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The financial sector *is moving to T+1,* but why stop there?

Settling securities trades in a single day (T+0) will represent a paradigm shift, and the industry can get ahead of this future now

The U.S. Securities and Exchange Commission (SEC) announced last year its intent to shorten the settlement cycle for most securities trades from two business days to one – a change that will come into effect on May 28, 2024.

It's the latest evolution in a long-standing trend of shortening trade cycles – one that could extend to same-day settlement.

Individual investors – who accounted for 52 percent of global assets under management in 2021, a segment expected to grow to over 61 percent by 2030 – have become accustomed to the idea of real-time settlement. Many already experience this in the consumer payments space.

This reality is likely to accelerate the case for T+0 settlement, which would mean even more change on the horizon for the financial sector. And while moving to T+1 settlement requires time and investment in technology as well as change management, moving to T+0 will create significantly more disruption. But institutions don't need to wait until the SEC mandates this change. Beginning the process of transitioning now will put companies in front of the massive change that is coming.

The case for *speeding up trade settlement*

It's tough to imagine now but, 30 years ago, a standard securities trade took five days to settle. Back then, documents had to be couriered back and forth for signatures on hard copies. Today, trades are settled electronically, but the process still takes two days as investors, brokers, and financial institutions ensure requirements are met and information (and intent) is confirmed.

But in the last several years, a rise in retail investing facilitated by the growth of mobile trading platforms and the gamification of stock trading has led to a larger demand for digital processes – and efficiencies.

Reducing the time to settle trades has other benefits. It also reduces counterparty risk – the possibility that one party may not fulfill its obligations in the trade – by decreasing the amount of time parties are exposed to one another.

Currently, the SEC mitigates counterparty risk by requiring margin (also known as collateral) to be held based on the value of an institution's open and unsettled transactions. This is cash that could otherwise be available for investment purposes. Reducing the time required for settlement also reduces the time that institutions must hold their collateral.

T+1 settlement will mark a radical transformation across the capital markets landscape

We have seen the following pressing challenges across the industry in navigating from T+2 to T+1.

Inadequate batch processing: The trade settlement cycle is heavily dependent on batch processes that are run overnight or at different points throughout the day. A T+1 settlement cycle puts pressure on these processes. If organizations plan to continue relying on batch processing to facilitate settlement, they should shift towards an intraday model to align to the new market deadlines. Institutions should consider more frequent, near real-time processing models to de-risk and align to market requirements.

Counterparty day one readiness: According to the Depository Trust & Clearing Corporation, only 46 percent of market participants expect to be ready for T+1 by May of 2024. Smaller institutions are disproportionately impacted by this transition due to their reliance on manual processes, entrenched technical infrastructure, and challenges in funding and staffing. This leaves large institutions vulnerable – even if they are prepared for T+1, their counterparties may not be.

Cloud adoption acceleration: T+1 settlement will require institutions to scale complex, automated workloads. Financial institutions across North America are undergoing ambitious cloud modernization activities – often bogged down by decades of reliance on legacy mainframe architecture. The advent of T+1 is going to require these institutions to accelerate their ambitious transformation goals and harness the power of the cloud for capital markets.

Global coordination and time zone challenges: T+1 settlement heightens global coordination challenges, particularly for firms involved in international trading. It requires enhanced synchronization across time zones and markets. This demands strategic planning, robust technology, and strong communication to align with various market hours and practices, aiming to prevent settlement delays. For firms in APAC, the shift necessitates processing at almost T+0 speeds, highlighting the need for a globally aware operational strategy.

Risk of increased failed trades: One of the immediate risks of an unprepared transition to T+1 is the potential increase in failed trades. Banks and brokers will have 80 percent less time to manage the settlement process, leaving no room for error margin. The potential rise in failures poses risks of operational disruptions and financial losses, requiring firms to enhance their accuracy and efficiency. Firms must adopt robust systems and prepare contingency plans for swift issue resolution.

Why preparing for *T+0 makes sense now*

Institutional change designed for speed and efficiency gains not only requires a heavy investment in process and technology, but also a mindset shift. Meeting the T+1 requirement in the coming year means financial institutions are already looking at operational changes and exploring opportunities to eliminate errors in trades. It's a natural progression to T+0, so why not go one step further?

The reality is that the current market infrastructure already supports same-day trade settlement – the securities lending process plus some vanilla cash equities are already settling on a T+0 basis. In both of these cases, same-day settlement has increased liquidity and allows participants to respond to changing market conditions more quickly.

Moving to T+0 settlement offers the same benefits provided by T+1: reduced counterparty risk and freeing assets held as margin sooner for other investments.

Facilitating T+0 on current technology is possible and is successful today within limited scenarios, such as securities lending, however achieving same-day settlement at scale for the majority of securities transactions will stretch current infrastructure beyond its limits. That's where newer technologies will be needed to bridge the gap.

As with any change, the move to shorter settlement cycles also comes with challenges, in particular, operational risk. With less time to process transactions, the potential for errors can increase. Fortunately, there are many opportunities to create operational efficiencies that mitigate errors and also achieve the level of speed the industry is seeking – and even beyond.

DLT-enabled settlement **has already proved itself viable**

Distributed ledger technology (DLT) is one potential settlement vehicle that would enable larger industry players to move to T+0 at scale. Same-day settlement via DLT eliminates manual touchpoints, resulting in a far more efficient process with a faster turnaround.

This decentralized electronic system of recordkeeping allows multiple parties to control a shared database, or ledger, which is distributed amongst many nodes (computers) that participate in the network. Each node has a copy of the ledger and can independently verify transactions. Once the majority of nodes on the network have reached consensus that a transaction is legitimate, it will be entered as the newest transaction on the ledger – an immutable record that cannot be changed by an outside party.

In 2021, the Depository Trust and Clearing Corporation (DTCC) launched a prototype for Project Ion, an alternative settlement network that represents and settles securities and cash on a private distributed ledger. Based on feedback and testing from more than a dozen financial institutions, the platform went live in production in August 2022, processing 100,000 bilateral equity transactions on average per day, with peak volume exceeding 150,000 transactions daily. That proved DLT-enabled settlement is a viable vehicle for achieving T+0 at scale and that it can plug in to existing market utilities. And it stands to make T+0 settlements a reality for the industry at large.

A T+0 settlement cycle would require a significant reduction in the effort spent in the reconciliation and confirmation of trade details between back offices post-trade. A settlement platform enabled by DLT would eliminate the need for manual intermediation by validating data in near real-time and automatically reconciling trades as they are placed. Such a platform would likely require securities to be tokenized – translated into digital form on the blockchain. The tokenization of a security is necessary for trading and settlement via distributed ledger technology and greatly increases the speed and efficiency of transacting in that security.

Overcoming the challenges to *T+0 through DLT*

Despite the success of DLT as a proof-of-concept, the most significant challenge in the way of wide-scale adoption is that all parties involved must be ready to make the switch. That will require partnerships between regulators, financial services, market utilities, and participants.

The industry will also need to come together to define common standards, methodologies, rules, and tools in order to create an ecosystem capable of same-day settlement. While DLT isn't the only technological solution to be explored here, the bigger-picture issue of change management associated with the transition to T+0 can – and should – start now.

For more information about T+0, **please contact our team:**

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