

# **Shortening the Settlement Cycle (T+2)**

## **Bank Depository User Group**

**September 22, 2014**

# Background

- In 2012 SIFMA and DTCC decided the time was right to re-examine Shortening the Settlement Cycle (SSC)
- In early 2012 DTCC issued - “Proposal to Launch a New Cost-Benefit Analysis on Shortening the Settlement Cycle” outlining approach including RFP
- In May 2012 BGC was selected to conduct the cost benefit study
- In October 2012 BCG issued report, “Cost benefit of shortening the settlement cycle”, indicating a positive business case and their view that a move to T+2 was possible in 3 years and T+1 in 4 to 6 years
- Fall 2012 to early 2013 DTCC interviewed 126 firms, including investment management firms, to validate the BCG study and found a consensus to move to a shortening of the settlement cycle with a minority against because the “agenda are already full”
- In throughout 2013 DTCC continues its effort to build industry consensus
- In Q2 2014 DTCC received support from major industry organizations to move to T+2



# Benefits of Accelerating Settlement (1)

- Benefits include:
  - Counterparty risk exposure-removes one day of trades from pending settlements
  - Reduces buy-side counterparty exposure
    - Default events are sporadic with impact difficult to quantify
    - BCG modeled benefit based on probabilities implicit in broker-dealer credit ratings that might occur once a year (stress scenario) and once every 10 years (high stress scenario). Results were:

	T+3	T+2		T+1	
<b>Stress Scenario</b>	\$300MM	\$190MM	-35%	\$80MM	-70%
<b>High Stress Scenario</b>	\$2,600MM	\$1,600MM	-40%	\$600MM	-75%

- Reduction in sell-side counter-party risk exposure as measures in NSCC's Clearing Fund margin requirement under normal (Oct 2010 to Aug 2011) and stress periods (flash crash August 2011)

	T+3	T+2		T+1	
<b>Average Period (10/2010-8/2011)</b>	\$4B	\$3.4B	-15%	\$3B	-25%
<b>High Volatility Period (8/ 2011)</b>	\$7.3B	\$5.5B	-24%	\$4.6B	-37%

# Benefits of accelerating settlement (2)

- Liquidity benefit:
  - For Mutual fund complexes
    - A large number of equity, corporate and muni bond funds issuance/redemptions settle on T+1
    - Underlying assets settle T+3
    - Liquidity need reduced if fund assets settle T+2 rather than T+3
  - For sell-side
    - NSCC, as a CCP, must have enough liquidity on hand to close out its largest firm/family
    - NSCC's average liquidity need is \$16.7billion in a normal market environment
    - T+2 reduces liquidity need by 20%
- Procyclicality benefit
  - Reduces increase in margin and liquidity requirements in stress scenarios
- Systemic Risk Reduction (especially in times of market stress)
  - Eliminates one day's trade exposure between trade parties
  - Reduces exposures of sell-side to clearing house
  - Procyclicality benefit; lower increase in NSCC's margin/liquidity needs in stress periods



# Benefits of accelerating settlement (3)

- Overall positive impact for end-investors
  - Under Securities Investor Protection Act trades not yet settled are considered owned by the broker-dealer
  - Accelerated settlement reduces end-investor exposure to broker-dealer for such trades
  - End-investors receive (and pay) funds and securities faster under SSC
  
- Aligns US with other geographies

# Business case-summary

- Savings (\$195 million annually)
  - Operational cost reduction (\$170 million annually)  
Driven by T+2
  - Funding costs of NSCC clearing Fund reduction (\$25 million annually)  
Impacts sell-side
- Investment (total \$550 million over multiple years)
  - Mainly testing with some systems changes plus any upgrades required to BD and custodian interfaces
- Industry payback period:
  - 3.3 years counting operational cost saves
  - 2.8 years if margin saves also included
- Results vary by segment and firm size:

Type of firm /size	Investment (\$ mil)	Operations cost reduction
Buy-side/Large	\$1.0	2%
Buy-side/Medium	\$0.6	2%
Custodian/Large	\$4.0	15%
Custodian/Medium	\$4.0	10%
Inst. BD/Large	\$4.5	5%
Inst. BD/Medium	\$1.0	5%
Retail BD/Large	\$4.0	4%
Retail BD/Medium	\$3.0	2%



# Progressing T+2 in the US

- Industry driven initiative
- Creation of an Industry Steering Committee (ISC)
- Creation of an Industry Working Group (IWG)
- Define project scope and timeline
- DTCC participates in both the ISC and the IWG and provides overall Project Management to the SSC initiative

# Industry Steering Committee (ISC)

- Provide **guidance, direction** and **support** for the SSC initiative
- 20-25 members
  - Association representatives
    - AGC
    - AII
    - ICI
    - MFA
    - SIFMA
    - STA
  - Additional industry representation
    - Buy side firms (“40 act” and “non-40 act”)
    - Retail broker dealers
    - Institutional broker dealers
    - Custodians
  - Utility representation
    - DTCC
    - Omgeo
- ISC Co-Chairs
- First meeting on July 17 (Associations)
- First full meeting on September 10



# Industry Working Group (IWG)

- Identify, review and finalize business and rule changes required to facilitate a move to T+2
- Currently membership 50+
  - Co-Chairs
- Members across a multiple market segments
- Frist meeting September 11
- Agreed overall project approach with both ISC and IWG

# Shortened Settlement Cycle Approach

	Group	Industry Segment	Work streams										
			AM4	AMN4	GC	IBD	RBD	TA	SE	DTCC	OM	O	I
			Buy-Side			Sell-Side		Utilities					
1	Alpha	ETFs	X	X	X	X	X	X	X	X	-	-	
2	Alpha	Munis	X	X	-	X	X	X	-	X	X	-	X
3	Alpha	Product Scope Validation (Incl. MMI) (what products are subject to SSC, e.g., impact on equity)	X	X	X	X	X	X	-	X	X	X	-
4	Alpha	ADRs	X	X	X	X	X	X	X	X	X	-	-
5	Bravo	Access equals delivery	X	X	-	-	X	X	-	-	-	-	-
6	Bravo	Buy-side changes	X	X	X	X	X	-	-	X	X	-	-
7	Bravo	Fund/SERV	X	X	X	X	X	X	-	X	-	-	
8	Bravo	Standing Settlement Instruction (SSI) utility	X	X	X	X	X	-	-	-	X	-	-
9	Charlie	Corporate Actions	X	X	X	X	X	X	X	X	-	X	X
10	Charlie	Dematerialization (Incl. DRS)			X	X	X	X	X	X	-	-	X
11	Charlie	Securities Lending	X	X	X	X	X	-	-	X	-	X	-
12	Delta	Foreign Exchange / Foreign Investors	X	X	X	X	X	-	-		-	-	
13	Delta	Initial Public Offering (IPO)	X	X	-	X	X	X	X	X	X		X
14	Delta	Prime Broker	X	X	-	X	X	-	-	X	X	-	-
15	Delta	Retail Funding	X	X	-	-	X	X	-	X	-	-	-
16	Delta	Street-side changes (changes to NSCC's processing incl. ACATS)	X	X	X	X	X	-	X	X	X	X	-
17	Lima	Legal & Regulatory		-	-	-	-	-	-	-	-	-	-



# Sub-Working Groups

- Sub-work groups will be populated with industry members
- Each sub-working group will have one industry leader
- The sub-working groups are scheduled to meet bi-weekly for at least one hour
- Work steam templates will be produced to capture and document information in a standardized format:
  - Regulatory changes
  - System changes
  - Process changes
  - Technology changes
  - Behavioral changes
  - Market impact
- DTCC will provide Project Management support to each sub-working group

# Communication Approach

## Industry

- Creation of an industry T+2 website ([www.UST2.com](http://www.UST2.com)) and brand identity
- Press Release
  - Formation of the ISC and the IWG
  - Selection of Co-Chairs
  - Announcement of the T+2 web site

## Regulator

- Regulators have expressed support for the SSC initiative and are eager to see a proposed project timeline
- Concern that Regulators may take a more active role in the process if they do not see progress from the industry committees
- Members of the ISC will establish formal meetings with regulators to:
  - Present approach
  - Discuss progress
  - Outline anticipated rule changes



# Contact



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