KPMG

Accelerated Settlement - Part 1

Shortening the settlement cycle for U.S. markets to T+1

"Nothing good ever happens to a trade between trade date and settlement date."

J. Carter Beese Jr. (Former SEC Commissioner)

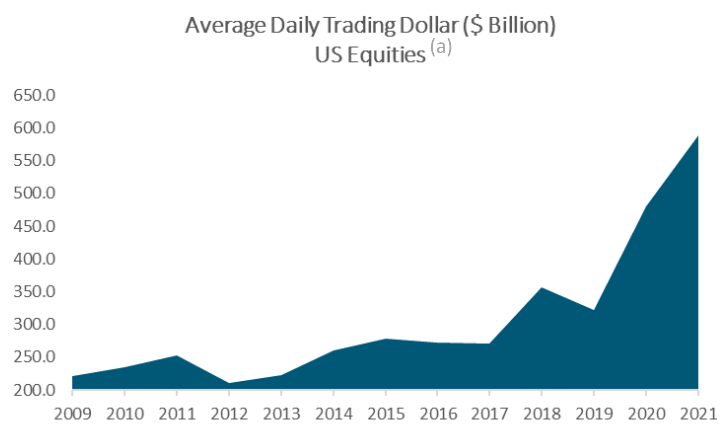
After the 2008 credit crisis, there was an urgent need to transform the market environment to be safer and more transparent. While regulators established new requirements and passed landmark legislation, the financial services industry also came together to respond. In what became one of the most meaningful changes to the U.S. market's settlement cycle in decades, the industry migrated from "T+3" to "T+2" in September 2017.

T+2 is the current standard that applies to securities traded on stock exchanges, as well as bonds, municipal securities, and mutual funds traded via brokerages. The time to settle in the settlement period enables clearinghouses to net trades and payments between institutions, drastically increasing efficiencies in the market.

The time to settlement, however, also introduces uncertainty to the market, namely in the form of counterparty default risk. To mitigate these risks, participants are subject to margin requirements, which are ultimately a cost.

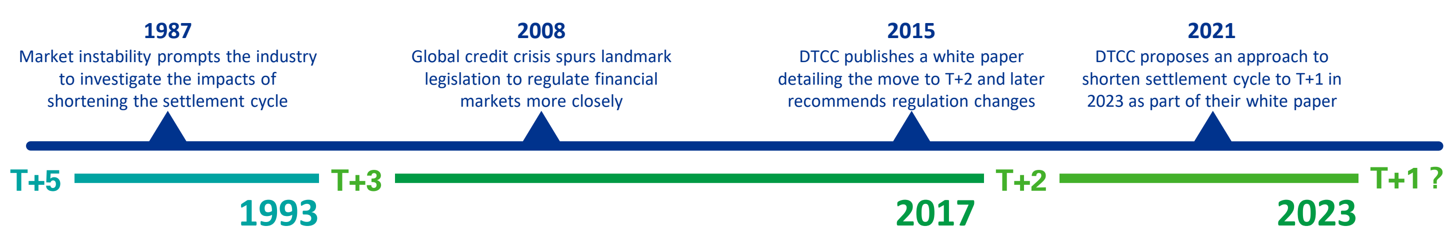
Margin requirements are derived from a calculus of market volatility, the concentration of securities, and other considerations.

Growth in markets and volatility often go together. Global events, fiscal actions, and monetary measures, impact financial markets to a significant degree. The pandemic continues to have an unprecedented impact on the markets, creating records in terms of traded volumes and outstanding notional value. More recently, the meme-stock investing frenzy established market volatility patterns previously unseen.



High market volumes and increased volatility have reignited the conversation to further shorten the settlement cycle from T+2 to T+1, and there is a definite appetite in the industry to transition.

Today the trade execution happens in milliseconds but still takes two days to settle. The time has come to bring T+1 settlement to reality.

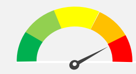
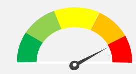
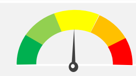
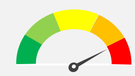
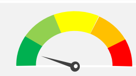
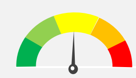


[a] Data sourced from SIFMA

1 Why T+1 settlement and why now?

The rationale for moving to an accelerated settlement cycle is based upon several factors. Shortening the settlement cycle is a direct way to reduce the time exposure, reduce counterparty and liquidity risks, and lower margin requirements for industry participants. Trades will settle faster, reduced liquidity and procyclical margin demands, particularly in times of market stress.

Market participants are potentially impacted in different ways:

Market group	Participant	Key focus area	Impact
Financial Market Utilities	Centralized counterparty Central securities depository	• Operational and systemic risk • Volatility • Margin requirements	
Sell side	Broker dealers (agent or principal) Executing/Introducing Prime brokerage	• Liquidity risk • Collateral/Margin requirements • Financing cost • Settlement cost • Errors/Fails resolution	
Buy side	Institutional investors Private equity Hedge funds	• Excess capital allocation	
		• Funding gaps • Reconciliation • Trading costs	
Retail	Retail investors	• Access to funds/securities	
Custodians	Custodian banks	• Trades processing cycle • Time for credit checks • Processing inefficiencies • Reconciliation	

We expect that transitioning to T+1 settlement will lead to further reduction in systemic risk and enhanced financial stability along with improved protection for investors.

Moving to T+1 settlement would help to strengthen U.S. positioning in the global markets and serve as a catalyst for industry change.

2 The road to T+1 to date

Market participant adoption of T+1 settlement cycle has multiple dependencies, including industry readiness in terms of operations and technology, market infrastructure support, regulatory greenlight, a systemic risk mitigation strategy, and a balanced approach that brings minimal disruption to existing processes.

Regulators and industry associations have always explored the possibility of shorter settlement cycles. The Securities and Exchange Commission (SEC) had a concept release[1] on the operational efficiency of U.S. Clearing and Settlement System, and The Securities Industries and Financial Markets Association (SIFMA) has published a study[2] that explored the case for moving to T+1 with a benefits versus investment approach. The Depository Trust and Clearing Corporation (DTCC), with its settlement reengineering programs and the Distributed Ledger Technology (DLT) initiative (Project ION[3]), has been exploring different ways through which settlement can be accelerated. Recently, Paxos, a fintech[4], created a blockchain based settlement service to settle equity trades in U.S., markets. Only two trades were executed in the day and were settled the same day marking a T+0 instead of T+1 settlement. Settlement happened at end of day for both trades and one of the trades was executed well past the 11 A.M. cutoff that is used by DTCC today for T+0 settlement. Also, Paxos claims that this service is not limited to one particular settlement cycle (T+1 or T+0).

With advancements in technology and changes in the market infrastructure and operations, and in conjunction with the efforts since T+2 implementation, the industry is well placed to leverage these building blocks and accelerate the shortening of settlement cycle. Instead of an end-of-day settlement at T+1, the industry could also explore the option of intraday settlements, which could have an overall positive impact on margins and capital.

Automation in operations and settlement processes has also brought an increase in same-day affirmation rates and consequently a decrease in exceptions that leads to fails. When the industry moves towards T+1, careful consideration alongside a systematic approach, similar to the transition to T+2, will result in benefits that will certainly outweigh the efforts.

[1] *Concept Release: Securities Transactions Settlement*. www.sec.gov/rules/concept/33-8398.htm
[2] *T+1 Business Case Final Report*; May 2020. https://www.sifma.org/wp-content/uploads/2017/05/t1-business-case-final-report.pdf
[3] *Project ION Case Study*; May 2020. https://www.dtcc.com/~/media/Files/Downloads/settlement-asset-services/user-documentation/project-ION-paper-2020.pdf
[4] *Instinet and Credit Suisse conduct same-day settlement of traded stocks in historic first with Paxos Settlement Service*; June 4, 2021. https://www.sifma.org/wp-content/uploads/2017/05/t1-business-case-final-report.pdf

How KPMG can help

KPMG can support every phase of the T+1 transition journey. Our KPMG Transition Team is involved directly in assisting a number of transformation programs and providing internal support to many market participants. Firms need to act now. Our team has the industry experience to provide guidance and market insights to support T+1 transition activities and conversion process efforts across all asset classes and lines of business, as momentum continues to grow

Extensive financial markets and T+2 experience

KPMG has deep understanding of clients in the financial markets space along with a dedicated focus towards post-trade processing across asset classes and can leverage the T+2 implementation experience for the T+1 journey

Impact and readiness assessment

With an inventory of accelerators, toolkits and guiding principles covering key aspects of transition, KPMG can help to accelerate the readiness assessment for T+1 and significantly aid in building a roadmap, current state and gap assessment for the transition

Enterprise-wide framework

KPMG stands as a pioneer in advising clients on establishing an enterprise-wide governance structure to oversee the transition and an overall framework along with a risk plan to mitigate high-impact systems and processes.

Industry engagement

KPMG engages with various industry bodies, including DTCC, SIFMA, and ICI who are at the forefront of shortening the settlement cycle for financial markets and are looking very keenly towards T+1 as the next destination for settlement in equity markets.

What's next

In the part 2 of the series on T+1 transition we will review additional topic areas which have a high impact due to the transition to T+1, notably

- Securities lending activity and impact to the short sales process
- Operational issues arising out of shortening of settlement cycle
- Fails or errors processing
- Processing timeline from trade execution to settlement and how it needs to shrink
- Cross border transactions
- Leapfrog to instantaneous / T+0 settlements leveraging Blockchain

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