

# T+2 SETTLEMENT

Following the 2008 global financial crisis, the industry increased its focus on reducing risk, achieving greater transparency and improving efficiency in order to establish a safer market environment. As a result, markets across the globe have transitioned, or are in the process of transitioning, to a T+2 (trade date plus two days) settlement cycle. Many of the European Union (EU) member states, Hong Kong, Australia and New Zealand have already made the transition; the U.S. and Canada anticipate migration to T+2 in September 2017.

## **OVERVIEW**

Central Securities Depositories (CSDs) are systemically important infrastructures in modern securities markets, performing crucial services to support the registration, safekeeping and settlement of securities. Through the operation of securities settlement systems, CSDs perform a critical role in carrying out the safe and efficient transfer of securities.

The Depository Trust Company (DTC) is a CSD in the U.S. market providing settlement services for most of the equity, corporate debt and municipal debt trades transacted on the New York Stock Exchange, NASDAQ, regional exchanges and electronic communication networks (ECNs) in the U.S.

The aftermath of the 2008 financial crisis and more recent industry problems brought into greater focus the risks and inefficiencies in post-trade processes. In response to this, the DTC commissioned an independent study to analyze the costs, benefits, opportunities and challenges associated with shortening the settlement cycle in the U.S. market to T+1 or T+2. This study confirmed the risk reduction benefits, operational efficiencies and feasibility of a move to T+2 settlement for equities, corporate bonds, municipal bonds and unit investment trusts.

Following the 2012 study, industry groups expressed strong support for a move to T+2, and partnered to establish the Industry Steering Committee (ISC) to

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oversee the T+2 settlement cycle initiative. The ISC is co-chaired by the Securities Industry and Financial Markets Association (SIFMA) and Investment Company Institute (ICI). The ISC oversees the Industry Working Group (IWG) and Sub-Working Groups (SWGs). These groups were responsible for assessing the scope, requirements and changes needed to facilitate the implementation of T+2. The information gathered by the SWGs was summarized in the June 2015 white paper, "Shortening the Settlement Cycle: The Move to T+2."

Since publishing this paper, the ISC has established various working groups to assist industry participants in preparation for a move to T+2, and has worked closely with the regulators to ensure the necessary rule changes are made. In June 2016, the ISC recommended that the move to shorten the settlement cycle occur on September 5, 2017.

### WHAT ARE THE BENEFITS?

Shortening the settlement cycle is expected to yield the following benefits for the industry and market participants:

- Reduced credit and counterparty risk
- Operational process improvements
- Cash deployment efficiencies
- Increased market liquidity
- Lower collateral requirements
- Enhanced global settlement harmonization

### KEY CONSIDERATIONS

As a global provider covering multiple markets already operating within a T+2 environment, Northern Trust is ready to support the shortened settlement cycle. In preparation for the move, it is important for clients to consider the following:

- Under the new shortened settlement cycle, trade allocations, confirmations and affirmations should be completed electronically and as early as possible in the trade lifecycle (ideally on the trade date) using standardized industry tools, messaging or protocols
- Complete and accurate trade instructions should be provided to Northern Trust as soon as possible to allow for early pre-matching and exception handling prior to the settlement date
- On September 5, 2017, as transactions executed on two separate trading days will be settled, clients are encouraged to adequately plan their liquidity requirements as early as possible due to exceptional settlement volume
- Securities on loan or used as collateral will need to be recoverable in sufficient time to enable T+2 settlement of any subsequent sale trades
- Foreign exchange spot trades follow a T+2 settlement cycle; these trades will need to be placed on trade date (T+0) within the same time zone of the associated securities trade to ensure the delivery of the purchased currency without the need to borrow and manage incoming cash

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- For dividends and all other types of distributions, the relationship between ex-date and record date will be reduced by one business day

### FUND SETTLEMENT CYCLE CHANGES

- Many investment managers are reconsidering their fund settlement cycle to more closely align market and fund settlement, preventing any performance or funding drag associated with being out of the market
- Clients considering changing the settlement periods of their funds should discuss the implications with Northern Trust at an early stage to ensure the impacts can be assessed in the context of their business model
- To assess implications, a number of factors will be considered including, distribution channels, investor notification mechanisms and intra-day funding requirements
- Northern Trust requests a minimum of one-month notice for any settlement cycle change; a 60-day notice period may apply for investor notification
- As funds may be forced to move to T+2, there will be additional considerations for exchange-traded fund clients

### NORTHERN TRUST'S RESPONSE

Northern Trust supports the global efforts to harmonize settlement cycles and has assessed potential systems and processes impacts at each step of the trade lifecycle—pre-trade, trade date, post-trade, settlement date and post-settlement. Leveraging the T+2 Implementation Playbook as a baseline, Northern Trust's corresponding impact assessment activities include:

- Create execution plan and testing strategy
- Work with vendors and other external stakeholders to prepare for changes
- Secure budget and resources needed to make desired changes
- Assess changes needed to systems and processes; identify upstream and downstream dependencies
- Create inventory of impacted systems
- Identify processes and functional areas impacted by the move
- Create program and implement governance

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### LEARN MORE

Clients should contact their relationship manager for additional information about T+2 Settlement.

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