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T+1 Settlement

The implications of faster USD asset settlement for FX

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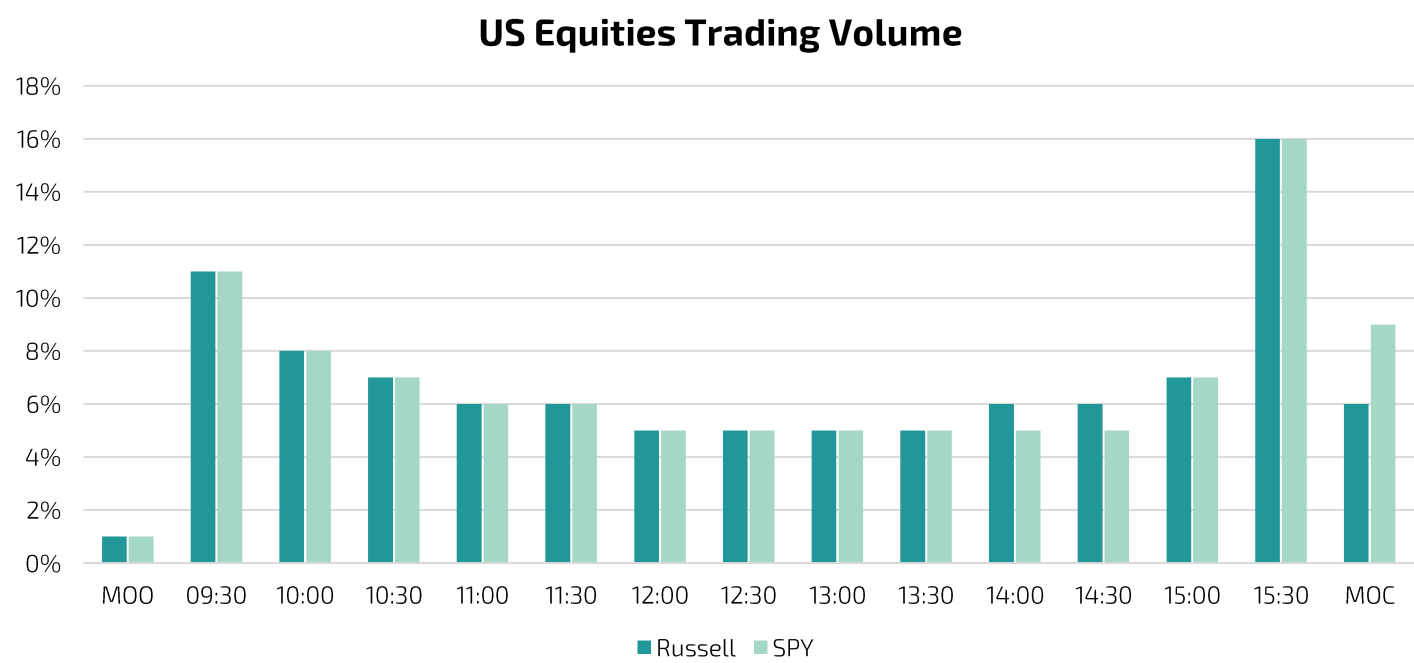
1 What does a change to T+1 settlement mean?

At the end of May 2024, the US and Canada are migrating from T+2 to T+1 settlement cycle for assets.

This change is driven by a focus to reduce risk and improve efficiency in financial markets.

The SEC has said recent episodes of market volatility, for example, March 2020 or the 'meme stock' incident in 2021, "*highlighted potential vulnerabilities in the US securities market*" and so shortening the settlement cycle "*can promote investor protection, reduce risk, and increase operational and capital efficiency*"

However, there are concerns within the industry as to how this will affect financial markets.



Given a disproportionate percentage of US equities trading occurs near the New York close (4pm EST), these changes will lead to less time to meet the FX requirements of these trades.

Source: BofA Securities, 'T+1 Settlement: Impact on FX and Other Asset Classes', Nov 2023

2 What are the implications of this change?

25% Of volume in S&P 500 indexes is traded in the final 30 minutes of trading

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- Less time to generate FX requirements from asset sales/purchases and reconcile trades
- European desks will have 2 business hours between the end of the trading window and the start of the settlement window, compared to 12 hours previously
- Only 1 hour to execute FX on the same day on a T+1 basis (in late US hours), or have to trade T+0 the next day
- Further operational challenges if there is a public holiday on T+1

90% Reduction in interbank FX liquidity from London time to 'Twilight' time (9pm – 10pm London)

Source: RBC Capital Markets, 'T+1: Shortening the Settlement Cycle', Nov 2023

3 How are asset managers looking to address this?

1 **Execute during US time zone**
Expand operations to US time zone or move trading desks to the US

2 **Pre-fund US equities transactions**

3 **Estimate funding requirements pre-trade**
Use subsequent 'true up' trades for any mismatches post trade

4 **Execute with non-standard settlement**
Borrowing or lending assets by trading further out than spot

5 **Outsource trading and settlement**
Use third-party managers for FX and operational management due to increasing complexity

6 **Improve internal trade processing**
Accelerated internal processing of asset trade booking to facilitate t+0 trading the next day

None of these options are expected to decrease costs

"The implications of this change are affecting companies in different ways, but evidently the operational considerations are becoming more complex, and many of the knock-on effects could lead to an increase in portfolio costs.

Using a specialist currency manager could help mitigate these impacts"

Nathan Vurgest
Head of Trading

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4 How will this impact FX markets?

Wider spreads

With the same liquidity now spread over more hours there is the possibility of wider spreads in normal market times

Irregular currency moves

Increased volume during illiquid times could lead to more unexplainable, flow-driven currency moves, and ‘flash crashes’ (as previously seen during Asia hours)

Increased costs of execution

More trading taking place in illiquid ‘twilight’ hours

Rise in non-standard settlement

Increased credit risk if trades are settled outside of CLS (increasing credit costs)

Increased use of custodians

Higher execution costs as custodians are typically expensive for executing FX

Outsourcing to specialist managers

Increased outsourcing of FX and operational management to specialist managers as settlement becomes more complex

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