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Now that T+2 is here, some ready for even shorter cycle

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Pinar Kip sees T+0 as a definite possibility with the proper technology.

The apparently seamless shift in the U.S. to a trade-plus-two-day settlement cycle, or T+2, from the previous three-day cycle has some industry participants looking to reduce the cycle even further to bring more benefits to asset owners and money managers.

The move to T+2 resulted in an estimated 25%, or $1.36 billion, reduction in capital requirements for settlements, according to clearinghouse and settlement provider Depository Trust &

Clearing Corp. That same amount of savings could be realized by reducing the cycle by another day, said John Abel, DTCC executive director, settlement and asset servicing, New York, though he cautioned it would come at a much higher compliance cost for industry participants than T+2.

"T+1 is definitely possible," said Ryan Burns, head of North American relationship management, global fund services, Northern Trust Corp., Chicago. "The big consideration and approach is the success of the T+2 process. If custodians, brokers and other market participants can do the transition to T+2 seamlessly, then an eventual transition to T+1 is possible."

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Pinar Kip, New York-based executive vice president and head of global strategic operations at State Street Corp. (STT), took it a step further. "If you have an arrangement with a trading partner, you can have T+0 (immediate settlement) now. You'd have to have the assets and cash ready, and make sure your custodians are aware. … You would need that level of requirement and the technology to do it. We don't have that yet."

Reducing the settlement cycle is a plus for asset owners and their money managers, sources said. For asset owners like pension funds, a shorter cycle means reduced market and counterparty risk while a trade is being settled. For managers, a reduced cycle adds an alpha source as it frees up assets for investment that otherwise would have had to be held longer as collateral.

"If we think about the biggest benefits in the transition" to a shorter settlement cycle, managers that are well positioned to handle a shorter cycle "are in a situation where they can tout that (to asset owners) and display operational alpha opportunities," said Rian Akey, partner and global head of operational due diligence at Aon Hewitt Investment Consulting LLC, Chicago.

Ms. Kip said a shorter cycle "absolutely" benefits asset owners. "They care about the cash management phase of the cycle," Ms. Kip said. "With a shorter cycle, it frees up money to invest."

By all accounts, the Sept. 5 shift to T+2 in the U.S., Canada, Mexico, Peru and Argentina went off without a major hitch.

"It reminds me of Y2K," Steven Dapcic, Jersey City, N.J.-based director, corporate actions group, Pershing LLC, Bank of New York Mellon (BK) Corp. (BK)'s clearing and settlement unit. "It took a lot of work to get there, but once it happened it went pretty smoothly."

Technology needed

While the drivers of the move to T+2 — including harmonization with existing European rules that have been in force since 2014 — could apply to a further reduction of the settlement cycle, several sources said, the likely main driver of any future move would be rapid technological advancements such as blockchain or cloud-based systems.

"With distributed-ledger technology, who needs a central clearinghouse?" said Oren Blonstein, managing director and head of product at administration software developer TORA Trading Services Ltd., Burlingame, Calif.

However, the use of legacy trading systems among industry participants still dominates, which is why the transition to T+2 in the U.S. took at least six years. Even though the advanced technology could hasten the move to even shorter settlement cycles, the cost of that technological transition makes it prohibitive for many broker-dealers, money managers and third-party providers, said Marty Burns, chief industry operations officer, Investment Company Institute, Washington, and co-chairman of the T+2 Industry Steering Committee.

Had the move to T+2 occurred 10 to 15 years ago, "with the technology infrastructure both on buy-side and sell-side legacy systems, making a change like this would have required traders to go client-by -client to make those changes," said Mr. Blonstein. "Some are still using those legacy systems, which is why in one regard it took so long to do the transition."

DTCC's Mr. Abel said that any shift to T+1 would require more industry change than was necessary for T+2. Processing systems that trade in batches as well as in real time were able to handle the cycle reduction to T+2, but batch systems cannot work with T+1 or T+0, he said. Also, a further cycle reduction would eliminate the harmonization that was reached with other markets with the move to T+2, specifically in foreign exchange, where T+2 is the global standard.

"Barring any changes in regulation, it will be the business model that will drive" the move to T+1 because of the investment and procedural changes involved, said Mr. Abel. He added the Securities and Exchange Commission, in recommending T+2 last March, also called for a cost-benefit analysis of a move to T+1, with results expected in 2020. "If they come back saying the industry should go to T+1, that will be the driver," Mr. Abel said.

ICI's Mr. Burns said technological advances "are still in a nascent stage. There would need to be a lot of work to be done" to move to T+1. "A lot of organizations could move to T+1 tomorrow," he said. "But it would put a lot of smaller organizations in a bind. It would not only put them at a disadvantage but also at a higher risk. Their needs are different than those of the big money managers or the big broker-dealers; those firms have the systems to handle those changes, but smaller firms don't. Also, how would that impact the investor in the end? Are the payment mechanisms available to them to support T+1? Those are factors that have to be considered. Those are things that weren't a stepping stone in the move to T+2 but would be for T+1."

However, Aon Hewitt's Mr. Akey said the assumption that smaller money managers can't keep up on technological advances isn't necessarily true.

"A lot of times, folks assume operational issues are more common with smaller managers," Mr. Akey said, "but sometimes smaller managers are very good with operations, and the larger managers are the ones with the legacy systems that decades ago were best-in-class but have not been updated. Smaller managers can be more nimble, making it easier for them to upgrade their systems to be in a better position to adapt to things. You can't say one class of managers is good and one is bad; I'd say it's idiosyncratic."

Sources said one reason for the smooth transition to T+2 from T+3 was the work of the T+2 Industry Steering Committee, which organized the move and created a playbook for market participants to follow. The playbook worked, said Mr. Burns.

"It was mostly the preparation," Mr. Burns said. "Clearly, some of the industry with their T+2 experience (in Europe) helped. But all the analysis that went into the (T+2) playbook, all that preparation got everyone ready. What the collaboration of the buy side and the sell side showed was that we were able to do this without having a regulator tell us to do it."

Extensive planning

Added Pershing's Mr. Dapcic, "There was an extensive amount of planning over the years, which intensified over the past 18 months. At the end of the day, it wasn't that bad, but you had to analyze everything out there before you could do this." Forty-eight rules from as many as nine regulatory bodies, including the SEC, Financial Industry Regulatory Authority, New York Stock Exchange and Office of the Comptroller of the Currency, had to be changed for T+2 shift, Mr. Dapcic said.

Added Northern Trust's Mr. Burns: "The advance work done, both in Europe's switch to T+2 a few years prior and all the efforts here have been testament to how the operational environment can work. … If custodians, brokers and other market participants can do the transition to T+2 seamlessly, then an eventual transition to T+1 is possible. With the advent of new technologies, like blockchain, they will provide an opportunity to move to T+1 more quickly than it took to move to T+2. But you'll need a consistent, joint effort to do this, just like with the shift to T+2."n

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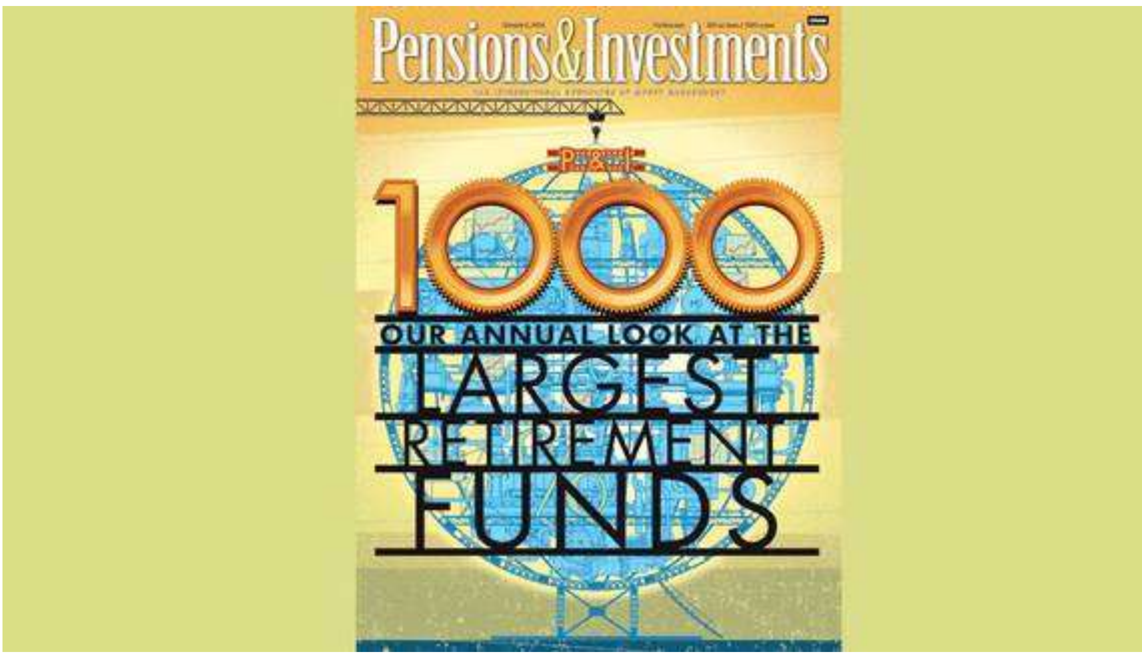

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