T+1: Cash and liquidity management functions impacted

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The reduction of settlement times from T+2 to T+1 for many US securities, set to come into force at the end of May 2024, is likely to impact a number of business processes across the sell side. Nadeem Shamim, head of cash and liquidity management at SmartStream, explores the potential consequences of the move on banks' cash and liquidity management practices, and the best way for them to mitigate those operational risks

Nadeem Shamim
SmartStream

It is likely banks' cash and liquidity management practices will be impacted by the move to T+1 settlement of many securities transactions in the US. Which areas will be most impacted by the move?
Nadeem Shamim: There are four areas in which banks are likely to be impacted: increased demand for intraday liquidity, the potential impact on funding costs, increased transparency, which is a double-edged sword, and potentially higher operational costs.

How do you see intraday liquidity—arguably the greatest impact on banks' existing workflows—being impacted?
Nadeem Shamim: For T+1 settlement, banks will need to provide payment and delivery of securities faster than at present. That much is obvious. This, in turn, could increase demand for intraday liquidity, which means banks' treasuries might need to hold higher levels of cash and other liquid assets to ensure they have sufficient funds to meet payment obligations throughout the day. However, there are expectations that these demands and liquidity will level out and, in fact, should improve going forward.

How do you see the potential increase in funding costs transpiring?
Nadeem Shamim: To manage the increased demand for liquidity, banks' treasuries may need to rely more heavily on short-term funding, such as repos and money-market funds. Those instruments tend to be volatile, but the cost fluctuates quite a lot as well. This could potentially increase banks' funding costs if short-term rates rise or if there is increased competition for those funds because, when settlement times compress, more banks will be chasing the same funding sources.

Is the move to T+1 likely to impact not only US banks, but all banks that trade the securities that the US Securities and Exchange Commission requires them to settle one day after trade day?
Nadeem Shamim: Correct. It's not just US banks that will be affected—banks operating in different parts of the world will be similarly impacted, but the impact will not just be on direct currency funding but cross-currency funding too. Traditionally, the currency conversion would be on spot foreign exchange (FX) but, with T+1, you're looking at the settlement of FX as well. There could be a potential move in terms of how the cash flow is settled—the industry might start using real-time gross settlement as opposed to automated clearing house settlement or any other faster payment mechanism.

You described the resulting increase in transparency of the move to T+1 as a "double-edged sword"—why is this?
Nadeem Shamim: T+1 settlement may increase transparency in the market due to settlement time compression but, as trades settle more quickly, there will be less time for discrepancies to be identified. This could potentially benefit banks' treasuries because errors can be handled quicker. But, at the same time, there is a reduced time frame to identify and address those settlement discrepancies or failures.

Real-time information about payment obligations can only help banks identify problems. If you are reconciling in real time, you'll know that what you were expecting to happen has not happened, or that something has happened that you weren't expecting. You need more up-to-date information to take those corrective actions, but you also have a much shorter time frame to do so. The key remains that, if a trade has not been confirmed and therefore the projections for liquidity needs are not correct, this could lead to late funding requests. And the reduction of settlement times means such events leave limited time to investigate and fix them.

What do firms need to do to ensure they can cope with the likelihood of new cash and liquidity arrangements on a T+1 basis, and what aspects of those functions do they tend to underestimate in terms of complexity?
Nadeem Shamim: Some larger firms are already working on this and have strong intraday and real-time liquidity solutions in place. But, if you look at smaller firms outside of the global systemically important banks realm, the situation is not consistent, and many firms are not ready to handle this requirement of real-time liquidity management. The move to T+1 settlement may require banks to invest in additional technology and operational resources to support this compression of settlement times. This could result in higher operational costs. You can either throw resources at the problem in the form of bodies or you can invest in technology to address it. Obviously, technology is the right direction. It was clear during the Covid-19 pandemic that outsourcing operations centers was useful for business continuity, but it also hindered the timeliness of information because those centers were equally affected by the pandemic. So, moving to a new system and processes that help gather that information and provide banks' funding needs in real time is going to be paramount. wt