Xceptor

Improve post-trade efficiency

Prepare your company for T+1

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1. Introduction

It has been widely claimed that the move to T+1 will reduce the available post-trade processing time by 50%.

However, the Association of Financial Markets in Europe (AFME) estimates a reduction of approximately 83%. Settlements teams will only have two core business hours between the end of the trading window and the start of the settlement window, compared to 12 core business hours under T+2.

This will present challenges for all market participants from sell-side and buy-side institutions through to custodians and fund administrators. The transition to T+1 can only be achieved by making large-scale modifications to infrastructure, systems and established behaviors.

Whilst many European and Asian financial institutions might feel that T+1 impacts will be limited, not only are there specific challenges to this part of the world but also early signs that the UK and Europe will follow suit in the not-too-distant future. In December 2022 the UK Chancellor launched the Accelerated Settlement Taskforce to explore the potential for faster settlement of trades in the UK, whilst AFME has established a Europe-wide industry taskforce to assess whether Europe should follow the US in moving to shorter settlement cycles and if so, how and when this should happen. Although Europe might not adopt T+1 for another few years, the regional high level of settlement trade failure could be reduced by implementing some of the same efficiency tweaks. According to a European Securities and Markets Authority (ESMA) study, equity settlement fails reached 12% three times between November 2020 and June 2021 (but this is still below the pre-pandemic highs of 14%).

In this e-book we will consider what financial institutions can do to prepare adequately for T+1, focusing on particularly challenging areas, and how these can best be addressed.

*Xceptor survey Q1 2023 From H1 2024, all US and Canadian securities trades will be required to settle one day after trading (T+1). Market participants will need to demonstrate their readiness for T+1 by Q3 2023. Missing this deadline risks reputational damage and the loss of business to financial institutions which are better prepared. Financial institutions should already have completed a review of trade processes and operating models which will be impacted by T+1 and embarked on a programme of building, testing and refining.

43%

of companies say they have not yet started preparing for T+1 settlement*

46%

of companies say internal technology is their biggest challenge*

37%

of companies say manual/sub-optimal processes are the biggest threat to a successful migration to T+1*

2. What does T+1 mean for the industry?

The high volumes and volatility levels experienced during the global pandemic focused the industry's attention on the risks associated with the present T+2 settlement cycle for US securities.

Settlement of corporate bonds, mutual funds, equities, security-based swaps, Unit Investment Trusts (UIT), Exchange Traded Funds (ETF), American Depositary Receipts (ADR), and share options will all fall under the scope of T+1.

T+1 is not without its challenges.

Firstly, with foreign exchange (FX) transactions traditionally settling on a T+2 basis, the process of purchasing US securities from overseas becomes more complex. The transaction will either need to be prefunded with US Dollars (USD), or a short-dated T+1 FX settlement will need to be put in place. Prefunding could impact other investments, since customers will need to sell a day earlier to have the USD available.

Secondly, whilst international markets will maintain T+2 settlement, the US market, which is last to close, will settle T+1. Cross-border transactions will operate across two different settlement cycles resulting in further operational risk and staff pressure.

However, T+1 is widely agreed to be beneficial to the industry.

The main benefits of moving to a T+1 cycle are the reduction of risk and the increase in capital and operational efficiencies which will come about as a result of upgrading infrastructure and standardizing industry processes.

A primary advantage will be the increased accuracy of settlements. It's currently widely accepted that between 5% and 10% of all trades fail. As the timespan between trade execution and settlement is reduced and automation becomes a necessity, the likelihood of errors caused by manual intervention will be eliminated.

An expedited settlement time will also allow investors to receive their funds more quickly. With the floodgates opened to increased liquidity and arbitrage opportunities, new cohorts of investors will be drawn in by this optimized, automated process.

T+1 will also see margin requirements reduced, leading to more efficient collateral management and a reduction in liquidity usage.

3. What do you need to do?

Asset managers and financial institutions should have begun their analysis of the impact of T+1 in 2022.

If they have not already started, they should now begin reviewing their trade processes and operating models as a matter of urgency. Doing so will prepare them for the test phases recommended for autumn 2023 while enhancing readiness for the run-up to implementation in May 2024.

2022–2023
Impact analysis; set budgets, secure management buy-in

2023
Build, implement changes, testing, optimize

2024
Final testing for go-live on March 31

As part of these preparations, it will be critical to work closely with technology partners who can roll out digital solutions and ensure real-time access to data on processing throughput. With these tools, post-trade processes can be optimized to help get ahead of the compressed timeframes.

For sophisticated companies, 80% of the T+1 challenge may already be within grasp. However, to operate in shortened cycles and cope with the expected volume increases following T+1 implementation, questions of scale and robustness remain, even if initial foundations are in place.

If T+1 proves successful, there can be little doubt that costs to trade will reduce, leading to an increase in volumes and associated post-trade ramifications.

It is the remaining 20% of the T+1 challenge that is likely to prove the biggest hurdle. Financial institutions will be challenged to automate areas where established T+2 environments are firmly entrenched and are wrapped in legacy, sub-optimal processes, and outmoded working practices.

Bringing in the forensics

Against the backdrop of these fundamental changes, specific tasks, actions, and processes will be unsettled by the move to T+1. Knowing which face the most significant disruption will help financial institutions build a more comprehensive strategy to optimise their post-trade operation.

Ahead of the H1 2024 implementation, financial institutions must ready themselves for a raft of changes that will affect trade allocations, affirmations, and confirmation turnaround times.

Still embedded in this trade flow are non-standard practices. The communication of allocations via fax and email, affirmations delayed through a lack of crucial settlement information, and confirmations waiting, or unfinished, based on incomplete data.

A compressed timeframe means operational considerations for all financial institutions functioning in European securities markets, and investors from other regions, as time zone differences will impact same-day matching processes.

In short, the time to communicate and resolve any breaks or exceptions will reduce.

The sobering effect

The shortened settlement cycle will force less efficient financial institutions to automate manual processes and upgrade trading technology to meet T+1's increased demands and constrained timelines.

This widespread automation will benefit the wider market as it's likely to ripple across the industry reducing operational risk while increasing productivity.

Focusing on the 20% inefficiencies will naturally result in eliminating sub-optimal or redundant processes, saving time, reducing errors, and decreasing trading costs.

The exponential market impact of everyone being a bit more efficient and greater standardization of industry practices should not be underestimated.

Inevitably, such far-reaching transformation puts pressure on resources and ramps up compliance costs. Moreover, the risk of positions failing to settle in time – or at all – could result in losses, reputational damage and the failure to secure highly sought-after client orders the next time around.

4. Core pain points in the trade lifecycle

T+1 will have an operational impact on all market participants, altering the way that business is done across many products and processes.

Speed will be of the essence, with operations teams needing to standardize and normalize processes, eliminating manual procedures and shifting to technology which can support the various stages of the trade lifecycle on an almost 24/7 basis. 'Trusted data' will be key to ensuring efficient and unbroken workflows.

Customer lifecycle

- Account opening
- Credit checks
- Account / sub-account SSI
- Outreach (re-papering)

Trade lifecycle

- Securities lending
- Securities financing
- Collateral margin management
- Trade validation
- Trade repair
- Trade enrichment
- Trade affirmation
- Trade confirmation
- Trade matching
- Trade integrity
- Allocations

Post-trade

- Trade clearing / settlement
- Funding management
- Balance sheet management
- FX cross border funding
- Reconciliations
- Fees & expense management
- Trade netting for settlement
- Corporate actions
- Physical securities

Reporting

- Regulatory reporting
- Transaction reporting
- Client reporting

Key: Highly impacted by settlement window compression · Medium impact · Marginal impact expected

4.1 Customer onboarding

Customer onboarding can be a lengthy inefficient task involving a plethora of manual processes and a disparate number of teams throughout an organization.

The excessive length of time and poor experience received by customers, in what can be their first exposure to the organization, can lead to sourcing services elsewhere.

In a 2022 report[1], McKinsey suggests that corporate customers care most about having access to streamlined digital onboarding processes which are fast, transparent and data-driven. In response, banks are committed to adding digital functionality to the onboarding process. 80% of banks surveyed said that they offer the electronic signing of documents, whilst half said they allow clients to apply for multiple products at the same time. A further 25% said that they would be implementing this capability within 12 months.

In the short to medium term, provision of a portal or similar smart client interface and end-to-end workflow were the top investment priorities for 86% of banks surveyed.

Bringing the onboarding journey into a singular platform drastically reduces manual input and speeds up the process, improving the customer experience from relationship management through to account opening.

Common customer onboarding problems

It may be that an account has completed onboarding detail and provided all settlement references and instructions for a particular asset class, but trades in another approved asset class require additional account reference data. Often this calls for manual intervention in the form of an email to the customer or representatives, manually capturing data, and manually updating the account static.

Another common issue surrounds the creation of an additional clone sub-account. The new sub-account is provided by the trading company as an allocation reference but the account opening procedure has not completed. The automatic highlighting of this exception type, and then targeting of it to the correct team for quick remediation, is key to ensuring T+1 settlement.

The customer communication and response can be automatically generated, captured, and used both to enrich the trade and update other internal and third-party systems.

[1] Winning corporate clients with great onboarding | McKinsey

Eight steps to successful customer onboarding

1

Capture
requests automatically from portal or email

2

Manage
exceptions in centralized work queues

3

Extract
necessary information from customer documents

4

Request
further documentation, generate and prepopulate documents

5

Connect
to internal and third-party reference data sources

6

Feed
data directly into downstream systems

7

Validate
and enrich information provided by customers

8

Monitor
SLAs via dashboards and reports

4.2 Account opening

A major impact to capital markets infrastructures by moving to T+1 will be the reduced time for remediating sub-optimal account onboarding and account and sub-account opening processes.

With significant legislation and regulatory obligations around initial account opening, the process is likely to be fully completed pre-trade and prior to execution of the first order. However, there are elements of the account-held static data which, if not in place, may impact the full and complete settlement process.

The move from T+2 to T+1 will mean many of these missing or incomplete elements will have to be remediated within the trading day or risk a settlement fail. This may increase risk exposure and create potential economic impact for participants through penalties or fines.

All steps of account opening can be generally improved through automation of non-formatted customer requests. Where deployed, automation of these flows can be used to enhance existing validation, exception identification, and remediation management.

> Our clients have experienced a 50% reduction in account opening time.

4.3 Trade management

The benefits enjoyed in the move from the T+3 settlement cycle to T+2 resulted in an increase in operational efficiencies and better coordination across market participants supported by changes in technology, communications, legal and compliance groups.

A similar level of appetite for change will be required to successfully migrate from T+2 to the T+1 settlement cycle.

Analysis should look to capture current trade volumes, fail rates, allocation rates, and affirmation rates. This can be used to review system-to-system data flow and the remediation employed. Metrics provide a baseline from which automation of non-straight through processes (STP), and the wider operational performance, can be measured and improvements evaluated.

Faster allocations and affirmation processing

Often, the affirmation and confirmation process begins after trades have been fully allocated at an account level. This allocation process causes delays as a considerable number of them are received in sub-optimal formats such as free text in email, Excel, Dropbox or STP.

Currently many allocations are processed after market close. This is less of an issue as in T+2 the current affirmation deadline is 11:30 ET. The affirmation cut-off in T+1 is likely to be around 21:00 ET on T0. Therefore, a T+1 settlement cycle will compress allocation timeframes, raising trade break numbers if they are not completed promptly.

Updating legacy technology systems and processes

Legacy processes and system performance throughout the transaction lifecycle should be reviewed, to improve efficiency and increase automated processing rates for allocations and affirmations.

Financial institutions should consider deploying technology solutions, and reviewing the messaging protocols used by systems, to drive out inefficiencies and achieve a higher STP rate.

When assessing readiness for the move to T+1:

1. Determine the business functions with sub-optimal processes that will be affected by an accelerated settlement cycle and identify how to mitigate the impact.
2. Identify the number of tasks requiring manual intervention that occur in the current trade process.
3. Pinpoint the day-to-day operational procedures that will need to be optimized or eliminated to support a compressed timeline.
4. Identify whether existing exception management processes and systems can highlight potential fails early enough for quick, efficient escalation and remediation.

4.4 Confirmations

Traditionally confirmation processes do not begin until trades have been fully allocated with the correct SSI information populated along with other key static and delivery data.

In T+1, financial institutions must consider a more co-ordinated approach into how the affirmation and allocation processes can lead to wholesale automation of the confirmation issuance, matching and subsequent follow up activities.

The confirmations process relies heavily on the quality and availability of data positioned across the entirety of the trade booking process, including reference data, fund information, legal identifiers, product descriptions, legal texts, and regional and jurisdictional variation.

The compressed timelines will challenge confirmations teams and their existing practices. Assessing whether their current processes are suited to a T+1 settlement window.

Corporate actions

Compressed timeframes

There is concern around the reconciliation and timely settlement of trades on securities subject to corporate action. A voluntary corporate action event will need a financial institution to consume the event notice, identify and generate client entitlements, execute a reconciliation, and provide the client instructions to the Depository Trust and Clearing Corporation (DTCC) in a compressed time.

Location of inventory

Determining the location of their inventory is a significant issue facing custodians in the current settlement cycle. It is vital to daily operational processes as it feeds into the elements of each corporate action event. Migration to the T+1 settlement cycle will exacerbate these concerns.

Review and update

A financial institution's review of processes and systems performance throughout the transaction lifecycle should include the goal of improving efficiency and increase automation of the confirmation issuance and matching process.

Technology exists today to help financial institutions address the key challenges of streamlining the confirmation process, through extrapolation of the economics and non-economics, providing customer or product specific templating, routes to legal input, distinct distribution channels, and monitoring of delivery.

However, this only gets you so far. How do you know whether your customers have carried out their own due diligence? Your success in achieving T+1 settlement is a bilateral one.

Depending on the model in use, delivering the confirmation is only the initial stage in the process. The return of the confirmation and agreement to it is of equal if not more importance. Influencing your customers to respond on T+0 to allow for any amendment processes will become a challenge in this unfamiliar environment. Identifying key contacts and maintaining close relationships with the customers' operation teams will be what distinguish the company's customer services level.

In mitigation, some commentators are recommending the broader adoption of 'no-response affirmation'. However, for this to be a success, guaranteed delivery and 'proof of view' must be accomplished. This leads to a wider conversation on newer technologies like blockchain. But while some progress has been made in this area, it's not enough to achieve critical mass in time for T+1. Moreover, the tight deadline imposed for the migration does not allow for testing, roll-out and adoption of new technologies. We will have to contend with the market architecture and systems in place.

Less sophisticated customers will shun investment, and shoehorn existing processes into a more compressed timeline. Spending costly resources in reviewing, signing, and returning the confirmation via fax or email. This will lead to staff having to react fast, validate signatures against mandates, and scrutinize standard settlement instructions in a short space of time. The effects to any netting in the settlement process also require consideration.

In summary, the move to a T+1 settlement environment will be an upheaval to most confirmations' teams, especially for those products which traditionally sit around the edges of automation, where standardization has yet to be adopted. In many instances, automated market infrastructures have yet to materialize. Financial institutions should think of this as an 80/20 exercise, where 20% of processes will increasingly become a burden to their business operation if not addressed as part of this T+1 initiative.

4.5 Reconciliations

T+1 will also create new challenges in the area of reconciliations, not least in the transition from a next-day to an intra-day process. Eliminating the need for multiple, disparate processes will mean a faster, more accurate reconciliation process.

Reconciliation is essential to client satisfaction and data consistency, where multiple copies of the same trade data are maintained across your business architecture. Unfortunately, at many financial institutions it remains a laborious and time-consuming task, with teams aggregating and cleaning data before performing reconciliations manually using spreadsheets. This approach is risky, inefficient, and unsustainable and severely limits your ability to compete.

The quality and availability of the right data is key to a smooth reconciliation process.

Complexity requires a single solution

Traditional financial services reconciliations include positions, transactions, cash, and other categories that support essential components of a financial services business. There are many systems and tools to support these traditional and legacy reconciliations which process high volumes (millions of records) daily and throughout the day. In addition to standard reconciliations using fixed reconciliation tools, there are often many reconciliations to be done "offline" using spreadsheets and macros which may not make it into a larger reconciliations tool for several reasons.

Aggregating, validating, and enriching data from various external sources, particularly PDF documents, into the reconciliation process is a key challenge financial institutions continue to face. Typically, it is easy to obtain data from internal systems. However, the process of ensuring that complete data is available for the reconciliation is more challenging than the reconciliation itself.

There is little point in a reconciliation where the accuracy and integrity of the source data cannot be ascertained and demonstrated. Validating the data before it arrives in the reconciliation system is key to identifying breaches of data integrity, for example, duplicate data, missing and wrong data files.

Exception Management: non-standard reconciliations

A common challenge stems from the need to configure and run reconciliations that are not aimed at reconciling financial data. Examples include static data for financial instruments that need to be contrasted with data aggregators, regulatory reporting data matching and reconciliation and reconciling data after a system migration.

Consolidating reconciliations onto a single platform allows financial institutions to benefit from cost savings and greater functionality while achieving speed and scale.

5. Recommendation

With T+1 estimated to reduce available post-trade processing time by over 80%, there will be very little time for error-prone manual processes.

Financial institutions will need to retire legacy systems and put into place automated solutions which allow work to flow globally. Crucially, data acquisition, curation and normalization will all need to be done accurately at speed.

Financial institutions which modernize their operations and focus on the quality and integrity of their data, rather than simply relying on increased headcount in multiple geographies, will be the most successful in transitioning to T+1.

A trusted partner with industry expertise

To design an operating model that runs 80% faster, you need a technology partner who understands the complexities of capital markets.

Since 2003, Xceptor has been enabling financial institutions to automate simple to complex processes, end to end. Our deep domain knowledge and understanding of the entire trade lifecycle allows us to help financial institutions determine the changes required and assist with implementation, testing and deployment.

Without Xceptor

- Continued reliance on legacy systems and slow, manual processes
- Account opening delayed by missing or incomplete data
- Delays caused by receipt of allocations in sub-optimal formats
- Waiting or unfinished confirmations based on incomplete data
- Inefficient manual reconciliations processes

With Xceptor

- Trusted data ensures operational efficiency and resilience
- Automated extraction and capture of data in any format to accelerate account opening
- Automation of the entire confirmations process from capture through to repository
- End-to-end automation of simple and complex reconciliations
- Streamlined workflows
- Agility and scale to deal with changing market conditions

Wherever your company is on the journey to T+1, we can help you to analyse, test and implement the technology and operational changes required.

For help or guidance with transformative, automated post-trade technologies that unblock legacy processes, contact us at

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