Latin American market consolidation: coming soon in 2025

Where do we stand today?
On 14 November 2023, the consolidation of three Latin American markets into one became a legal reality with the legal formation of the nuam holding company.

With this key milestone now achieved, the regional project now enters a critical phase of execution as it prepares for live trading in just over one year.

Timeline

- 14 November 2023: holding company set up
- Seven IT projects running in parallel
- Mid-2025: testing
- H2 2025: live

Core workstreams for 2024 and 2025

1. IT and platforms

Seven projects are running in parallel across the trade execution, clearing and settlement layers in the three markets.

> "This is an intense, complex, interdependent exercise. We're making a level of technology investment here that none of the three countries could have afforded to do on their own".

2. Regulatory approvals

Interoperability of CCPs means changes to membership categories across borders. Regulators have to approve not just a new rule book but the same rule book across all markets.

> "We need 'enabling' regulation to harmonization across three different countries. Every country has to make adjustments to make a single market possible".

3. Market participants

Core change requirements need to be taken into account for day one (for example, accounting systems in each market are in local currency only). Critical importance of working with local banks and brokers to build ecosystems and capabilities that can serve global players.

> "Local firms cant just be on board with the change — they have to be ready to build a sophisticated market ecosystem around nuam".

Juan Pablo Córdoba, CEO, nuam

T+1: smooth sailing, but harder than expected

T+1 in 2024: what happened?

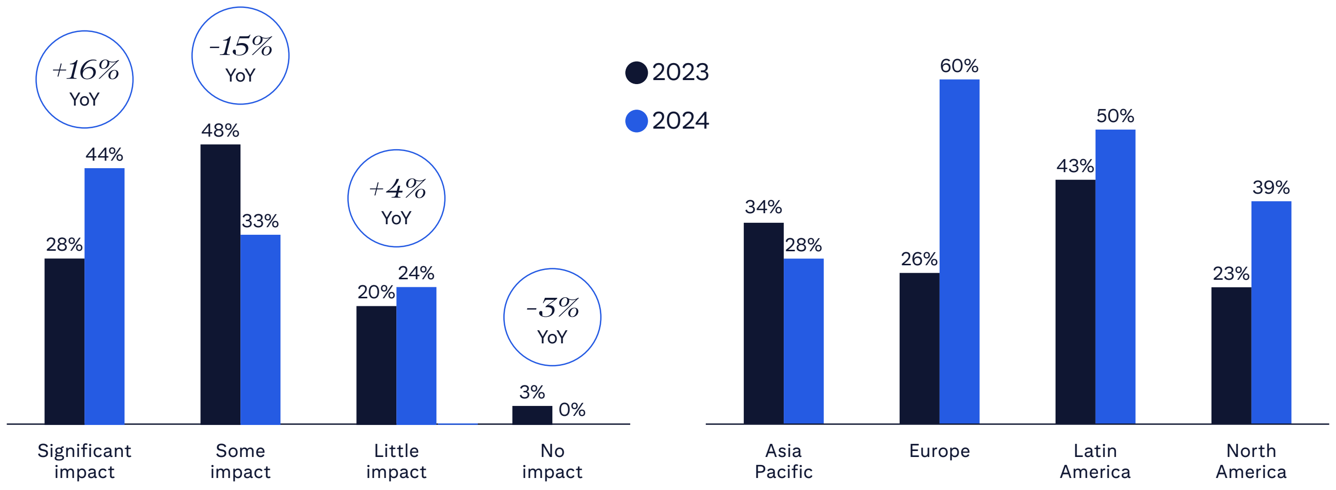
In the first weeks after the US and other markets transitioned to T+1, all appeared to have gone smoothly. Six markets representing nearly USD59 trillion of market capitalization[18] have transitioned to T+1. In addition, USD308 billion of market capitalization in the Philippines[19] has moved from T+3 to T+2. And shares in 25 Indian companies[20] are even settling on an instantaneous basis (mainly for domestic retail investors).

> *The US T+1 implementation with fail rates remaining consistent with T+1 has set the gold standard for other markets. It's definitely possible.*
>
> Valentino Wotton, Managing Director and General Manager of Institutional Trade Processing, DTCC

Throughout June 2024, Citi together with Global Custodian and The ValueExchange led an industry-wide initiative to track and discuss the impact of North America's T+1 move in the days and weeks following the transition. These discussions were overwhelmingly positive, with much less disturbance and a faster return to business-as-usual resourcing than originally projected.

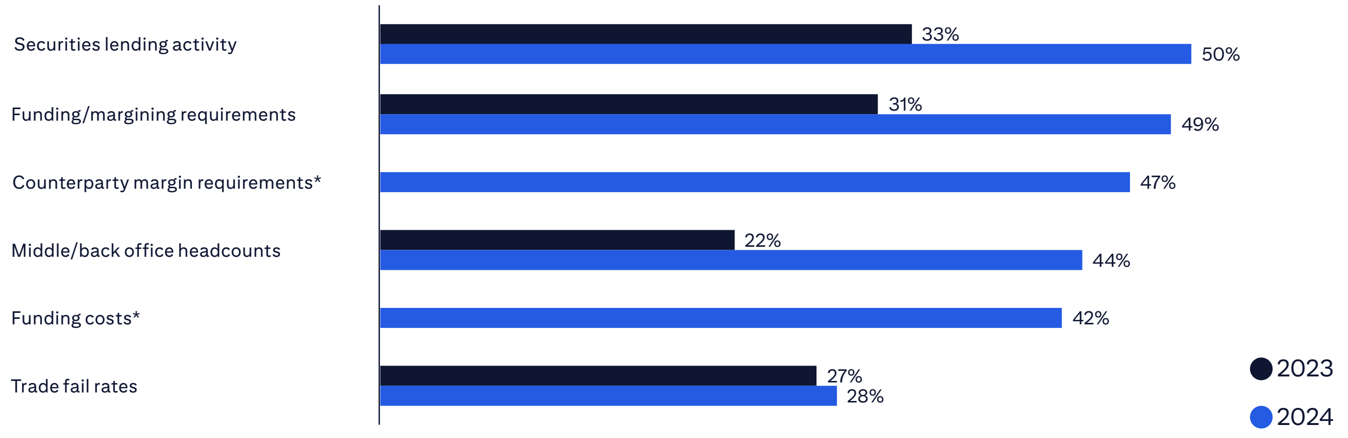
Within the first week of settlements, industry affirmation rates had risen to above 95% globally (ahead of target), trade fails had remained low and more than 30% of clearing funds had been returned to market participants.[21] Some firms even reported seeing a decrease in trade fails after the transition. But even though the transition itself passed without incident, the journey to prepare for and execute on T+1 over the last year appears to have been harder than expected. This year's survey which was run one month after the American transitions, 44% of respondents indicated that they were significantly impacted by T+1, up from 28% a year ago. Every area appears to have been more impacted than originally anticipated, from funding to headcounts, securities lending and fail rates.

Figure 5a. Impact of T+1 across the industry



Question: Based on your experience of T+1 being live (in Argentina, Canada, India, Jamaica, Mexico, Peru and the USA), what are the impacts of a shortened settlement cycle on your organization? **Expressed as**: % of respondents indicating a significant impact, by region.

Figure 5b. Impact of T+1 on key processes



Question: Based on your experience of T+1 being live (in Argentina, Canada, India, Jamaica, Mexico, Peru and the USA), what are the impacts of a shortened settlement cycle on your organization? **Expressed as:** % of respondents citing a significant impact for each activity due to T+1. *New category in 2024.

As we projected in our last whitepaper, securities lending remains one of the most strongly impacted activities across the organization — jumping from 33% to 50% this year. Funding has also been at the center of this impact — albeit with an imbalance across the sell-side and buy-sides. The single biggest impact of T+1 for brokers and custodians has been the 30% reduction in clearing margin, with 80% of the sell-side (all) seeing this development as strongly impactful to their businesses.

But while the sell-side has seen a notable funding improvement, asset managers have seen their funding costs worsen, as 46% of them have had to cover significant gaps in settlements between T+2 and T+1 markets and in their funds' subscription and redemption cycles. With many asset managers and institutional investors having paid relatively little attention to T+1 in the preparation stages, the depth and impact of these funding challenges seem to have caught many by surprise.

Yet the same sell-side houses that have benefited from new funding efficiencies have also seen two other core part of their businesses hit by T+1.

First is securities lending (and recalls), where 56% of sell-side respondents claim to have been "significantly impacted" since the move. Market concerns around lending recalls have figured at the top of the industry issues agenda for much of the last two years but early experience is showing that the true impacts of T+1 are being felt across the entire trade cycle, through reduced supply, increased buffering and greater conservatism between traders. More time is needed though before we can understand the true, deeper impact.

Secondly, 52% of banks and brokers have seen T+1 significantly impact their headcounts and staffing levels. In the lead up to T+1, concerns were already being raised around the industry's preference for hiring over automation — many of which appear to have materialized. After the transition, the sell-side has found themselves exposed to large volumes of manual processing and exception handling triggered by their clients.

From a time-zone perspective, T+1 is evidently harder to deal with from 6-7 hours away than it is from 12-16 hours away. Counter to earlier expectations, 60% of European respondents claim to be significantly impacted by T+1 in 2024, compared with only 28% in Asia Pacific (figure 5a). While this may also have much to do with Asian investors being protected from FX challenges due to their (often) holding USD as their base currency, the relative challenges of managing settlement and funding issues in the middle of the night (instead of first thing in the morning) is clear. While those in Asia have had the benefit of full clarity on funding requirements in their morning (with the full day to arrange funding as required), those in Europe have only a few hours to run from initial instruction to fully funded trades.

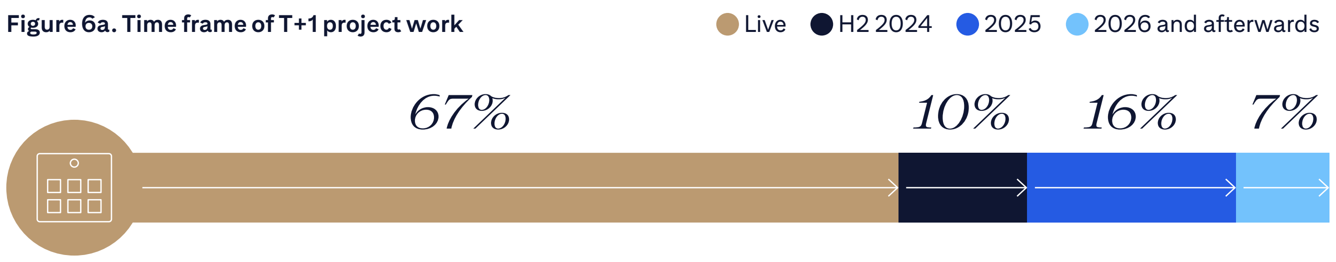
The transition is still ongoing

As all-consuming as the T+1 transition appears to have been over the last 12-24 months, the industry is still only two-thirds of its way through its North America T+1 project agenda. With 33% of project work still to be undertaken (mainly in 2025) in the form of further automation as well as additional hiring, the effort and focus on T+1 extends well beyond the transition date.

As we saw in 2023, almost every firm (90% of respondents) were heavily engaged in internal process automation over the last year. From institutional investors all the way through to their brokers, T+1 appears to have delivered on one of its core original objectives — of triggering a wave of internal rationalization and automation that would form the foundation for future growth across the industry.

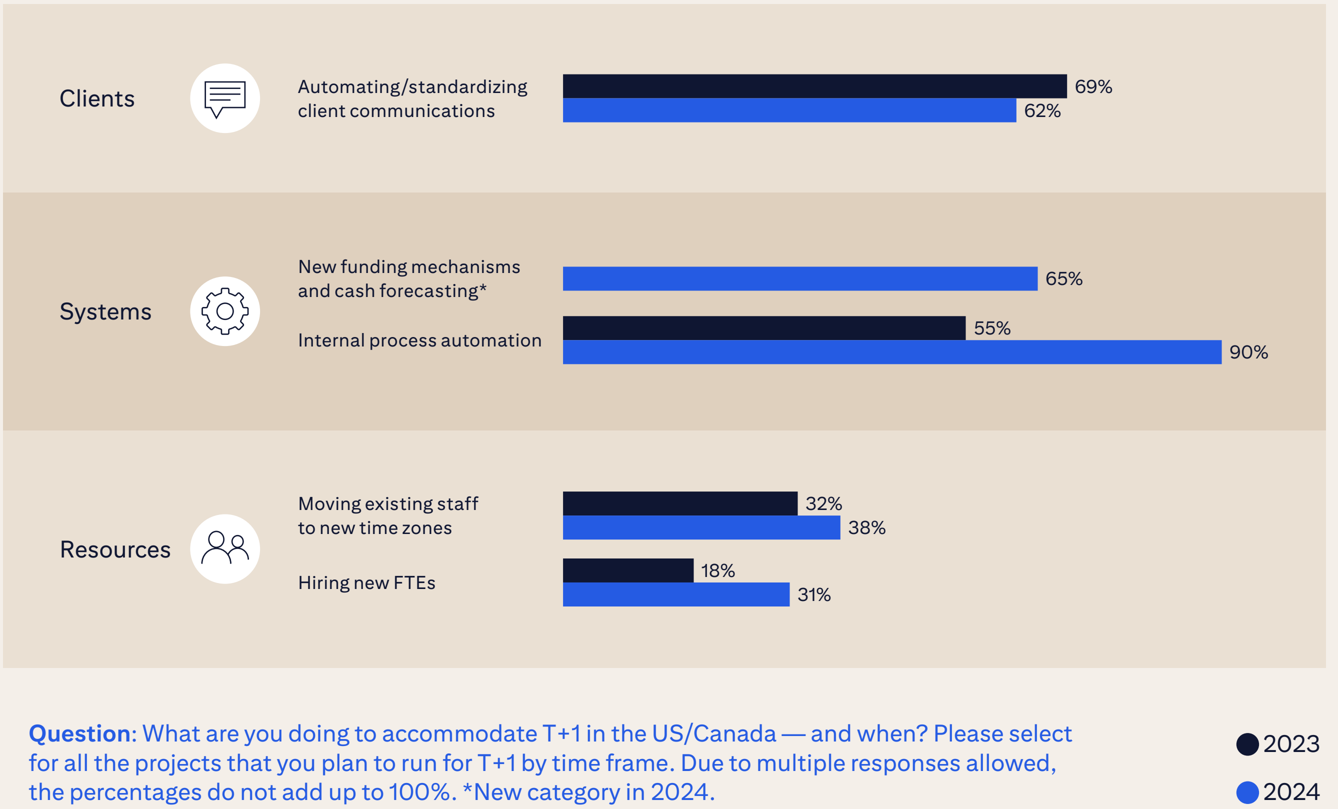
For brokers and custodians though, much of this internal automation work came to a close early in 2024. As these projects have reached completion, firms have then shifted their attention heavily towards client communications — as the final stage in their preparations for T+1. 20% more banks are focused on this in 2024 than in 2023, as final blockages were removed and manual client communications automated.

Figure 6a. Time frame of T+1 project work



Question: What are you doing to accommodate T+1 in the US/Canada — and when? Please select for all the projects that you plan to run for T+1 by time frame.

Figure 6b. Action taken to prepare for T+1 — a year on year comparison



Question: What are you doing to accommodate T+1 in the US/Canada — and when? Please select for all the projects that you plan to run for T+1 by time frame. Due to multiple responses allowed, the percentages do not add up to 100%. *New category in 2024.

What have we learnt from T+1?

While it will take several months still to know the true impacts of the North American T+1 transitions, early feedback is consistent on three areas that have helped to improve the smoothness of the transition.

The role of affirmations

Having spent much of the last two years trying to understand affirmations, the world is quickly acknowledging the pivotal role of this core process as an enabler to T+1. By providing a clear matching of asset manager's trade instructions on T+0 (and hence enabling automated, timely processing of settlements), affirmations and allocation-based models such as DTCC's CTM Match to Instruct workflow are now seen by 85% of respondents as the most critical enabling technologies for T+1 settlements. This rises to 94% among broker-dealers and 92% among asset managers.

Within an organization, the success of the T+1 transition has been enabled by a host of technologies all working together. While 2024 appears to have been the "year of the affirmation" and of the technologies that support it, the role of artificial intelligence (AI) and machine learning has also been significant with 25% of respondents singling it out as a core driver of success. In many ways, the need to accelerate a host of manual, fractionalized tasks across the trade cycle has been an excellent showcase for the potential benefits of artificial intelligence and machine learning.

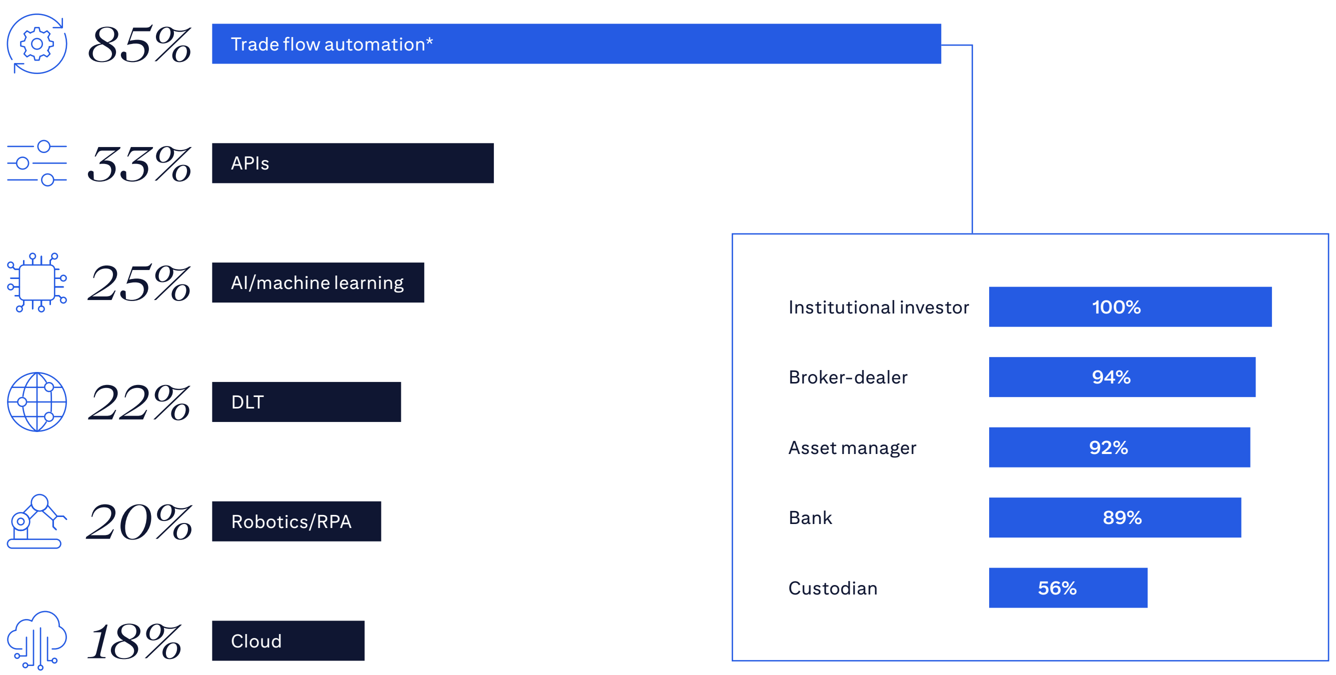
This is about changing the way that people think. If at 20:59 there must be a settlement instruction ready to go, why can't allocations happen earlier in the day? It's evolution, not revolution.

Andrew Douglas, UK Accelerated Settlements Task Force

Preparation, preparation, preparation

In parallel, the "39 months" of global industry preparation played an essential part in the success of the transition. First, the industry was given a clear deadline and a clear message that the date would not be moved. Market infrastructures, providers and associations then went to extraordinary lengths not only to coordinate their efforts onshore, but also to reach out to physically and functionally distant stakeholders. With research consistently highlighting the core role of offshore investors in the T+1 project, the hours of webinars and education sessions were essential. Market testing was then run transparently across the US and then Canadian markets, providing real and usable insights to the market around stress points and areas for improvement.

Figure 7. Critical technology that enabled a successful transition to T+1



Question: Based on your experience of T+1 so far, what technology is most critical to a successful transition to T+1/T+0? Please select all that apply. **Expressed as**: % of respondents in each segment selecting trade flow automation. Due to multiple responses allowed, the percentages do not add up to 100%.*New category in 2024.

On the people front, a key theme throughout T+1 preparations has been the redeployment of staff and activities to different time-zones to optimize coverage. Ahead of or as a result of the May 2024 transitions, 38% of overall respondents (evenly spread across the buy and sell-sides) appear to be moving their staff as a result of T+1 — as they move key delegations (usually on FX and funding) into the North American time-zones (figure 6b).

Global custodians: a critical choice for T+1

As providers of affirmations, FX liquidity, cash liquidity services funding, settlements and asset servicing support, global custodians have been central to firms' T+1 transition management. In providing both the processing infrastructure to support core tasks and the integration to draw the many steps of the trade cycle together, they have played a pivotal role in helping organizations simplify their T+1 operating models and enabling smooth transitions.

Custodians that can provide access to a global pool of instant liquidity will be critical so that parties can instantly settle in USD in New York, for example, ensuring that their capital is available where and when it is needed without the need for slow transfers or for extensive buffers to protect against failed movements. Historically the broker, custodian and cash management were all different discussions and decision points but there is increasing realization — and action by leading banks and custodians — to bring this all together now.

In a world of old systems and new settlement cycles, there simply hasn't been enough time to physically move funds to where they need to be, fast enough.

This has created a significant delta in the opportunities and threats presented by T+1. For those unable to accelerate their cash funding, the challenges of overnight funding costs and of funding gaps risked triggering a major drag on portfolio performance. But for those that can mobilize their cash, T+1 presents an opportunity to reap the benefits of an extra day of funding liquidity, deploying valuable investment cash faster and with greater agility than ever.

Other lessons

But there were of course other lessons to be drawn. A lack of clarity on the sanctions and penalties that would follow poor affirmation performance was cited throughout industry preparations as a challenge and potential obstacle to stakeholder engagement. Equally, the lack of market consensus on securities lending recall deadlines has often been held up as an example of the problems that can occur when the market fails to agree. Finally, the late confirmation of T+1 plans and cut-offs by some market infrastructures is said to have created unnecessary project risks at a critical time, although thankfully these risks did not materialize.

Looking ahead: changing expectations of T+1

The world's transition from T+3 to T+2 settlement cycles is estimated to have taken four years to realize (beginning with Europe's move in 2014 and concluding with the US's move in 2017). In our 2023 survey, we appeared set to match that schedule and in 2024 the outlook remains similarly positive: 95% of respondents expect to have moved away from T+2 settlement cycles within the next five years.

By 2027

But things may move slower than expected. Despite the success of the North American transitions in May 2024, 27% of respondents still expect to be running on T+2 cycles in their own markets by 2027 (see figure 8b), compared with only 8% last year. This rises to 32% in Europe. Overall, one in five respondents believe that T+1 will take longer to realize than a year ago.

This longer time frame is indicative of two core learning points from the last year. First, it was harder than expected to remove 83%[22] of processing time from the North American settlements.

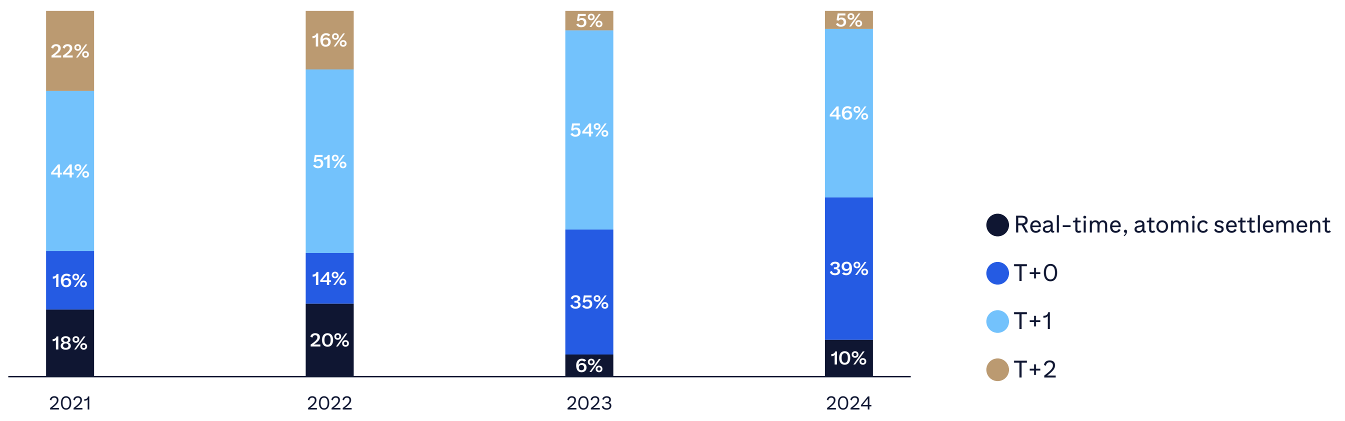
Second, the case for other markets to trigger their own transition to T+1 is still unclear. As we have seen in Australia's detailed consultation on T+1[23], there is a wide perception of value in T+1 at a high level, but few market participants appear to be pressing for it in the short term. The market appears to see the next wave of expected T+1 transitions in Europe (potentially in 2027) as the trigger for the next round of market moves.

While the buy-side and sell-sides seem to disagree on future timings (with asset managers increasingly bullish about T+1, in contrast to their sell-side service providers), it appears that many expect the (anticipated) transitions in the UK and Europe to be the global trigger points for more markets to initiate their own T+1 move.

We don't see the benefits outweighing the costs today based on feedback from stakeholders - and it is not obvious there is a first-mover advantage.

Yao Loong Ng, CFO, Head of Equities — Designate, SGX Group

Figure 8a. Expected settlement cycle in five years



Question: Within the following time frames, what do you expect to be the prevailing settlement time frame for equities in your major markets? **Expressed as**: % of respondents selecting their expected settlement cycle within a five-year time frame. Due to multiple responses allowed, the percentages do not add up to 100%.

And in 10 years

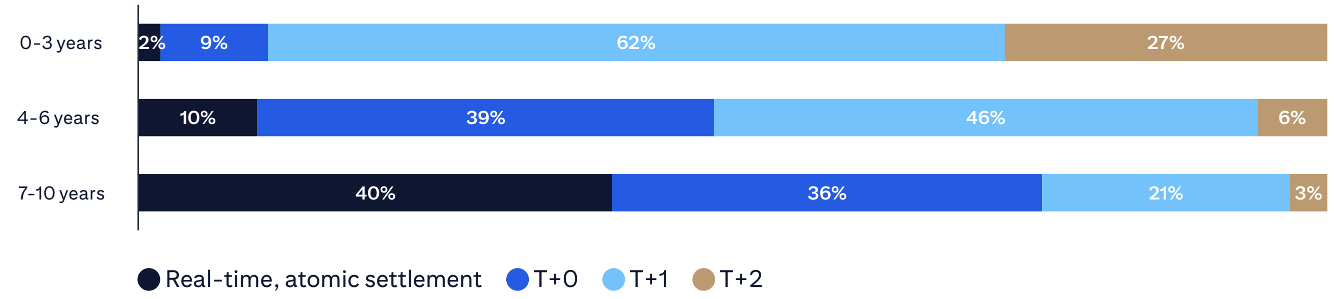
And what happens after T+1? Not necessarily T+0. Over the last year, the number of people expecting to move to real-time, atomic settlements within a decade has risen from 13% to 40% of respondents. This is evident across all geographies, especially in Latin America (where expectations jumped 36% from 2023 to 2024).

Is real-time settlement about to supersede T+0 as the next milestone in our industry's transformation?

While we've seen low take up of T+0 settlements in India, it is because we are on beta mode, only for 25 stocks, and institutional participation has not yet been permitted. It seems that retail investors are not in a rush to get their money for now but the need for improved funding costs and liquidity are bound to set in.

Sriram Krishnan, Chief Business Development Officer, NSE

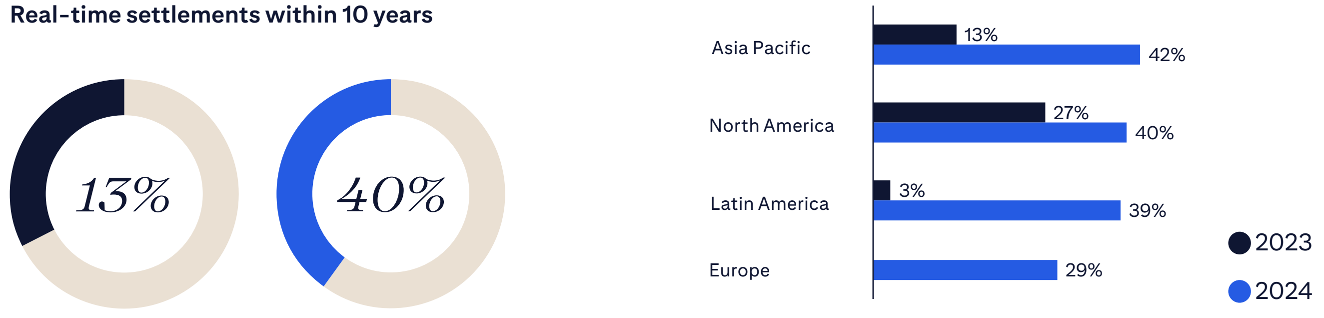
Figure 8b. Expectations of settlement cycles



Question: Within the following time frames, what do you expect to be the prevailing settlement time frame for equities in your major markets?

Figure 8c. Beyond T+1: instant settlements

Real-time settlements within 10 years



Question: Within the following time frames, what do you expect to be the prevailing settlement time frame for equities in your major markets? **Expressed as**: % of respondents expecting real-time settlements within 10 years and by geography.

Next stop: London?

Having published its guidelines for transition in 2027, the UK Accelerated Settlements Task Force appears to have put the UK next in line globally for a T+1 transition.

On timing for transition, there are two camps. The front-office see investment dislocation from the US as a central theme. The back-office see operational dislocation from Europe as a core issue. Both however are driven by the need to harmonize.

Andrew Douglas, UK Accelerated Settlements Task Force

But there is a long way to go before then. With 66% of respondents globally apparently in a low state of readiness for a UK T+1 transition, the industry is clearly back at the beginning of another long road ahead. As seen with the North America transitions, the buy-side is very much unprepared, with 55% indicating that they are not ready, as are 70% of overall respondents in Asia Pacific.

Interestingly, North American firms view themselves as most ready for a UK T+1, with 50% claiming to be in a good state of readiness today. Having been relatively unexposed to the funding and FX challenges involved in their own market transitions, are these market participants perhaps underestimating the size and complexity of adapting to a cross-border T+1 transition?

And where do firms expect to struggle?

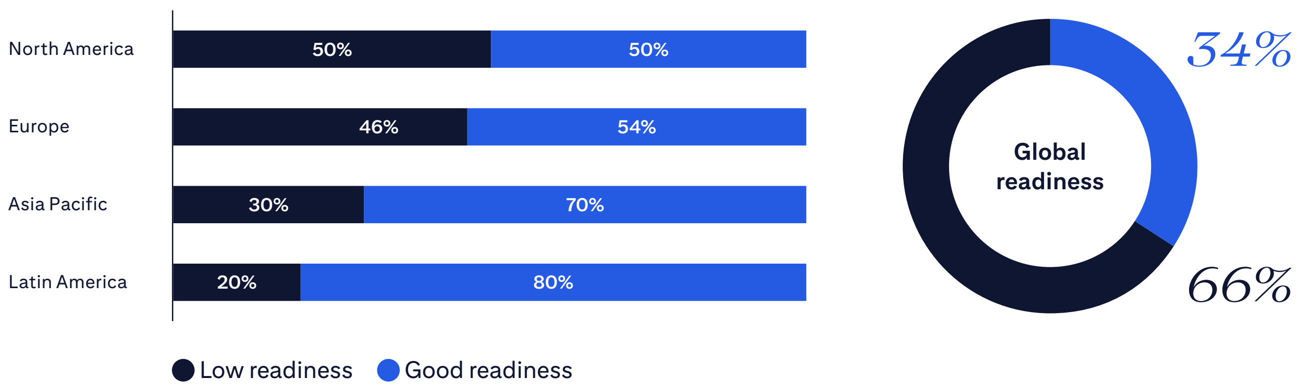
Looking ahead now to the potential UK and European transitions, the industry is learning from its recent experience. Cash, funding and liquidity management remain a top obstacle for both a UK (68%) and Europe transition (59%), with legacy technology in a close second place. Given the higher volumes of foreign investment into the UK than into the US, the funding and liquidity impact is likely to be even greater in this next transition (although the fact that the majority of this liquidity is to the West, not East, is a potential mitigant in timing terms).

But the technology question cannot be overlooked. While the core foundations of the UK market are similar to those of the US (i.e. government debt already settles on a T+1 basis; and the market infrastructures are capable of real-time settlement processing today), 51% of respondents consider existing market infrastructure technology (notably CREST) to be a critical obstacle to a T+1 transition in the UK. Despite the similarities with the US, the absence of any affirmation-like market practices in the UK (among other differences), will undoubtedly require additional focus as the British trade matching and settlement spaces come under scrutiny in 2024 and 2025.

The UK has a higher percentage of overseas investors than the US — so we are particularly sensitive to the need to communicate to a much wider, international audience.

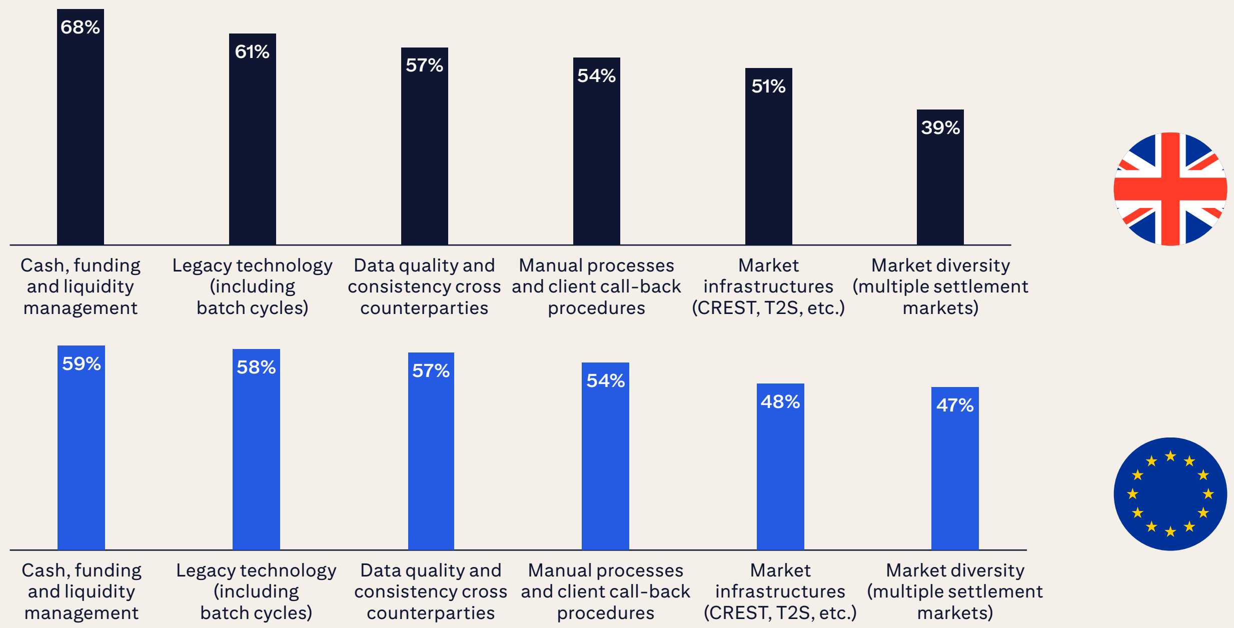
Andrew Douglas, UK Accelerated Settlements Task Force

Figure 9. Industry readiness for a UK T+1 transition by 2026



Question: How would you score your overall readiness for the transition to trade-date processing of all UK trades by 2026?
Expressed as: % of respondents by level of readiness and by region.

Figure 10. Top obstacles to achieving T+1 settlements in the UK and Europe



Question: In your opinion, what are the top three obstacles to achieving T+1 in the UK and in European markets?
Expressed as: % of respondents citing each area as top three.

Similar concerns are echoed for the prospect of a European transition to T+1, albeit with a multiplying effect of relying on nearly 40 different FMIs, rather than one in the UK. While 57% of respondents expect to struggle with their market infrastructures in a European transition, the same number again also expect market diversity in Europe (in terms of national laws, rules and practices) to be their core obstacle to a smooth transition. Even as people begin to prepare for a European T+1 transition, it is clear that Europe's diversity is its biggest challenge in a T+1 context, causing significant issues for the majority of respondents.

[Our Group European exchanges] all run on the same trading technology and have access to the same liquidity pool. We are contributing to a true capital market union, while keeping strong ties in local communities. Yet when you look at the post-trade side of the value chain in Europe, it's still extremely fragmented. We have several clearing houses supporting our markets, and over 30 national CSDs [Central Securities Depositories]. It's on a different scale in terms of complexity.

Roberto Pecora, CEO, Euronext Clearing

As the UK Accelerated Settlement Taskforce, European Securities and Markets Authority (ESMA) and the Australian Securities Exchange (ASX) all conclude their own evaluations of T+1 for their respective markets, these factors will no doubt form part of expected decisions on transition dates, due before the end of 2024.

So who goes next?

In Asia, the relative ease of the transitions in May have triggered a wave of outreach across several markets including Hong Kong, Japan, Singapore, South Korea and Taiwan — as regulators have sought to quantify the impact of a transition in their own markets. In Latin America, working conversations continue in Brazil, while a T+1 transition in the nuam markets (Chile, Colombia and Peru) is still expected in 2025.[24]

Across all markets, the question of alignment (in the timing of a transition) is a critical concern. With fund gaps (between T+1 and T+2 markets) presenting themselves clearly as an outcome of recent transitions, many authorities are keen to avoid unnecessarily creating new additional costs to foreign investors. For this reason, authorities in the UK, the European Union and Switzerland will be following each other closely, as will those in Australia and New Zealand in their own move. Meanwhile in Asia, regulators have already begun discussions on a potential, coordinated, regional transition date.