade is considered final. Currently, US equities and other products have a standard T+2 settlement cycle, which was a key milestone achieved in September 2017 when the industry moved from T+3 to T+2. The industry is now planning to shorten the settlement cycle even further to T+1.

Q: Why is the length of the settlement cycle important?

A: The length of the settlement cycle is important because there is risk that a counterparty to a trade may not fulfill its obligations between the time a trade is executed and when the securities settle in a client's account. The longer this period, the greater the risk. This risk becomes elevated during times of high volatility and stressed market conditions, as unpredictable market events, such as the risk of a firm default, can potentially affect the transfer of cash or ownership of securities. Under the current T+2 settlement cycle, risk is spread over two full business days. Therefore, by reducing the settlement cycle to T+1, we would take a full day of risk out of the market.

The National Securities Clearing Corporation mitigates this risk for centrally cleared activity by guaranteeing settlement of all cleared trades; however, the length of a settlement cycle also has an impact on margin requirements. Because a longer settlement cycle equates to increased risk, market participants face higher margin requirements with a two-day settlement cycle to manage those risks.

Q: What are the benefits of accelerating the settlement cycle?

A: Reducing the settlement cycle will create greater efficiencies in the market and further protect investors. Accelerating the settlement cycle will help reduce systemic risk, operational risk, liquidity needs, buy-side counterparty exposure, and broker-to-broker counterparty risk—and, by reducing these risks, it would also reduce margin requirements and collateral requirements for broker-dealers. It will also allow investors quicker access to their funds following trade execution and settlement. Additionally, shortening the settlement cycle will mitigate systemic risk by reducing exposure between the counterparties to a trade, between the counterparties to the clearinghouse, and for the clearinghouse itself.

Q: What needs to change to reduce settlement time?

A: The settlement cycle involves complex processes and shortening it will require extensive due diligence around identifying operational and business impacts. As a result, we are currently working to identify and analyze the key products, markets, and processes that will need to be modified to move to T+1, including foreign exchange and securities lending and the potential impact on institutional trade processing, financing, and segregation requirements, and on processes such as post-trade affirmation and broker processing. We are committed to pursuing this work vigorously and have identified a series of goals to advance this effort, including:

- » mitigating risks to investors and industry participants;
- » analyzing and improving current business and operational processes;
- » minimizing the disruption of important industry services;
- » ensuring new risks are not introduced; and
- » conducting a comprehensive cost-benefit analysis.

Q: Why is the industry focused on T+1 and not T+0?

A: Moving to a T+1 settlement cycle is a complex undertaking and will require significant planning, execution, and testing, and it would fundamentally change market structure. While DTCC can support some T+0 settlement today using existing clearing and settlement technology, an industrywide move to T+0 is not feasible at this time.

A T+0 settlement cycle couldn't be leveraged by all existing industry participants due in part to legacy business and operational processes, which would not be able to support current trading volumes or existing business structures, and may introduce additional risk into the system.

Unlike a T+0 scenario, T+1 would allow the industry to retain the risk-mitigating benefits of netting, which frees up billions of dollars in margin that would otherwise be moving through the markets at any given moment. T+1 would also give brokers enough time to arrange for the financing that allows people to buy securities on margin, which is a loan from the broker to the investor.

Nevertheless, we will work with the industry to explore opportunities to one day advance to a T+0 settlement cycle, as we continue to create additional operational efficiencies and further modernize processes across the industry.

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