Lessons learnt

The relative smoothness of T+1 is reflective of the industry's readiness to adapt to regulation

Gabi Mantle, head of Post-Trade Solutions at EquiLend, looks at how the lessons learnt from a move to faster settlement can help the industry as it faces changing regulation

Since 2008, almost 20 separate pieces of regulatory reform have come into force across the global financial landscape, including Dodd Frank, the Shareholder Rights Directives (SRD and SRD II), the Markets in Financial Instruments Directive (MiFID) II, and the European Market Infrastructure Regulation (EMIR). Those even more directly impactful for securities finance include the Central Securities Depositories Regulation (CSDR), the Securities Financing Transaction Regulation (SFTR), T+1, and more to come with the US Securities and Exchange Commission's (SEC's) 10c-1a and Basel III. There are many global forces challenging market participants, including inflation and global socio-economic factors, but the strongest, pervasive force remains regulation.

T+1 is the best example so far of the industry's preparedness to adapt to regulatory change. As recently as 27 months ago with the introduction of CSDR, we saw a dramatic increase overnight in so-called 'ghost borrowing' — overborrowing to ensure collateral cover. This overborrowing meant an increase in recalls and returns volumes and a squeeze in collateral, stock availability and overall liquidity, putting undue pressure on systems.

Then, the driver for the system strain was a lack of trust that automated systems could both take the strain of what were previously human processes and could calculate such requirements correctly at pace.

Against this backdrop, it was a huge positive to see such a smooth adaptation to T+1 in the days post go-live in the American markets in late May.

Lessons learned and processes developed for CSDR in 2022 gave the market confidence to embrace T+1 and ensured this smooth transition to T+1 in late May 2024 for Canada, the US, Mexico, Argentina and Jamaica. The first contraction of settlement since 2017, the timelines proposed under T+1 simply do not allow for manual intervention. The only option for market participants was to place their trust in the tech. The result was a swift rise of 176 per cent in automated recalls on the EquiLend Risk Resolution Suite. Additionally, in response to the change in returns cut-off time from 15:00 EST to 23:59 EST, firms' recalls activity adapted overnight from the usual morning and late afternoon spikes to a spread of activity across the day in line with the later recalls cut-off. There was no spike in exceptions, just a smooth switch.

With T+1 set to become the global industry standard, increasingly firms are investing in vendor tech to ensure compliance.

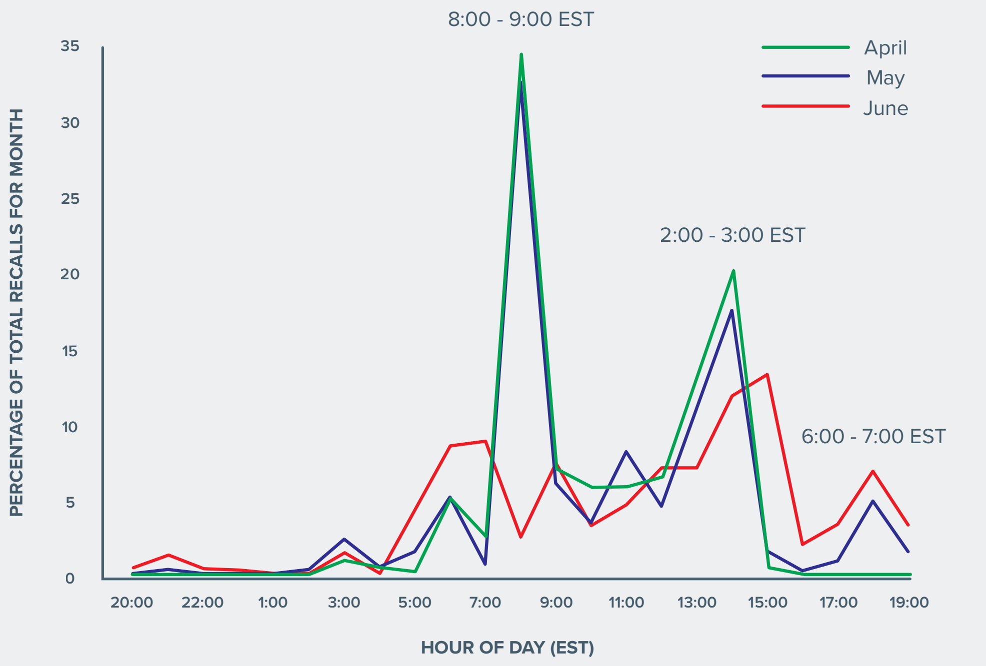
For EquiLend, automation is at our core, with wide-ranging interconnectivity across our solutions. Central to our T+1 solution is our post-trade Risk Resolution Suite (R2S), where the 176 per cent increase in recalls volumes since early May is evidence that firms have truly embraced automation.

This behaviour change, while directly related to T+1 go live, marks the true beginning of future-proofed trading behaviours which will extend beyond the regulation's impact in a single region to become commonplace globally. With regulation as a catalyst for change, the pathway to global data and reporting alignment is assured.

As we stand in early July, a month after T+1 go-live, we have seen this alignment in real-time with a marked shift in recalls behaviours as firms fall in line with the new notification cut-off of 23:59 EST, a change from 15:00 EST. Pre-T+1 we could identify two clear spikes: 08:00-09:00 EST where firms were processing recalls received after market close from the previous day, and 14:00-15:00 EST for close-of-day processing of those recalls received before market close. Immediately on T+1, firms adapted their behaviours to accommodate the new settlement regime and reduced post-execution time frame, initiating recalls as they came through.

The fundamental shift in timings depicted below shows that post-T+1, recalls are being processed during the afternoon on T+0 to allow for settlement on the T+1 due date.

Recalls received per hour



What these time and flow changes tell us more broadly is that where regulation may have initially driven the necessity for change, with greater adoption has come greater confidence in digitisation and automation. For EquiLend, that is the crux of the challenge — how to continually support our clients in the modernisation of their systems and workflows, oftentimes as dictated by regulation.

The move to T+1 was not without its challenges, but I echo what has been said by several industry representatives that preparation was key to its success. The UK government has confirmed a move to T+1 by the end of 2027, and we expect the EU to move in a similar timeframe. Looking ahead to the same shift in settlement for the UK by 2027, there are many more discussions to be had. EMEA crucially faces a number of challenges unique to the area which complicate T+1 further, including multiple clearing houses, currencies, time zones and the preference for non-cash collateral. Not only will firms need to upgrade their technology, they will also have to consider the availability of greater readily available collateral, which introduces its own risks. Firms in scope for Basel III face a similar challenge from the capital adequacy proposals based on risk-weighted averages.

Another post-trade solution, EquiLend Exposure, supports firms in identifying collateral needs and mobilising collateral quickly, but without the uptake of a cohesive end-to-end solution to address the overall market challenges of shorter settlement time, coupled with the demand for increased accuracy and ever more liquid collateral, firms will find compliance an expensive business. The true cost of regulation is in not adequately preparing for the change.

As a member of the UK Accelerated Settlement Taskforce and the EU cross-industry taskforce, I have been proactive in sharing our predictions and findings for T+1. The UK Taskforce is currently centralising the outputs from each of the subgroups here, hosted by KPMG. The committee is urging market participants to engage and share any further findings so that each region may be further prepared for T+1 in their region.

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The Taskforce Chair newsletter is also published on this site and contains valuable insight.

Regulation has changed what, why and how financial firms automate, but the pace of change has begun to outstrip any reluctance to capitulate.

It is no longer an option to underfund or resist digital transformation — in fact it is the newest frontier. Post-trade automation across the full lifecycle is rapidly becoming the standard across the globe.

Trading of the future looks very different, and even in the near future, newer forms of technology such as distributed ledger technology (DLT) with EquiLend 1Source will be the new way. Regardless of the technology itself, tech vendors are at the centre of that change, facing off to the dual needs of regulator and market participant. ■