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CDS

Canada's Transition to T+1

T+1 (T+2,T+3) refers to the number of business days between when a trade is executed ("T") and the related exchange of payment for securities, known as trade settlement.

The U.S. acting as a catalyst for the move to T+1

In September 2017, the U.S. and Canadian financial infrastructures shortened the conventional settlement cycle from T+3 to T+2 to align with the European Union that moved to T+2 in 2014.

In January 2018, Depository Trust & Clearing Corporation (DTCC) published a white paper stating its intention to explore opportunities to shorten the settlement cycle to T+1. More recently, in February 2021, DTCC published a second white paper that outlined its two-year industry roadmap to accelerate settlement to T+1 by the second half of 2023 and is currently engaged in an industry-wide consultation process to build consensus around the proposed new settlement cycle.

Benefits of a move to T+1

Shortening the settlement cycle to T+1 is expected to yield similar benefits to CDS Participants as were achieved after the move to T+2, namely:

1. Maintaining harmonization with the U.S. settlement standards

   In CDS's view, Canada should shorten its settlement cycle in tandem with the U.S., as it did in 2017. Settlement cycles of different duration between the two markets may result in arbitrage opportunities in the case of inter-listed securities and increase risk and capital inefficiencies for Participants who may be forced to accommodate collateral requirements for two different settlement dates.

2. Potential reduction in margin requirements

   During periods of market volatility and stress, as securities prices fluctuate and trading volume tends to increase, the magnitude of changes in margin requirements for Participants may be greater. A shorter settlement cycle results in less variability in the mark-to-market process for outstanding CNS positions and has the potential to reduce margin requirements, as fewer positions are subject to margin requirements.

   As a result, Participants may benefit from lower Participant Fund, CNS Default Fund, and Supplemental Liquidity Fund requirements as fewer unsettled positions would be marked to market on any given day. Lower margin requirements allow Participants the flexibility to deploy that capital elsewhere.

3. Increase operational process automation

   As was the case with the move to T+2, industry Participants will need to update (to shorten) automated internal processes — including trade reconciliation, trade correction, trade matching, and confirmation processes — to meet shorter settlement deadlines. As a result, the move to T+1 could accelerate the pace of innovation and automation in the industry when it comes to operational processes.

CDS's systems are already T+1 compatible

CDS's CDSX™ system was implemented with the flexibility to accept settlements between T+5 and T+0. As a result, CDSX currently supports T+1 and T+0 settlements for all asset classes when CDS receives instructions for accelerated settlement from exchanges or the relevant counterparties. The new CDS system resulting from the Post-Trade Modernization program will also be T+1 and T+0 compliant.

Delivering Post-Trade Modernization remains CDS's top priority

CDS's top priority remains its Post-Trade Modernization program, an initiative to modernize CDS's clearing and settlement infrastructure and the associated management of entitlements and corporate actions. We're continuing this work with Participants and service bureaus with a goal to deliver the program in 2022.

As we move forward on Post-Trade Modernization, CDS will support Participants as they, with consideration to the U.S., determine their appetite and readiness for a move to T+1.

Issues to consider in moving to T+1

Although DTCC has suggested the second half of 2023 for the move to T+1, there are a number of issues that must be considered before determining the implementation date. For instance, it is imperative that a move to T+1 does not introduce any new operational risks, as shortening the settlement time period leaves less time for system recovery should interruptions occur as well as a shortened timeline for trade error corrections. It is important to ensure technology systems are able to accommodate higher volumes and high volatility markets. It is also important to consider direct and indirect operational dependencies, such as ensuring all cash payments are made on settlement date, between CDS, DTCC and their respective payment systems: the Large Value Transfer System (Canada) and the Federal Reserve system (United States).

At a high level, the following action items must be completed before an implementation date can be determined:

- Conduct a comprehensive cost-benefit analysis;
- Mitigate risks to investors and industry Participants;
- Ensure new risks are not introduced;
- Analyze and improve current business and operational processes;
- Minimize the disruption of important industry services; and
- Seek regulatory approval of the T+1 settlement cycle from all relevant regulatory bodies, including the Securities and Exchange Commission (SEC) and the Canadian Securities Administrators (CSA).

CDS will play a supporting role in T+1 transition

In Canada, the Canadian Securities Administrators (CSA) will be responsible for approving a transition to T+1 settlement cycle and the related CDS Procedures changes. Similar to the role the Canadian Capital Markets Association (CCMA) played in Canada's transition to T+2 in 2017, the CCMA has assumed the role of coordinating industry efforts to move to T+1.

CDS's main role will be in facilitating end-to-end testing by its Participants - the same role it played in 2017 when the industry transitioned to T+2.

Next Steps

CDS is actively participating in the DTCC Stride Clearing and Settlement Working Group and taking part in SIFMA T+1 Industry Working Group discussions, both of which have already commenced their meetings. As discussions evolve, CDS will continue to keep its Participants informed to ensure alignment across the industry. CDS will also continue working collaboratively with the CCMA to address any issues that may arise and provide Participants with adequate opportunities to conduct end-to-end testing.

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