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The move to T+1

A business case for automating the middle office

Produced in collaboration with



The background to the move

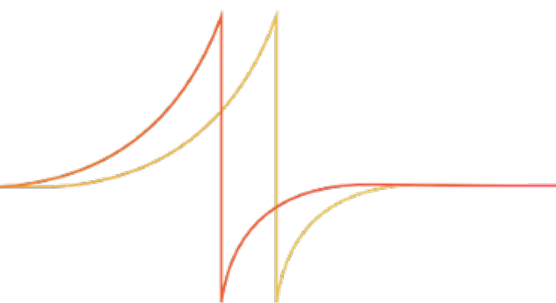
The start of 2021 saw US politicians and regulators discussing the modernisation of the settlement market infrastructure and a move to further shorten the equities settlement cycle from trade date plus two days (T+2) to T+1. The discussions stemmed from a confluence of events, including the retail trading volatility related to memestock activities that began in the earlier part of the year and caused margining activities to be thrown into the public spotlight. Throughout the year, various committees and industry groups discussed the benefits and challenges of shortening the settlement cycle, potentially to T+0 in the long-term but first to T+1.

Of course, this is not the first time the industry has spoken about T+1 or T+0, but it is the first time the topic has garnered so much industry attention. Capitalising on this opportunity, the Depository Trust and Clearing Corporation (DTCC) kicked off a campaign and an industry working group to push for the move to be completed in the next few years. Testifying before the US House Financial Services Committee, DTCC CEO Mike Bodson highlighted the benefits of the move, which also resulted in agreement by the Securities and Exchange Commission to examine the regulatory steps required to move the industry to T+1.

The DTCC's case for a move to T+1, which it published in February 2021¹ highlights the potential risk, cost and capital savings of taking 24 hours out of the cycle. The US market infrastructure provider indicates that the move would retain the benefits of settlement netting at its National Securities Clearing Corporation (NSCC) while reducing market and counterparty risk exposure. This, in turn, would lower the margin requirements at NSCC for market participants by a 41% reduction in the volatility component. Given the market volatility experienced throughout the last few years of the pandemic, the potential savings were publicly welcomed by numerous large market participants and industry associations.

Once it had established industry interest, the DTCC then went to work with an industry steering committee and a working group to begin to establish a playbook for the

¹ ["Advancing Together: Leading The Industry to Accelerated Settlement,"](#) DTCC, February 2021.



changes required for the move. The previous move from T+3 to T+2 in 2017 was preceded by a regulatory-driven shortening of the settlement cycle in Europe due to the implementation of the first phase of the Central Securities Depositories Regulation (CSDR). The DTCC worked with industry associations to put together a 174-page [playbook](#)² for the move to T+1. It has also indicated that it has a handle on all the required changes that it will have to make to its own systems to move to T+1, including steps it has already completed or begun such as night cycle reengineering and the adoption of an integrated settlement model.

What changes can we expect?

There are numerous areas where the SEC must alter existing regulatory requirements and guidelines to take into account the change in timeframe for settlement. The SEC has issued a series of proposals for comment that highlight all the amendments it will make to existing regimes by 31 March 2024, including:

- **Rule 15c6-1:** The technical rule change for the shortening of the settlement cycle for broker-dealers that concerns equities, corporate bonds, unit investment trusts, mutual funds, exchange-traded funds (ETFs), American depositary receipts (ADRs, where they are held in US-based accounts), security-based swaps, and options.
- **Rule 15c6-2:** A change that will require the same day allocation, confirmation and affirmation of trades, along with written agreements from broker clients to ensure they adhere to these arrangements. The use of the phrase “as soon as technologically practicable” to be able to address errors indicates that the regulator is expecting an automated approach rather than Excel-based email interchanges.
- **Rule 204-2:** Which entails investment advisers or their middle office service providers in the case of outsourced relationships retaining a record of each confirmation received and any allocation and each affirmation sent, including a

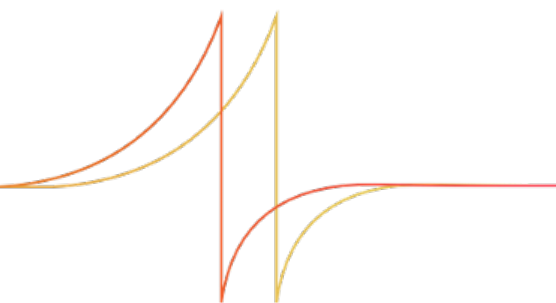
² [T+1 Securities Settlement Industry Implementation Playbook](#), DTCC, August 2022.

date and time stamp for each item. These records should be maintained electronically where appropriate.

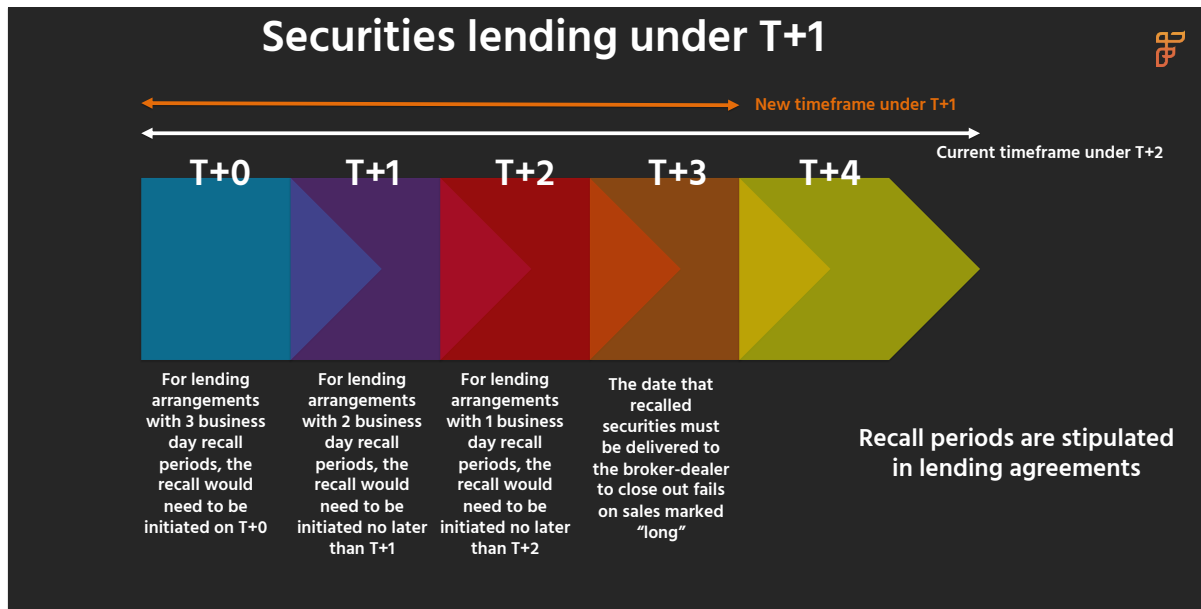
- **Rule 17Ad-27:** The requirement for the DTCC and any other matching platform service provider to ensure its central matching service offers straight-through processing (STP). These providers would be required to detail policies and procedures related to the matching services to the SEC on an annual basis alongside any information about future or planned improvements to these services. These reports would be submitted to EDGAR in XBRL format. They could also potentially include matching rate information for public dissemination.
- **Regulation SHO and Rule 10b-10:** The rules related to the timing of delivery of prospectuses, which means they must be submitted to the SEC by T+1, unless an agreement between the two parties for a longer cycle has been submitted. This is proposed to include for firm commitment offerings priced after 4:30 pm, which are currently subject to a T+4 deadline. The existing closeout requirement for fail-to-deliver positions resulting from short sales would also be reduced from T+3 to T+2.

The SEC has asked for comment on a long list of questions related to its proposals and the overall technical and operational requirements for firms to move to T+1. It has also flagged the need for greater standardisation within the corporate actions announcement process, given the need to shorten related timeframes and the fact that in most cases the ex-date will be the record date.

From the securities lending perspective, a number of rules must be altered to take into account the change including reducing the number of days that a broker-dealer will have to obtain possession of customer securities before being required to close out a customer transaction under Rule 15c3-3 from 12 to 11 days. Moreover, under a T+1 settlement timeframe, the closeout of a failure of a sale marked “long” would be required by the beginning of regular trading hours on T+4 (see the below diagram). With this further shortened timeframe, recalls of loaned securities would need to be



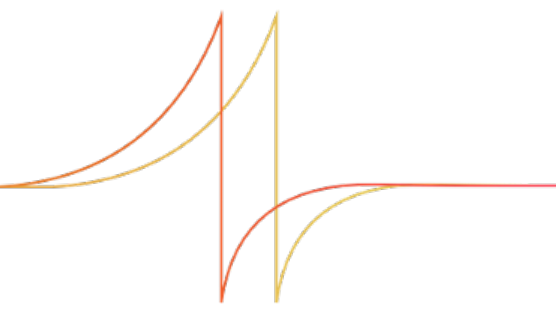
delivered by T+3 to be available to close out any fails on sales marked “long” by the beginning of regular trading hours on T+4.



The timeframe for the regulatory changes will also directly impact the overall market move to T+1. If the rules have not been confirmed as per the SEC’s proposed timeframe, the industry is unlikely to proceed with the 2024 deadline as it stands. Any significant delays to the required regulations will further delay the move and that isn’t taking into account the host of practical implementation challenges that the industry faces.

The practicalities

Interviewees at several large banks indicate that they view the move to T+1 as a testing ground for significant fintech change in the North American markets. While they expect their own firms to experience some aches and pains in the transition, it’s their clients and smaller counterparts that are going to face the greatest challenges. After all, the move to same day affirmation is likely to be much more painful for firms moving from manual or semi-manual processes to full automation. However, the SEC indicates that it believes the move can be implemented much quicker than the previous move to T+2,

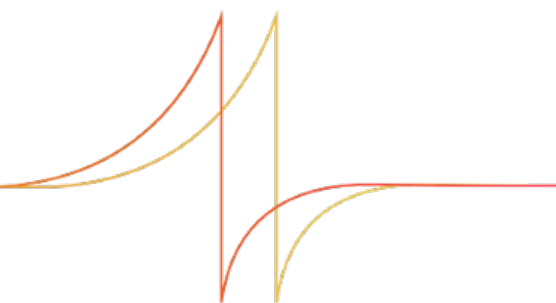


which took three years. The industry is unlikely to agree with this assumption and the regulator will likely receive feedback to this effect during the current comment period.

The graphic below highlights some of the numbers to bear in mind when considering why the move will be more painful than expected. Just under a third of trades are not affirmed on trade date, which highlights the long tail of firms that likely have limited automation and are not using a matching solution or service. The last move took a total of three years from planning to execution, but the reduction of the cycle by a third is considered by most interviewees to have been much easier than they anticipate the challenges they will experience during a halving of the settlement timeframe. Changes will have to be made to numerous internal systems as sell-side firms have an average of 9.1 core processing systems, not to mention corporate actions, securities lending, cash management and collateral management systems to address.



Repapering for client agreements related to the confirmation and affirmation process will also be required before the implementation deadline, which will take time and manual effort on the part of any firm interacting with US counterparts. Internationally, cut-off times and deadlines will have to be significantly reworked to account for the reduction of 24 hours. Firms will also have to review their matching tolerances for



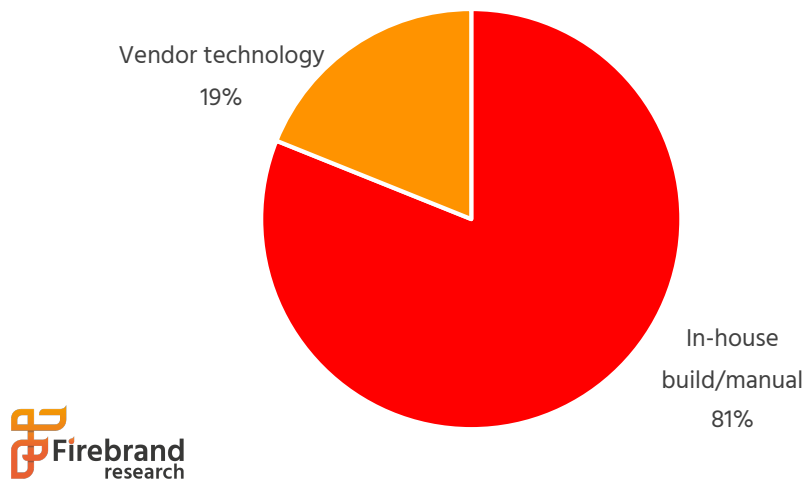
allocations and confirmations on a field-by-field process to ensure that resolution workflows are correct for the new SEC requirements. From an international perspective, some accounts will likely need to be pre-funded to some degree, particularly for clients operating in Asian time zones.

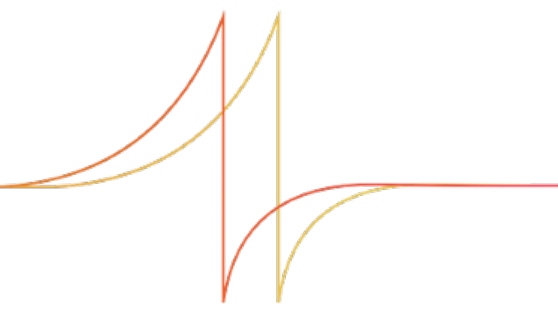
The other implementation processes will include:

- **Front office systems:** Reviewing and reconfiguring trading systems, including trade order management and trade capture processes.
- **ETFs and mutual funds:** Adjusting ETF creation and redemption processes and revising mutual fund settlement dates.
- **Trade confirmation systems:** Reviewing and amending trade matching and affirmation processes, automating as much as possible.
- **Trade funding and payment systems:** Reviewing and updating these systems to ensure payments can be delivered within the required timeframe.
- **Physical delivery:** Amending of the processes for physical delivery of securities.
- **Corporate actions:** Updating of reorganisation announcement platforms and adjustment of ex-date notifications in corporate actions processing systems. Modification of the process for handling voluntary reorganisation applications. Reviewing of timeframes and resolution processes for the cover/protect process for certain tender offers. Assessment of the options exercise and assignment processes and dividend reinvestment plans.
- **Accounting and billing:** Adjustment of due bill processing and modification of interim accounting processes.
- **Securities lending, collateral management and liquidity management:** A wholesale review of the timeframes and automation of these processes.
- **Reference data:** Reviewing the use of SSI services and data cleansing workflows, automating as much as possible and potential use of external services.
- **Consideration of industry standards:** FIX and SWIFT message adoption may be an option for firms seeking to further automate their post-trade processes.

A good indicator of how ready the industry as a whole is for the changes is the number of firms that have adopted dedicated vendor technology platforms for the core processing of their securities. The below Firebrand estimates indicate that the vast majority of brokers and banks (81%) active within the North American markets are either using manual processes or home-grown systems to support their post-trade processes. It is this long tail of small and midsize firms that will need to invest either in internal IT projects or work with vendors or consultants to update their systems for the upcoming changes.

**Vendor versus in-house build/manual support at
North American sell-side firms in 2021
(number of firms)**






The business case for automation

There is no doubt that a shortening of the settlement cycle will place significant pressure on any manual or semi-manual processes across the middle and back office. The previous move from T+3 to T+2 meant the time in which key processes had to be carried out reduced by a third, this move entails a halving of the time and will therefore have a much greater impact on inefficient processes. If these are not addressed, settlement failures and related client disputes will increase and greater costs will be incurred, as well as the negative impact on client relationships.

The benefits of investing in a platform to automate key post-trade processes go well beyond preparing for T+1, however, and encompass the following:

- **Coping with market changes without increasing the number of operations staff:** The market can expect that T+1 isn't the end goal, given the SEC's discussion of T+0 and key developments at the DTCC such as Project Ion. This means that even if firms don't immediately invest in automation, they'll be compelled down this road soon enough. Operations staff are already thin on the ground and the Great Resignation of the last couple of years hasn't helped matters. There are therefore very few staff to deal with post-trade processes to support the full spectrum of assets a client may wish to trade.
- **Focusing operations staff on more value additive, client-facing tasks:** Process efficiency is of paramount importance with the industry's focus on shortening the settlement cycle, reducing operational risk and improving resilience. Exception-based processing is foundational for this effort alongside reducing the number of manual tasks that can be easily automated and centralised across the full spectrum of asset classes. Staff can then be redeployed to focus on tasks related to improving client service and supporting new product development efforts.
- **Dealing with higher volumes of electronic order flow and market volatility:** The post-2008 crisis reform agenda pushed many over-the-counter (OTC)



instruments onto trading venues and clearing houses, which increased the volume of data that post-trade teams must deal with on a day-to-day basis. Moreover, market volatility has become much more commonplace over the last few years and this places significant pressure on any manual processes. Scalability and operational stability are granted via greater automation.

- **Providing greater operational resilience:** The post-2020 industry mantra is all about supporting a more resilient architecture and lowering operational risk is a key benefit of middle-office automation. Firms cannot afford to be in the spotlight for the wrong reasons
- **Modernising in line with the era of cloud:** There has been an industry-wide push to modernise legacy systems in the middle and back office alongside a move to a cloud hosted environment. The cloud migration has picked up pace in the post-pandemic environment as firms seek to make access to key systems easier and more secure. Cloud environments also tend to be more scalable than on premises deployments.

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