

# **The Global Move to Shorter Settlement Cycles**

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## Agenda

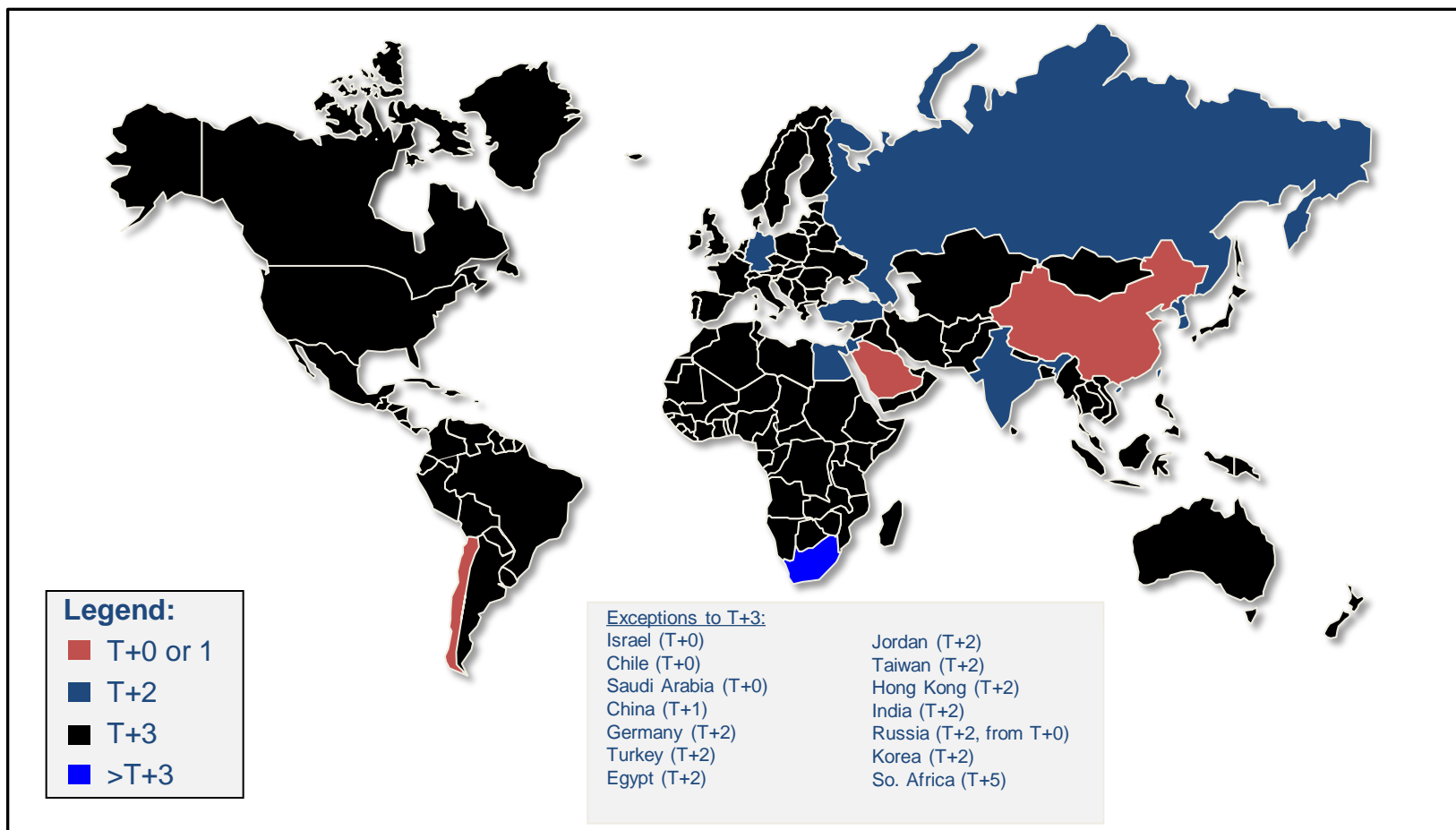
- Background
- The path to SSC
- Drivers behind the change
- Challenges and benefits
- Keys to success
- Reality check on Global T+2 readiness

## Background

- Global trend to minimize operational, counterparty and systemic risk – with shorter settlement cycles increasingly viewed as a way to reduce these risks
- The benefits of a move are widely acknowledged, including:
  - Reduce risk exposures: credit, counterparty, operational, settlement
  - Boost liquidity with faster reinvestment of capital; money left on the sidelines can be reallocated more quickly
  - Achieve savings: capital, cash, credit, collateral
- Local markets are at various stages in adopting SSC, and are taking different approaches
  - Several markets in Asia already operate on T+2 (India, HK, Taiwan)
  - EU member states are poised to move from January 2015 (CSD Regulation)
  - After being tabled in 2001, the US is also starting to consider accelerating its current T+3 cycle
  - Canada already requires “trade date matching” in NI 24-101; this operational requirement will be increasingly important across all markets
- Successful implementation of SSC will require firms to focus on preparing their middle and back office operations



## Global settlement cycles *(cash equity trades)*



Source: World Federation of Exchanges

## The path to SSC

1. US move towards T+1 (pre-2001)
2. NI 24-101 in Canada (2007)
3. T+2 on the European agenda post-GFC
4. CSD Regulation proposed in March 2012
5. BCG Study sponsored by DTCC and SIFMA

# Spotlight: United States

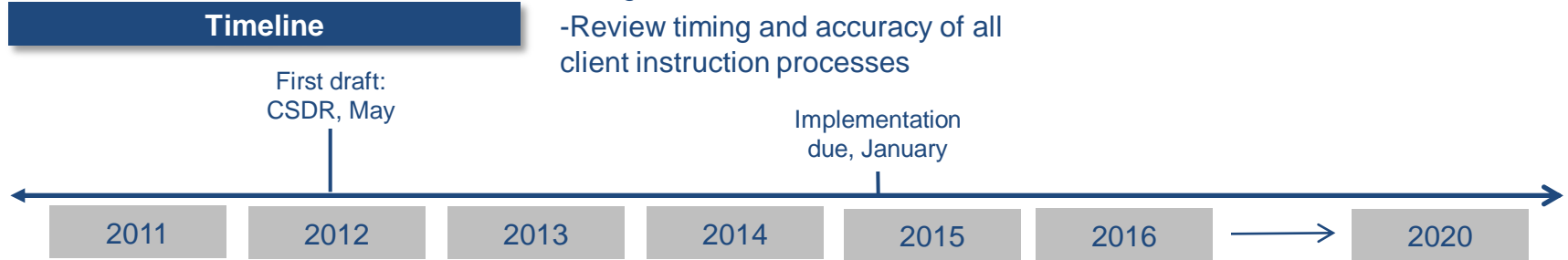
## Description: A comprehensive review of DTC settlement processing in the US equity & fixed income segment

Objectives	Client Impact	Omgeo Response
<p>Reduce risk and cost across the US market</p> <ol style="list-style-type: none"> <li>1. Enforce settlement matching for</li> <li>2. all trades</li> <li>3. Remove reclaim process</li> <li>4. Aim for T+1 processing (2020) with intermediate step of T+1 (2016)</li> <li>5. Introduce pricing incentives for SDA</li> </ol>	<p>The US market will need to create a Trade-Date Environment (TDE) incorporating SDA rates above 90% for T+2 and close to 100% for T+1</p> <p>The industry enablers to achieve TDE are:</p> <ul style="list-style-type: none"> <li>• Migration to trade-date central matching</li> <li>• Settlement Matching: all trades must be matched prior to settlement</li> <li>• Cross-industry SSI solution</li> <li>• A regulatory mandate</li> </ul>	<p>Focused on SSC enablers:</p> <ol style="list-style-type: none"> <li>1. How the US market can create a trade date environment?</li> <li>2. How the US can achieve SDA levels above 90% (currently 47-48%)? → detailed analysis on-going</li> <li>3. Delivering industry outreach program to clients, partners, trade associations, media, etc.</li> </ol>



**Description: CSDR is a European Union Regulation which will apply in all 27 EU member states.**

Objectives	Client Impact	Omgeo Response
<ol style="list-style-type: none"> <li>1. Harmonization of CSD operational and risk processes, ahead of T2S effort</li> <li>2. Competition between CSDs</li> <li>3. T+2 and settlement discipline</li> </ol>	<p>Enhance TDE, with SDA rates 90%+</p> <p><i>Buy-side</i></p> <ul style="list-style-type: none"> <li>-Migrate from batch/end of day processing to real/near-real time</li> <li>-Review accuracy, completeness SSIs</li> <li>-Review manual middle-office processes</li> </ul> <p><i>Broker/Dealers</i></p> <ul style="list-style-type: none"> <li>-Implement TDE (which is prevalent but not universally adopted today)</li> </ul> <p><i>Custodians</i></p> <ul style="list-style-type: none"> <li>- Implement new market cut-off timings</li> <li>-Review timing and accuracy of all client instruction processes</li> </ul>	<ol style="list-style-type: none"> <li>1. Full engagement with various stakeholders re: practical steps needed to achieve a smooth transition to T+2</li> <li>2. Extensive educational work with European Commission staff</li> <li>3. Partnership with AFME and other trade associations to assist the development of an industry plan to address implementation issues</li> </ol>



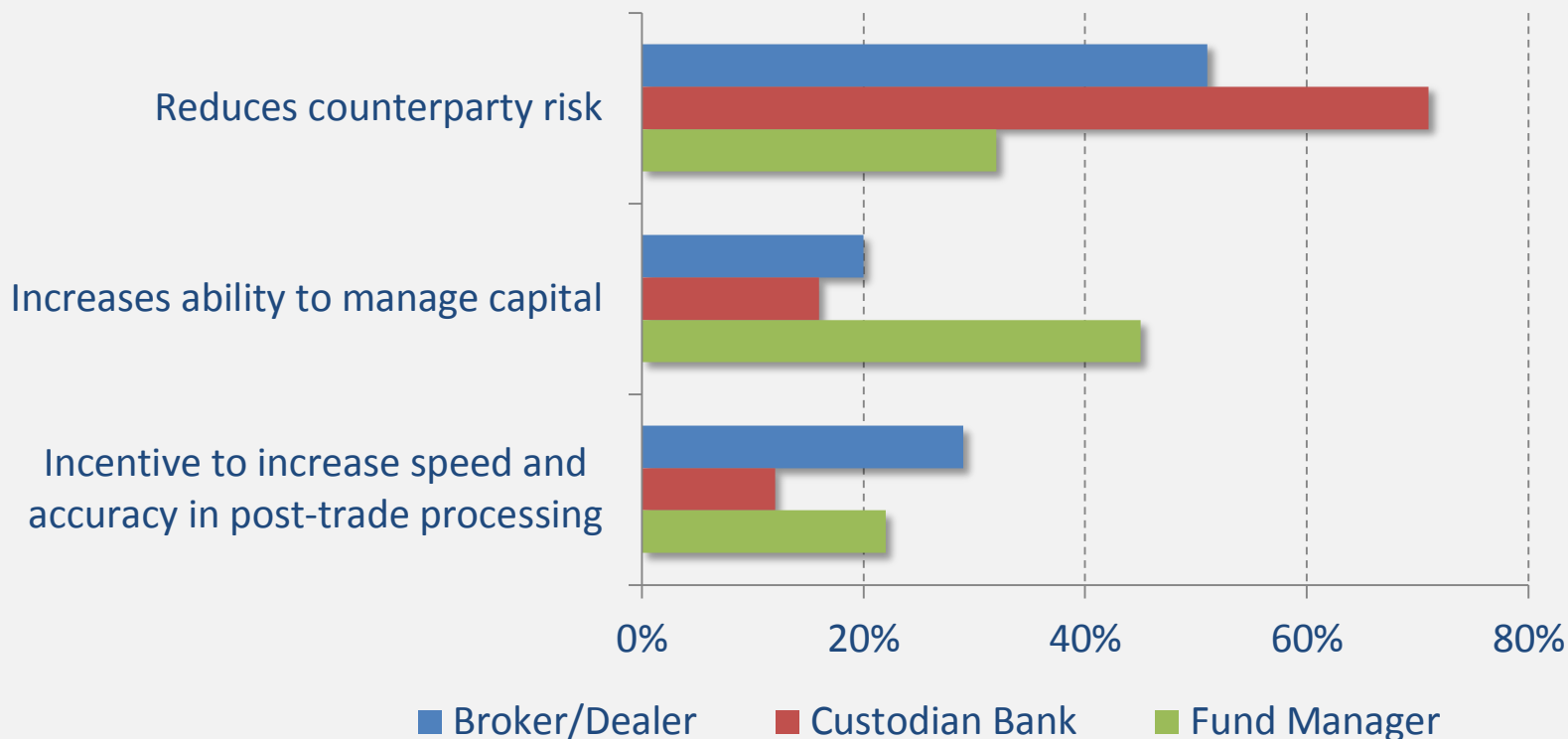
## Drivers behind the change

- Industry's change in priorities post-GFC
- Focus on risk reduction
  - Dealer-to-client trades are uncollateralized and unguaranteed
  - Risk in these trades is a function of time and volatility
- Increased attention on inefficiencies
  - “Do more with less” environment
  - Lack of standardization and harmonization across markets and asset classes



## Benefits of shortening the settlement cycle

What is the most important benefit of shorter settlement cycles?

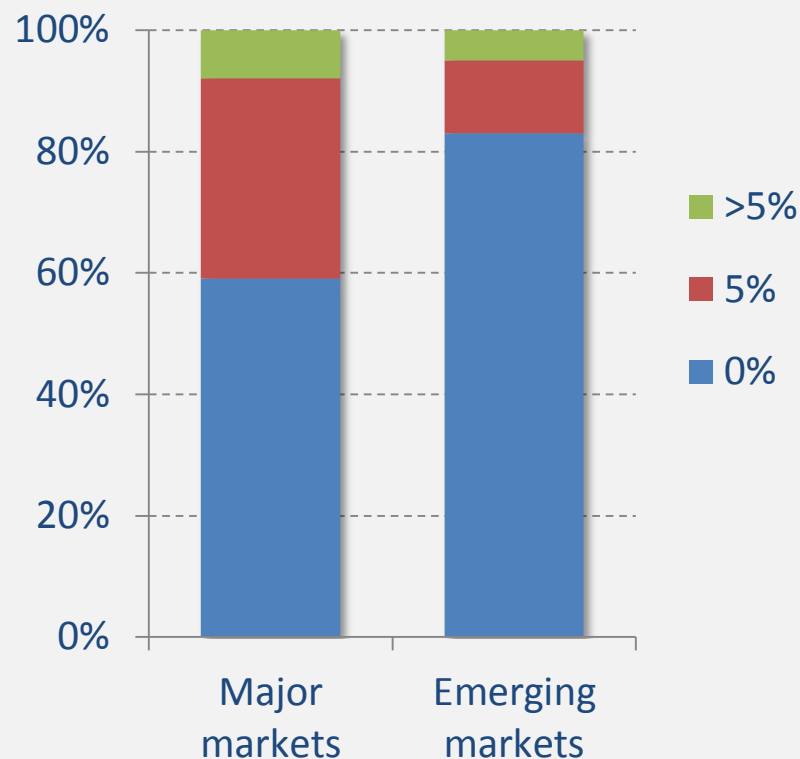


Source: Omgeo whitepaper "Preparing for T+2 Settlement" November 2012

## Yes, there is still risk in failed trades!

- Indeed, some trades still fail to settle on time:
  - 2.8% of equity trades
  - 1.5% of fixed income trades
- ~US\$976 Bil in equity trades and \$308 Bil in fixed income trades is at risk annually
- Annual cost for these fails could be as high as:
  - \$2.9 Bil for equities
  - \$925 Mil for fixed income

Percentage of trades that fail to settle on time



Source: Global Custodian annual survey of Agent banks

## Markets with the highest failure rates

Best performing Major Markets...	Market	Equity	Fixed Income
	France	0%	0%
	Korea	0%	0%
	Greece	1%	0%
	Australia	1%	0.5%
	New Zealand	2%	1%

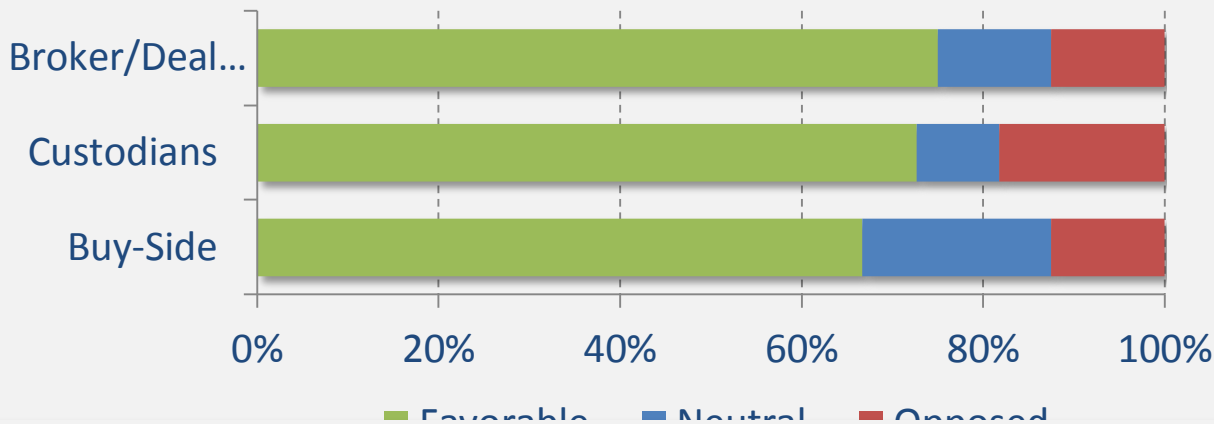
  

<i>Worst</i> performing Major Markets...	Market	Equity	Fixed Income
	Portugal	10%	5%
	Israel	7.5%	7%
	Austria	4%	4.3%
	Germany	5%	0%
	Nordics	5%	0%

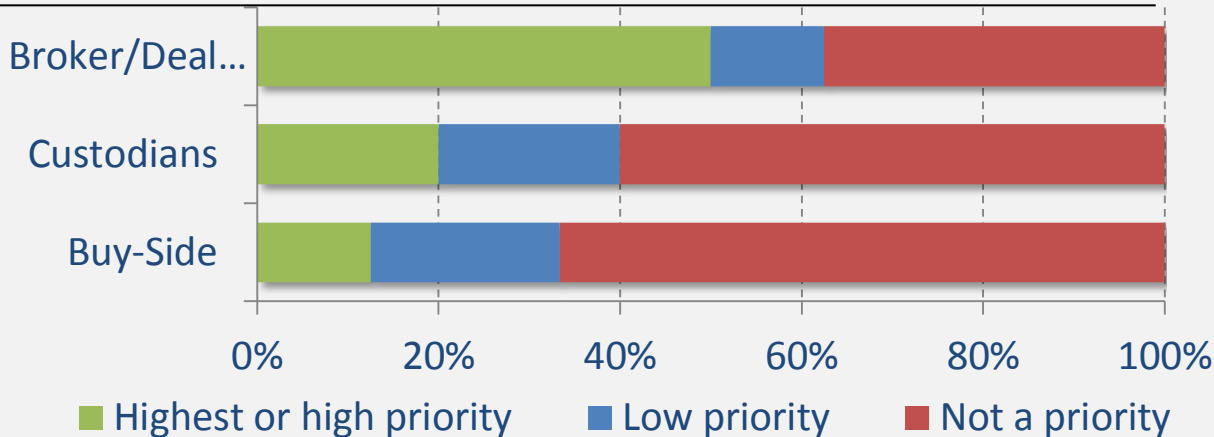
Source: Global Custodian annual survey of Agent banks

## Is the industry really interested?

Overall, 68% of firms surveyed by BCG favor a shorter settlement cycle for the U.S.

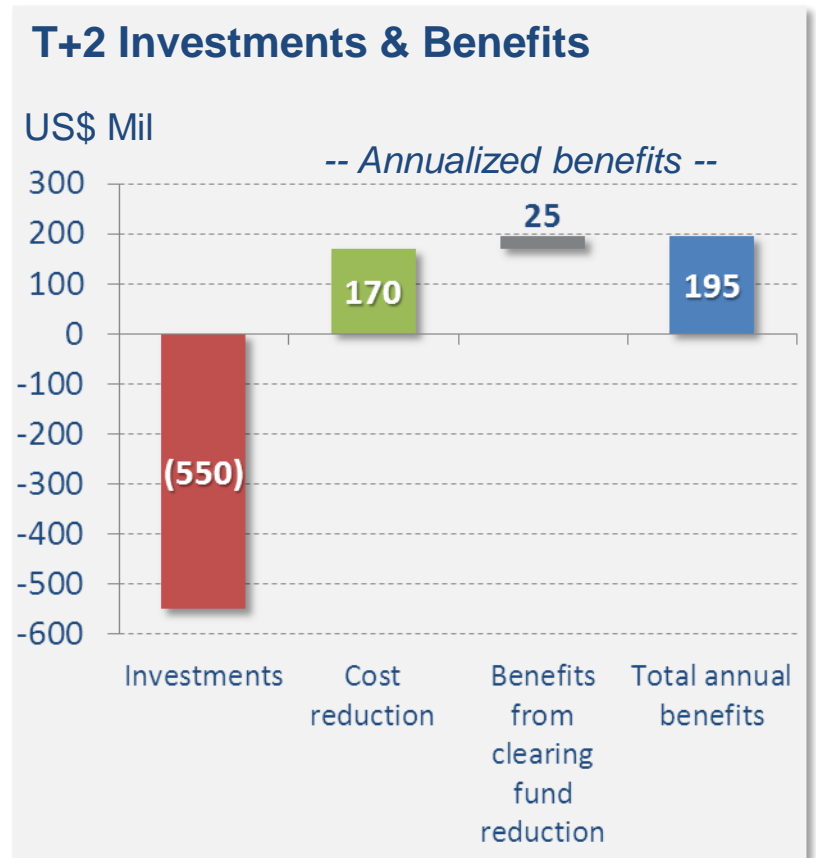


... and 27% consider this a top priority



## Potential benefits of T+2

- For B/Ds and Custodians, counterparty risk reduction
  - BCG est. \$200M in reduced loss exposure
- For IMs, freeing up capital, cost reduction
- Benefits from clearing fund reduction
- Suggests a ROI of ~3yrs



## Costs and challenges of T+2

	Avg. Investments	Examples
Inst'l B/D	Up to \$4.5M for large firms	<ul style="list-style-type: none"> <li>• Analysis and testing</li> <li>• Systems changes</li> <li>• Controls on inventory mgmt.</li> </ul>
Retail B/D	Up to \$4M for large firms	<ul style="list-style-type: none"> <li>• Analysis and testing</li> <li>• Systems changes</li> </ul>
Buy-Side	Up to \$1M for large firms	<ul style="list-style-type: none"> <li>• B/D interface enhancements</li> <li>• Process redesign</li> </ul>
Custodian	Up to \$4M for large firms	<ul style="list-style-type: none"> <li>• Interface enhancements</li> <li>• Standardize data formats</li> </ul>
Industry Total	~ \$550 M	

Source: Boston Consulting Group, October 2012

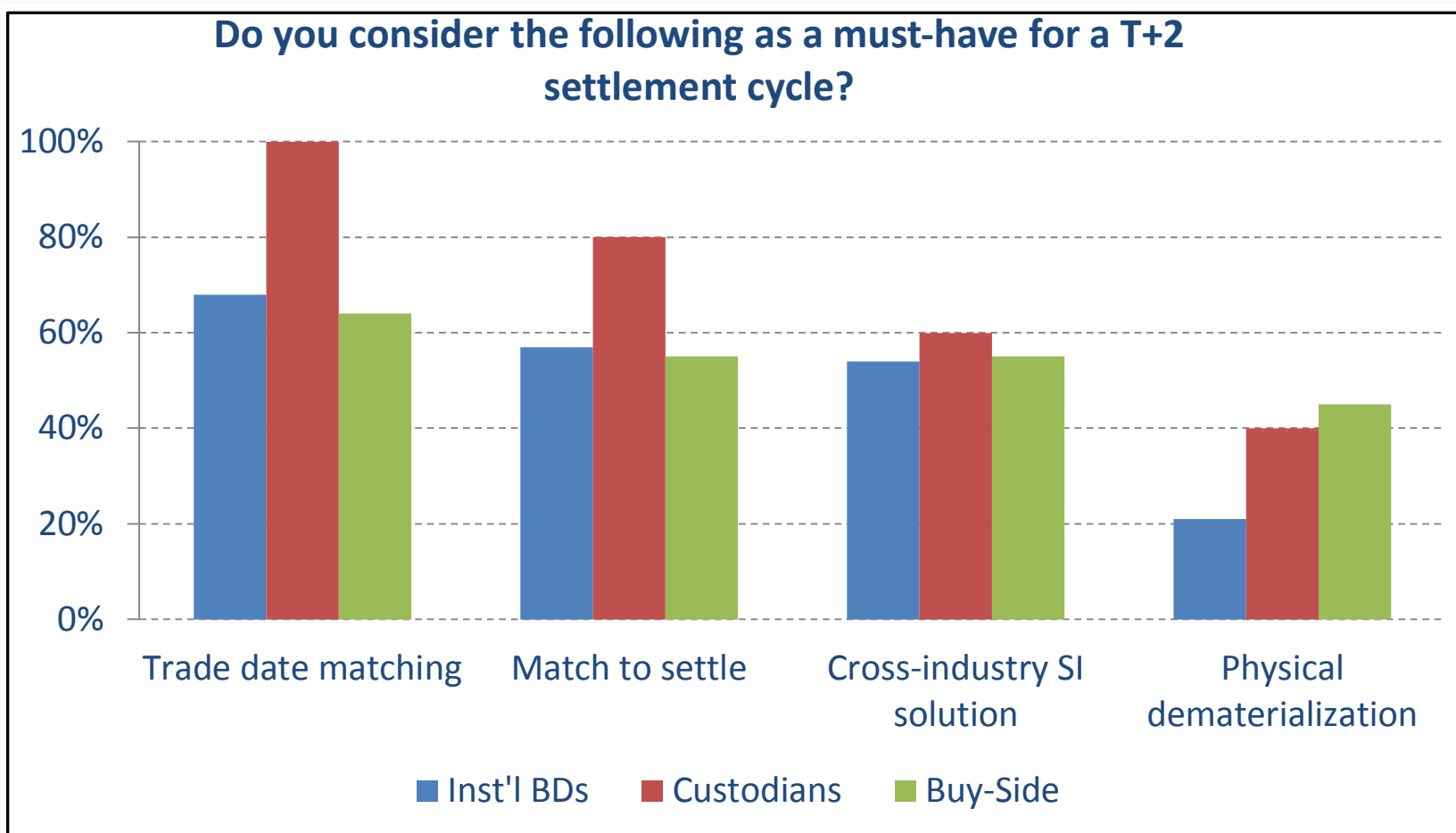
## Enablers of shortened settlement cycles

- 1. Migration to trade date matching**
- 2. Mandated match to settle**
- 3. Cross-industry SI solution**
- 4. Dematerialization of physicals**
- 5. “Access equals delivery” for all products**
- 6. Compress timeframes / rule changes**
7. Infrastructure for near real-time processing (no batch processing!)
8. Transformed securities lending processes
9. Transformed foreign buyer processes

Additional elements:

- Increased penalties for fails
- Retail funding acceleration

## Which enablers are must-haves?



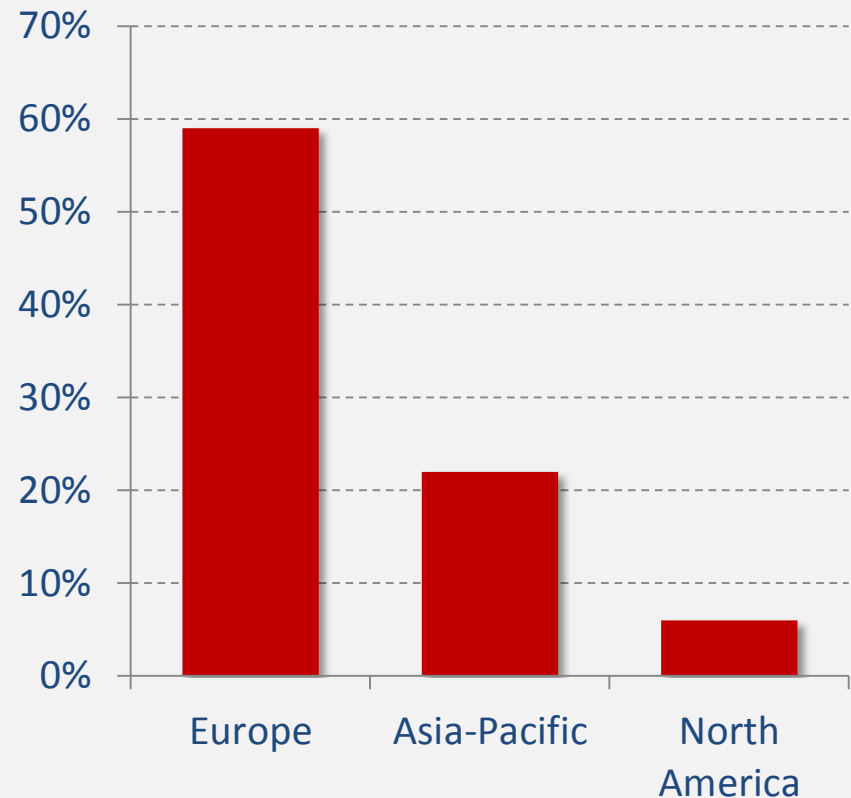
Source: Boston Consulting Group, October 2012



## But SSC awareness is not high globally

- Awareness is highest in Europe, for obvious reasons (T2S, CSDF)
- Awareness is relatively high in Asia-Pacific
- But awareness in North America is negligible!

Industry awareness of the case for shortening settlement cycles

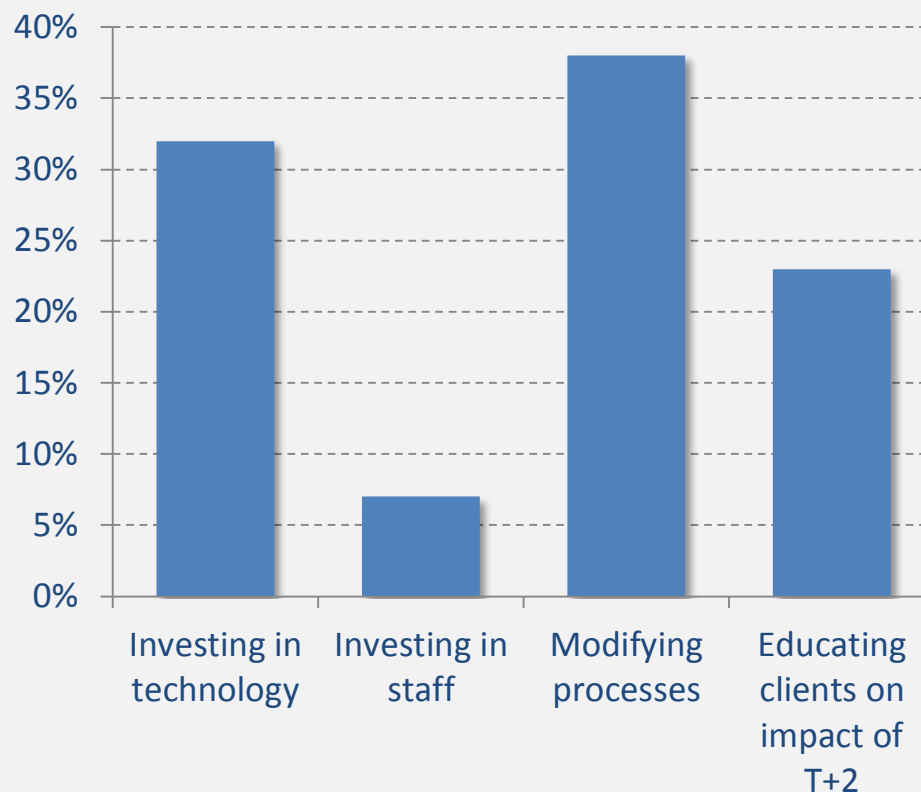


Source: Omgeo whitepaper "Preparing for T+2 Settlement" November 2012

## So is the industry ready?

- 62% of firms believe they are “ready” for T+2
- 10% of firms in Europe do not expect to be ready for at least 2 years
- 50% of firms are doing **nothing** to prepare for T+2

Preparations Being Made for T+2



Source: Omgeo whitepaper “Preparing for T+2 Settlement” November 2012

## Questions?



### Resources:

“The Road to Shorter Settlement Cycles” - <http://www.omgeo.com/ssc>

“Preparing for T+2 Settlement” - <http://www.omgeo.com/tplus2>

“How to Make Settlement More Efficient and Less Risky” - <http://www.omgeo.com/settlementpaper>

BCG Whitepaper - [http://dtcc.com/downloads/leadership/whitepapers/BCG\\_2012.pdf](http://dtcc.com/downloads/leadership/whitepapers/BCG_2012.pdf)