T+1 trade settlement: a new headache?

With T+1 trade settlement set for introduction in the US and Canada next year, Nadeem Shamim of SmartStream considers its impact on cash and liquidity management practices.

The first half of 2024 will see the United States move from the current T+2 cycle to T+1 settlement. It follows the United States' transition, in 2017, from T+3 to T+2 settlement processing. The US is not alone in taking this step. Canada will also make the move to T+1 processing in 2024. In India, stock exchanges have already commenced a phased transition to a T+1 settlement cycle.

Other locations are currently weighing up the pros and cons of a similar move. In December 2022, the UK Government announced the setting up of an industry taskforce to explore the case for an accelerated settlement cycle, such as T+1, with a full report due from the taskforce in December 2024. In early March 2023, the Association of Financial Markets in Europe (AFME) established a new industry taskforce to investigate whether Europe should copy the example of the US in shifting to shorter settlement cycles.

The introduction of T+1 settlement stands to benefit the industry by increasing financial stability, mitigating risk, and driving the more efficient use of capital through reduced credit, market, and liquidity risks. Shorter settlement times will, it is hoped, lead to an increase in liquidity, ultimately enabling banks to reduce the level of buffer they hold. Infrastructure changes, particularly greater automation, and the standardisation of inefficient processes, should also prove beneficial.

Turning specifically to the implications of T+1 settlement for liquidity management practices, firms are initially likely to see increased intraday liquidity, a need for faster payments, and a greater requirement for cash and liquid assets. Eventually, this demand should settle down but, in the interim, treasuries will need to remain vigilant and ensure that they are in a position meet these increased pressures.

Firms are likely to face higher costs, particularly as they invest in new technology to facilitate faster settlement. Some firms have progressed further than others where automation is concerned. Large Tier 1 firms typically have advanced systems in place, and some are already able to settle at T+0. Far from being an obstacle, the shortened timeframe of T+1 represents an opportunity to expand their businesses, with the ability to settle trades rapidly an attractive draw to potential clients.

Further down the tiers, however, the picture differs. Some smaller firms remain reliant on manual processes, and this is a potential trouble spot. Those that have not already done so will

need to embrace greater automation and rethink inefficient working practices. Aside from meeting the demands of T+1 settlement, the industry already sees some 5%-10% of trades fail per year – yet another pressing reason to automate more widely and re-engineer poor processes.

The introduction of the T+1 regime will cut in half the present time allowance for trade settlement. Firms will need to understand their liquidity position more rapidly and accurately – not just at the beginning of the day but throughout the day. Besides that, time pressures may also force them to make use of different types of funding instruments, possibly at higher cost. Generally, institutions will have a far more limited window in which to carry out confirmations, remedy errors, process rejections and so on. Delays and inaccuracies in these areas may create headaches and unexpected overheads – if a late funding request must be made because of an earlier processing error or delay, it is likely to prove expensive.

If financial institutions are to manage funding efficiently, they need an accurate and up-to-date picture of the cash and other liquid assets they have at their disposal. Organisations using traditional working practices usually have a good understanding of what their projected liquidity is each morning and what funds are available in a particular currency. What they cannot readily do, however, is gather information in real time from, for example, nostro accounts and compare it against internal requirements.

Yet an accurate, up-to-the-minute picture is essential if a firm wants to compare unfolding events against projections or to cope with unanticipated demands on liquidity. The tight timings of T+1 settlement make this capability even more essential – especially if an institution wants to plan funding optimally and avoid expensive shortfalls.

Clearly, an automated solution that allows a company to view, monitor and manage cash and liquidity, in real time, can be a huge boost. For banks looking to gain greater visibility into and control over their liquidity, advanced technology can offer a lifeline. Sophisticated applications, such as SmartStream's TLM Cash and Liquidity Management solutions, can provide much-needed clarity, at speed, and to plan funding activities with greater efficiency.

Our cash and liquidity solution also forms part of an extensive suite of post-trade solutions. These range from reference data and reconciliations, through to collateral management tools, and are uniquely well-positioned to help firms meet the upcoming demands of T+1 trade settlement. Additionally, they are enhanced by a range of managed services, which offer access to both the latest SmartStream technology and highly experienced resources.

Given the short timeframe imposed by T+1 settlement, firms will need to monitor closely the quality of information entering their systems, to weed out discrepancies which could later cause downstream delays. Reference data should be as clean and accurate as possible – a neutral, industry utility such as the SmartStream RDU can offer valuable assistance in this respect.

In conclusion, getting cash and liquidity management practices in order promptly is imperative if financial institutions are to navigate the introduction of T+1 trade settlement smoothly, and avoid losing client business to more efficient, technically advanced competitors.

Tackling any lingering weaknesses is desirable for two other important reasons. Firstly, being able to maintain efficient, up-to-the minute supervision of liquidity is becoming ever more central to survival in today's choppy economic waters.

Secondly, additional regulatory initiatives are driving the need for real-time visibility. BCBS 248, for example, obliges firms to not only manage liquidity levels on an intraday basis, but also to provide reporting relating to their management of intraday liquidity. In the US, smaller and regional banks may soon become subject to a more demanding regulatory regime, including intraday liquidity management requirements, as regulators review the Dodd-Frank threshold for banks considered "too big to fail" – piling further pressure on firms to overhaul any outmoded systems and working practices that remain. ■