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Why and how settlements are transforming

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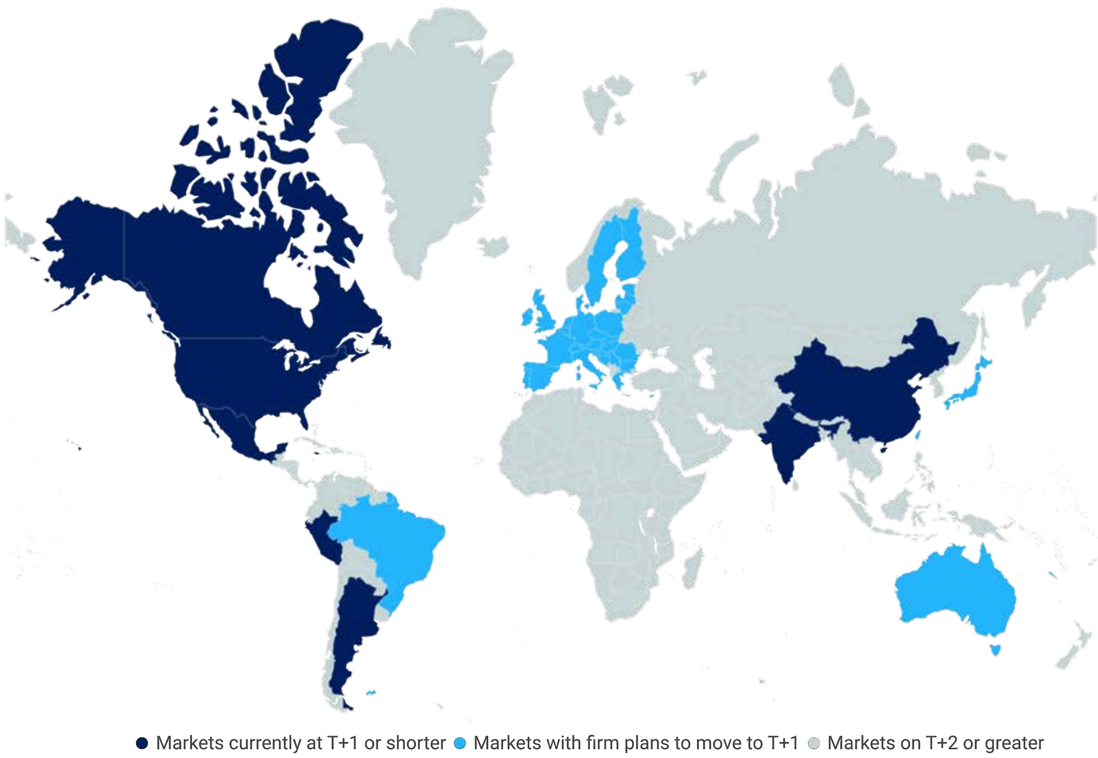
1. Introduction

Welcome to the first instalment of our four-part series exploring the evolving post-trade operating model. In this issue, we delve into the transformative changes reshaping settlement cycles globally. As markets worldwide adopt shorter settlement timeframes, understanding the drivers, challenges, and implications of these shifts is essential for market participants looking to stay ahead. Let's begin by examining the lessons learned from recent T+1 transitions and the ripple effects these changes have on operational workflows and market dynamics.

2. Accelerating settlements

Global capital markets are experiencing an era of transformation, with settlement timeframes shrinking to meet evolving regulatory demands. **In May 2024, the U.S., Canada, Argentina, and Mexico transitioned to T+1 settlement cycles, marking a significant step toward reducing counterparty risk, lowering costs, and enhancing capital efficiency.** While hailed as a success, the transition came at a high cost and fell short of delivering the operational overhaul many had envisioned.

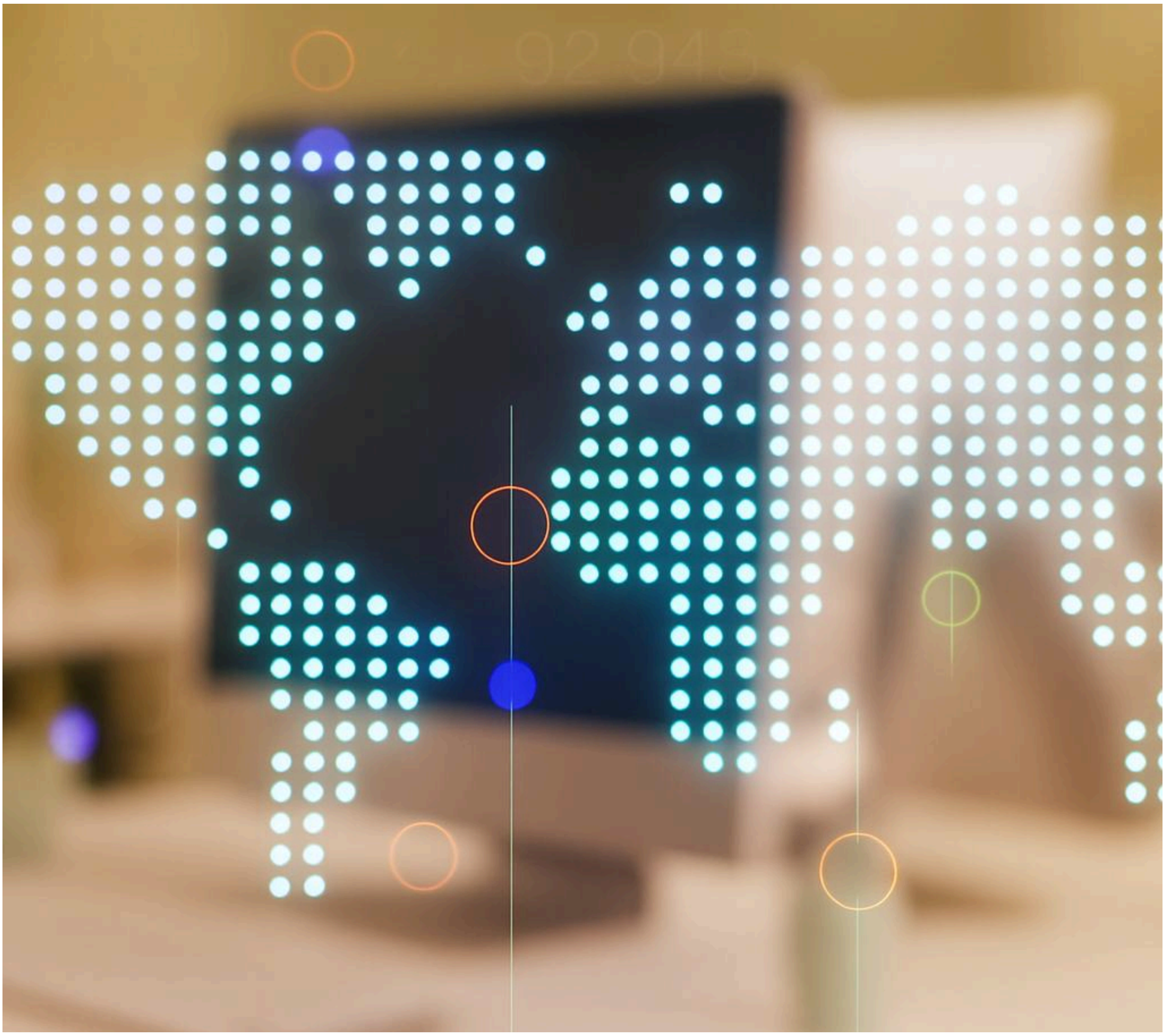
These North American implementations have significantly informed subsequent preparations, notably in the UK and EU, where detailed timelines and milestones are being established in 2025. However, they also prompt critical questions: What have we learned, and how can we apply these insights to future transitions? **The move to T+1 signals a new normal, but it is only the beginning of an ongoing transformation in global post-trade operations.**



3. Affirmations were a critical success factor

The affirmation process is unique to US markets, and getting it right proved critical to success, with 65% of firms saying affirmations were the key driver behind a successful T+1 migration. With counterparties confirming the accuracy of trade confirmation details before the cut-off time, and custodians verifying sufficient inventory and cash for settlement, the probability of overnight trade settlement significantly increased, whereas unaffirmed trades are 21% more likely to fail. Achieving this required completing affirmations on trade date, earlier in the cycle, which moved the entire process into the middle office. The resulting clarity has greatly reduced the volume of exceptions that need to be monitored by the back office on settlement date.

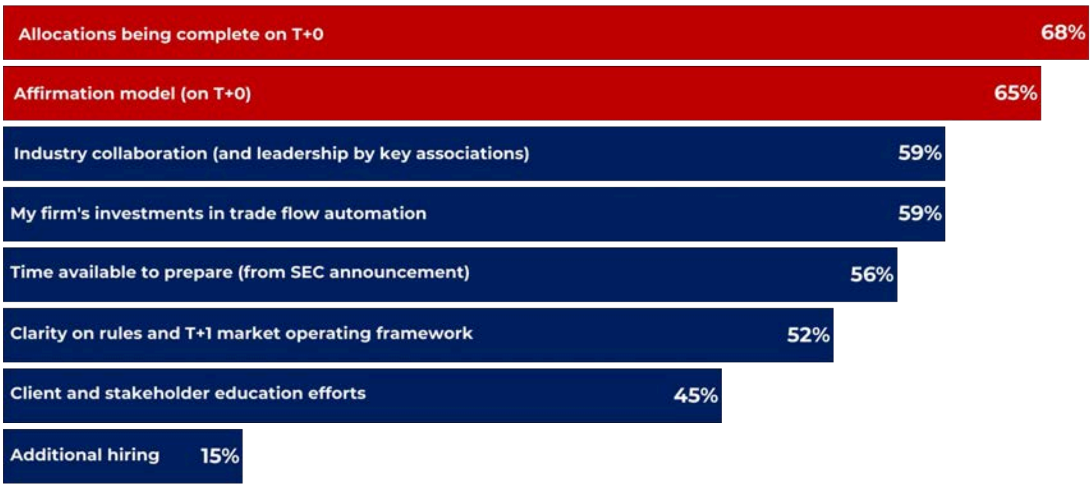
While affirmations are a T+1 success story, that success was achieved more by additional resourcing than by improved automation or better data. In fact, 15% of firms cite additional hiring as the key enabler of a smooth migration. Running a middle office is an expensive proposition, especially when a lot of the manual work is required to be completed outside of normal business hours, where staffing costs have increased by up to 20%. These higher staffing and salary costs leave room for further improvement. Furthermore, these lessons learned have limited transferability to other markets, whose processes are different. European and UK markets will need to tailor the US experience to their own workflows, such as matching, to achieve the same benefits.



4. As were T+0 allocations and confirmations

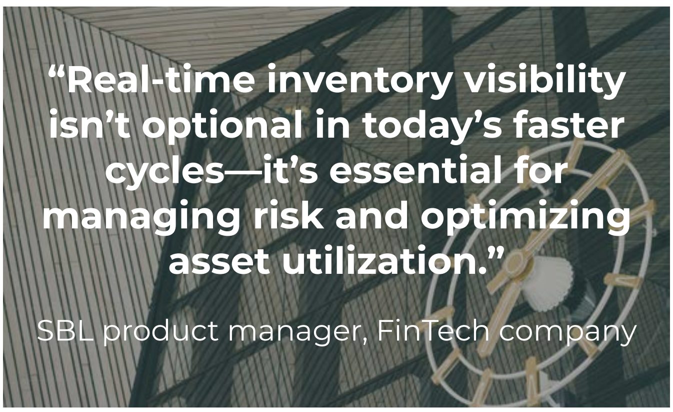
Another key enabler of a smooth transition to T+1, according to 68% of firms, was the compression of trade allocation and confirmation to take place on trade date, as soon after trade initiation as practicable, and so it's no wonder this is a priority of the UK accelerated settlement taskforce. It also aligns with recent UK survey results, where 76% of respondents highlighted T+0 as the key enabler to their planned UK T+1 transition Furthermore, recent insights show that upto 29% of UK allocations and confirmations currently occur after 23:59 GMT on T+0, emphasizing significant acceleration requirements by December 2026. Batch processing simply cannot meet these timeframes, forcing market participants to adjust their technology and communications protocols. While that occurred to some degree, the reliance on augmented staffing will eventually need to be addressed. We've seen costs rise by 20% in the US, Canada, Argentina and Mexico since T+1 adoption. Now that implementation is behind us, organizations should identify and rationalize redundant processes, make sure activities occur at the right place and time in the chain, and look at ways to more effectively utilize technology and streamline access to data and workflows.

% of respondents citing each factor as top importance in ensuring a smooth transition



Given the UK and Europe will move to T+1 in 2027, organizations would do well to dissect the lessons of 2024 and figure out how to do it better. By tailoring T+1 preparedness plans to their own operations, they can achieve broader benefits and avoid excess costs. This could include the ability to effectively decommission back-office settlement activity by more fully automating allocation, confirmation and matching on T.

5. The growing importance of real-time inventory management

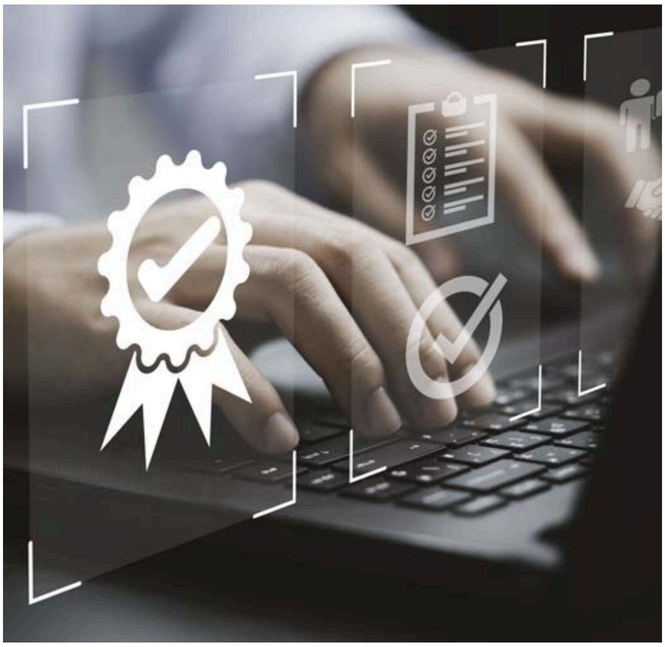


As settlement timeframes shrink, inventory management has also come into sharp focus. Lending securities or using them as collateral demands real-time insight over the assets you have available, including when assets are due back. In the U.S, where there is no market consensus on securities lending recalls deadlines, for example, organizations looking to generate value from idle assets will need to improve their ability to manage and update their inventory in real time.

6. The ripple effects: Securities lending activity has declined

While pre-implementation concerns about securities lending haven't materialized, that may not last. Without clarity on market frameworks or greater definition on recall deadlines in standard documentation, the current state of operations may not be sustainable. Presently industry recall guidelines are only being adhered to by up to 69% of firms. This may be causing a knock-on impact on volumes, with Europe reporting a 12% reduction in lending volumes and Asia an 8% reduction compared to pre-migration levels.

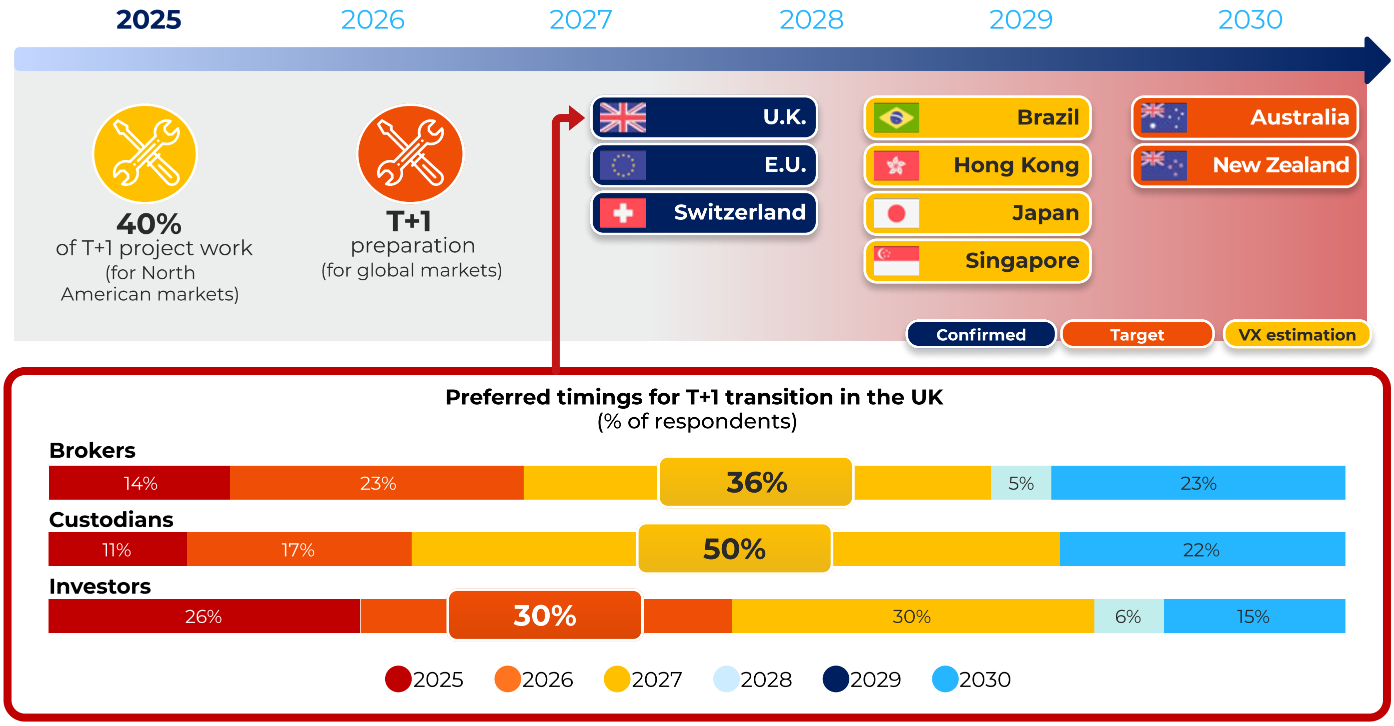
At the moment, it's functioning less because these assets are being handled more efficiently, and more because securities lending recalls are generally more of a bookkeeping than a settlement exercise. Most big brokers net their incomings and outgoings considerably, particularly for blue chips - resulting in an 80-90% netting ratio. This means only a small number of securities lending recalls end up in a settlement, and those assets are likely to be hard-to-borrow assets. That drives up the business cost and risk of borrowing and lending those assets even further.



7. And FX spreads have increased by up to 50%

All treasury movements are getting more expensive. 38% of firms are now executing gross FX during the trading day as opposed to the end of the trading day, and as such have seen FX spreads increase by as much as 50%. Shortened settlement timeframes mean that the moment a buy/sell equity order is placed, a corresponding FX message for that trade must be sent. This effectively rewires the FX process, which previously relied on one net settlement on FX at the end of the day. Unfortunately, there are few systems that can automatically handle constant FX transactions or provide STP, and the risk of manual processes is substantial. If someone forgets to initiate the FX or makes a mistake, the consequences are high.

8. 2027: A global convergence towards T+1



Momentum is building toward a universal T+1 standard. Given that the UK Accelerated Settlement Taskforce has outlined specific targets, with allocations and confirmations moving to T+0 by December 2026, and full T+1 compliance by October 2027, and with the EU widely expected to follow suit, the focus has sharpened significantly. **Meanwhile, markets across Asia, South America, and Australia are also advancing plans**, drawing lessons from North America's implementation. However, the path to T+1 is not one-size-fits-all: While learnings from North America are undeniably helpful, the lessons cannot simply be transferred and applied. These markets face disparate challenges, from multiple CSDs to different regulations.

- The EU is not a single market: European markets remain diverse despite common platforms like Target2-Securities, with a trading, clearing and settlement environment that involves a number of different central counterparties and central securities depositories.

- Regulations like CSDR will significantly impact the implementation of T+1, as there's less flexibility for trades to fail. In the US, failed trades are a balance sheet cost. Under CSDR, however, cash penalties are imposed on the failing participant for every business day a transaction remains outstanding.

As implementations continue, global organizations will be challenged to adapt to the complexities of multi-polar T+1. This will likely require rethinking the follow-the-sun models currently used in order to operate nimbly and flexibly in a world of shifting timeframes. And T+1 is unlikely to be more than a rest stop.

9. Looking beyond T+1: The case for real-time settlement

Markets globally are evaluating T+1, but momentum and timelines differ significantly. India, having successfully transitioned to T+1, is already pioneering faster, optional instant settlement models. The Securities and Exchange Board of India (SEBI) notes that their depository ecosystem has visibility of individual client level holdings in digital form, making it possible to affect an immediate transfer of securities. Similarly, their payments and settlement ecosystem allow for real time transfer of funds. According to SEBI Chair Madhabi Puri Buch, T+0 will allow the Indian stock market to compete with cryptocurrencies, giving investors greater control over their funds and securities. It will be interesting to see how or whether T+0 is eventually applied to institutional markets, as real time settlement is problematic for institutional investors. It eliminates the ability to net trades, which would have a substantial negative impact on the market.

In China, Stock Connect effectively institutionalizes a 4-hour settlement window and has demonstrated the operational challenges that come with trading across global time zones.

Thus far, counterparties have been able to adapt to China's shortened time frames, particularly with the introduction of HKEX Synapse. Synapse has been able to accelerate settlement for Northbound trades into China by providing a single source data and eliminating sequential processes to streamline post-trade workflows.

Although China's short timeframes are unique today, **it seems inevitable that the next step after T+1 will be atomic settlement, once real time payment infrastructures become more widely available.** Instantaneous settlement will put investments in China alongside other portfolio markets in the world during the trading day. It will create an enormous risk concentration at certain times of day, amplify the pressure on resourcing, and raise questions about what future operational model will be needed. Organizations that have moved to a global platform will find it unworkable in the future, when one person will be managing requirements from China and the US in the same span of time. Deciding where to spend time – on affirmations in America? Or matching and settling in China? – is simply not a sustainable model.

Real-time visibility across participants, throughout the trade lifecycle, and across markets will be needed to meet this challenge. It cannot be addressed simply through resourcing, particularly given the size of the markets. Instead, the technology, workflow and business processes must transform to provide the scale and flexibility to sustain global investing.

10. The pace of change is relentless

Even for markets that are operating with the same settlement regime, there's no single rulebook or operating model. Every market has its own trading nuances and investor requirements, making any kind of scalability difficult to achieve... even as scale becomes more essential.

Added to that, the pace of change is relentless, with multiple programs of work overlapping and shorter runways for major market implementations than ever before. In the US, T+1 went from proposal to implementation in 27 months; market participants in the UK and EU now face an approximate 18- to 30-month window for substantial operational adjustments, aligned with explicit milestones established by the respective T+1 committees.

Hiring isn't an answer and patching legacy systems won't work. The lack of resilience and risk is simply too high - these systems are too fragile and difficult to update, can't provide the flexibility needed, and there's no 'one-size-fits-all' patch anyway. The industry has reached the tipping point where better technologies and new tools are needed.

New technologies are facilitating new answers to these problems - from DLT-enabled solutions like HKEX Synapse to new workflow and collaboration tools that enable multiple parties to work with better data is a first step to faster settlement, removing layers of reconciliation and automating key tasks. **Automation and decision making are likely to be enhanced by AI. Although a newer entrant, AI promises profound change, particularly in predictive trade and fail analytics.** Predictive analytics are being used today, overlaying AI on top of a quality data set, allows market participants to accurately predict which of their trades have a higher risk of failure, allowing firms to concentrate their efforts on a smaller set of transactions.

11. Closing

As the global shift towards T+1 continues, it's clear that these changes are just the beginning. In the next part of our series, we'll turn our attention to corporate actions, uncovering how rising volumes, increasing complexity, and evolving investor expectations are reshaping this critical area of post-trade operations. Stay tuned as we continue to navigate the path forward.