T+1 for Asian brokers

Risk and Rewards

A ValueExchange factsheet report

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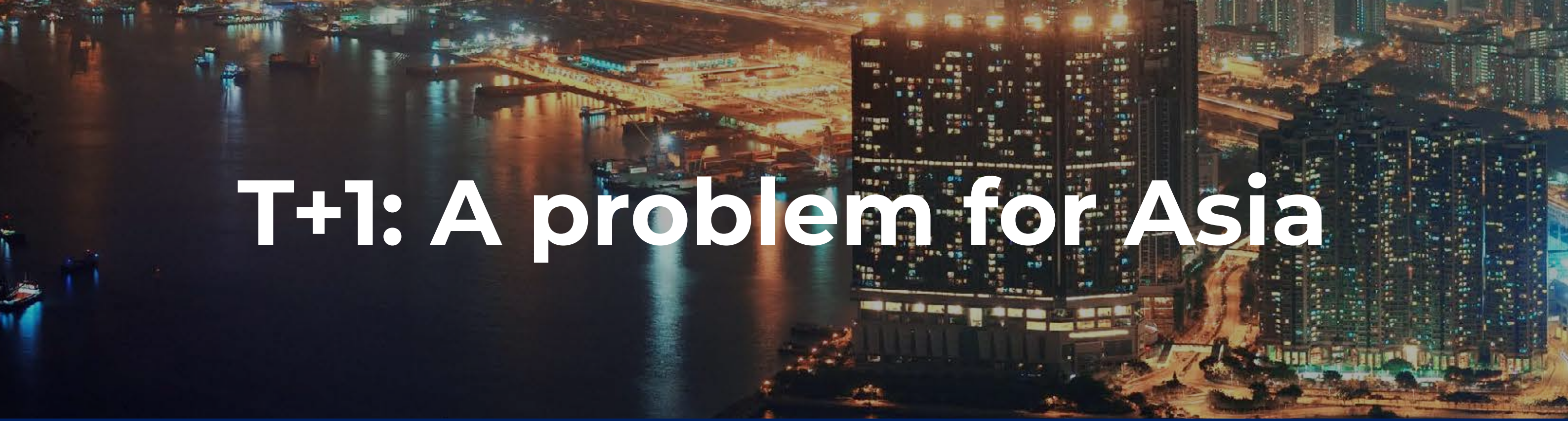


T+1: A problem for Asia

On May 27th 2024, Canada will be the first North American market to move to trade-date-plus-one (T+1) settlement cycles for Canadian securities. On May 28th the USA will follow (as will Mexico – TBC).

Under current market guidelines, this means that global investors will be required to "affirm" (effectively pre-match) all of their US trades by 21:00 ET on T+0, trigger all of their recalls on US securities by 23:59 on T+0, and then settle all of their Canadian trades by 03:59 on T+1. All trades in North America will then settle on T+1.

These shifts will have a profound impact on investors and their service providers around the world – most of all in Asia. Faced with time differences of up to 14 hours, Asian investors today will have no choice but to complete all of their processing for North American trades on trade-date – so that all trades are fully funded, matched and ready to settle before the end of the Asian trading day.

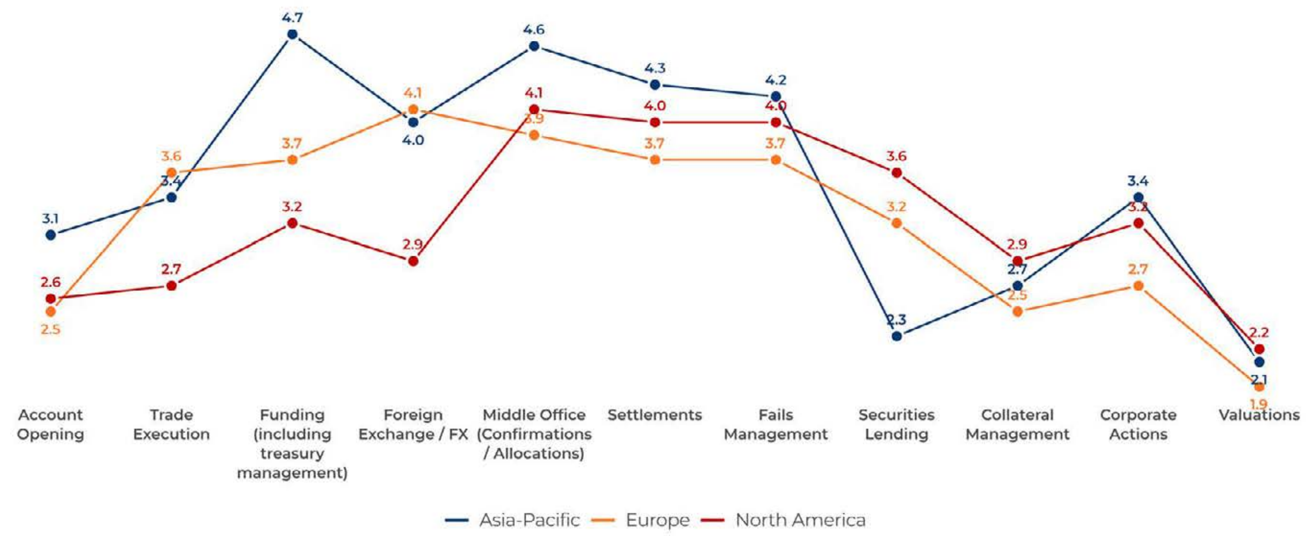
This acceleration of processing will have impacts across the entire front-, middle- and back-office operations of Asian investors – and will demand significant preparation and change over the coming months.

In October 2023, the ValueExchange and Broadridge led a round-table discussion of leading experts from the Asian securities and investments industry – to seek and share views on the impact of the T+1 transition to them.

The impact of North America's move to T+1 will be more strongly felt in Asia than anywhere else on earth – and its specific impacts vary depending on location and investment strategies.

From those who see it as a logical evolution of the financial markets, to those who consider it to be an opportunity for greater outsourcing and partnership, views on T+1 in Asia are significantly varied.

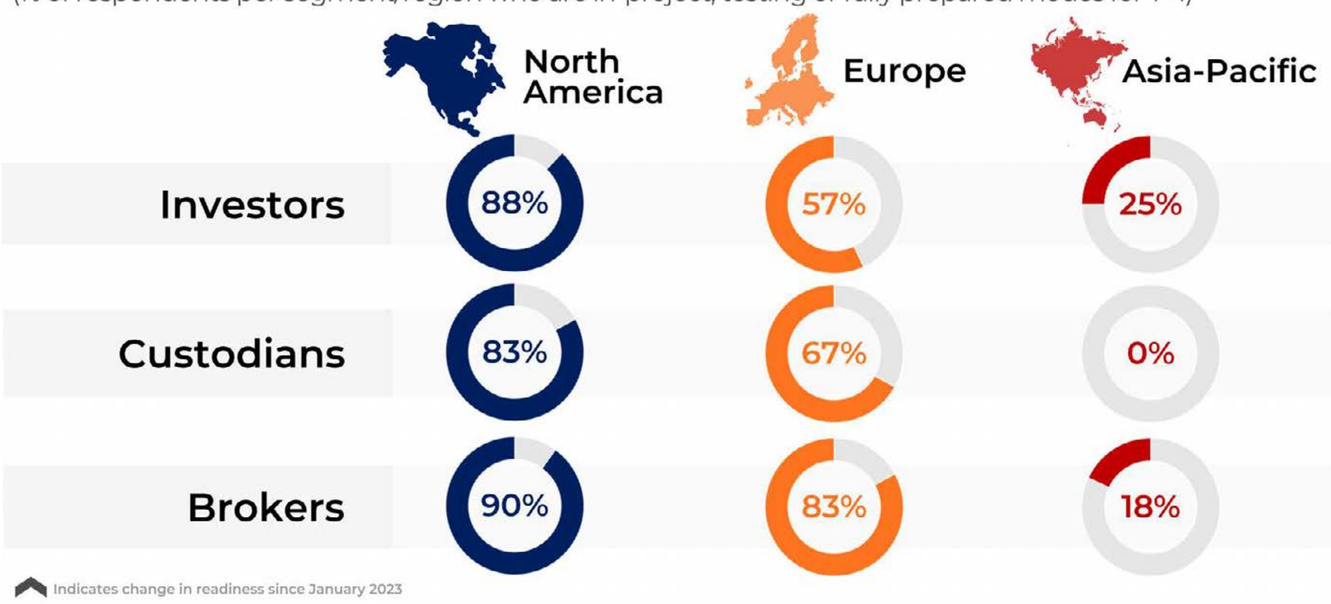
T+1 Impact
(0-5 scale, average by region and by activity)



Above all else, the common theme in Asia-Pacific is readiness.

With only a few months to go until the transition to T+1, only 25% of Asian investors are even preparing for T+1 – with little signs of growing activity to come.

T+1 readiness
(% of respondents per segment/region who are in-project, testing or fully prepared modes for T+1)



So what does **T+1 mean** to us in Asia and what can we be doing to prepare?

T+1 in Asia: today's reactions

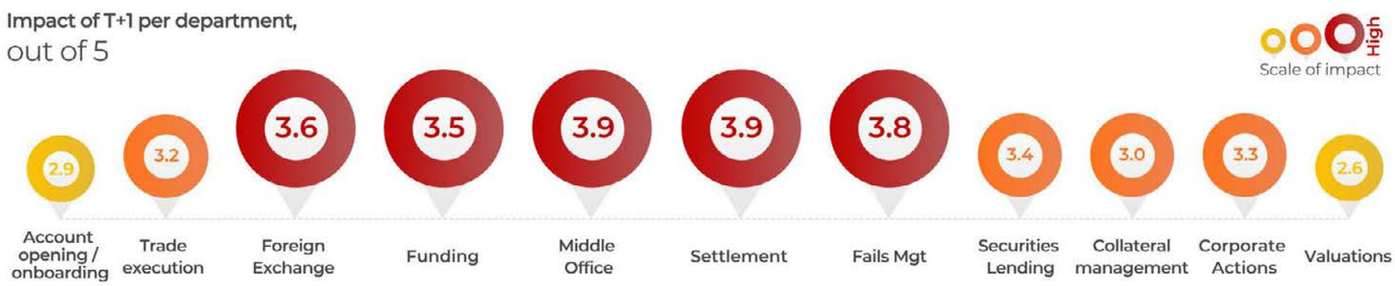
T+1 The P&L of change

“T+1 means a reduction in counterparty risk in return for higher operational risks and greater liquidity risk. Overall the risks will be higher.”

At its heart, the transition to T+1 will deliver funding and margining improvements to everyone who trades North American securities. In return, it will require all investors to process and settle their trades twice as fast as they do today – meaning an almost unavoidable increase in operational risk as processes are accelerated. In addition, with funding flows shifting and the likelihood of failing trades increasing, liquidity risk also looks set to increase.

For many back offices, this means a net increase in the risks inherent in trading North American securities. For some, it also creates new opportunities – especially for custodians and broker-dealers.

So how will T+1 impact the Asian back office?



Our industry roundtable leaders cited these key concerns in their own preparations for T+1

1.
What is affirmation?

Asian investors have historically had little involvement in (or awareness of) the US trade affirmation process, with affirmation rates being very low from Asia into the US. However, with the Securities and Exchange Commission (SEC) mandating a 100% affirmation rate for all US trades by 21:00 ET after the move to T+1, the US brokers who service Asian investors will be pushing hard to drive a change in these established behaviours. For those in Asia, this means either relying on global custodians (many of whom provide an auto-affirmation service for their clients) or on their connecting to the DTCC's CTM platform before May 2024.

2.
The end of bespoke instructions

Faced with such short timeframes for trade processing, Asian brokers and investors will have no choice but to ensure that their communications can all be handled on a straight-through-processing basis. Inevitably this means that they will have to dispense with all manual and non-standard forms of trade communication (e.g., allocations or trade confirmations by email) and ensure that all messaging is coherent with global standards (such as FIX or SWIFT messaging formats).

3.
Funding **– from pre-funding to credit?**

For many Asian wealth and retail investors, the question of trade funding looks set to become an issue. Under a T+1 environment, Asian investors will have to ensure that their brokers have received all trade funding on the same day as their trade order (i.e. T+0). This may not appear to be a significant shift for many (as most retail and wealth trading today works on a pre-funding basis), but this shift effectively removes all contingency for any potential errors in cash transfers. With an increased likelihood of trade failures due to a lack of client funds, Asian brokers will have to decide whether to pass on failing trades to clients – or to fund the trades and increase their credit exposures.

4.
Who will manage FX at 4-6am HKT?

Even when funding is received from investors, a pressing question is how these funds will be converted into US or Canadian dollars in time for the relevant market deadlines. With little likelihood of having anyone working in Hong Kong or Singapore at 4am to manage FX trades, Asian brokers will be compelled either to pre-fund their trades in USD or to receive only USD funding from their clients.

5.
Securities lending recalls: Do we have time?

For securities out on loan, Asian back offices will have to work extremely efficiently in order to instruct, process and reconcile recalls when they are required to facilitate a settlement. Given time differences, Asian back offices will have only one working day to complete an entire recall process and ensure that stocks are ready for settlement – creating a huge pressure on numerous processes. In the short term, this looks set to reduce willingness to lend by Asian counterparties and hence may impact the overall liquidity of (hard to borrow) North American stocks between Asian investors.

6.
Cash and securities ledger postings: Overnight

Assuming all goes smoothly (the US dollar funding is received and securities recalls completed successfully) the question of cash and securities posting into Asian brokers' accounts is then the next challenge. With many brokerage back office systems in Hong Kong, Singapore and Japan working on batch processing (and overnight downtime periods), many organisations will be effectively blind to whether cash funding is available, whether a security has been successfully recalled and whether a trade is ready to settle. Inevitably, these brokers will need to find alternative platforms to provide real-time visibility on cash and securities balances.

7.
Custodian cut off times

Unfortunately, few Asian investors have the luxury of contending only with market deadlines for settlement. Trading and settling through global custodians in many cases, the majority of Asian investors and brokers will see the time available to manage their T+1 settlements further limited by the cut offs required by global custodians. What was a 21:00 ET market deadline may become a 19:00 ET custodian cutoff, or even earlier if investors rely on multi-tier custody structures (where more than one custodian is involved). With each hour taken away by custodians, the pressure on Asian back offices will grow – driving many to consider transferring their settlement activity to custodians with direct, onshore presence in North America.

8.
Saturday is the new Friday:
Working on HK holidays and weekends

Who will safely manage trade settlement for any contentious trades on the North American Friday afternoon? The smooth processing of trade exceptions at the end of the trading week looks set to inevitably require Asian back offices to be active well into their Saturday mornings – or on Asian holidays when the North American markets remain open. Whilst remote working means that physical office presence may be optional in these cases, there is little doubt that the removal of one day to handle errors under T+1 will have a deep impact on back office resourcing in Asia.

T+1 and new opportunities

But T+1 is not all about cost and risk downsides....

Creating a trade-date processing model

For many, T+1 presents an opportunity to forge a new, optimised operating model that facilitates trade-date processing through end-to-end automation. Leveraging SSI libraries (such as DTCC's ALERT database), messaging platforms (such as Broadridge's NYFIX Matching, DTCC's CTM solution and Swift's Unique Transaction Identifier) and new back office processing capabilities (such as Broadridge's post trade platforms), many Asian brokers and investors can leverage the compelling event of T+1 to remove time, risk and cost from their North American trading activities.

> **"The funding side should all be scalable with a good global custodian – but they have to have service staff in Asia who know what is going on."**

Deeper cooperation with providers

This optimisation also extends to deepened relationships with key service providers – especially custodians. With many universal banks capable of managing FX trading, equities trading, cash funding, custody and securities lending within a single solution, there are obvious benefits for Asian investors in leveraging these connected platforms in order to remove potential weak points in the communications chain and hence reduce risk.

For those looking to these 'integrated solutions', two points stand out. First is to make sure that all contractual documentation (including GMSLAs, etc.) are in place well ahead of the May 2024 transition. Second is to ensure that the underlying service model of the custodian is suitably empowered: the people and the platforms must be available in Asia to communicate and action customer issues in North America.

Commercial opportunities for those able to manage risk

For those with the operational capabilities and balance sheets to lead the market, the transition to T+1 represents a strong commercial opportunity. Brokers can easily either warehouse client trades or issue structured notes in order to ‘manufacture’ a T+2 settlement cycle for Asian investors when the need arises – thereby protecting end-clients from all of the effects of this transition. Equally, those with seamlessly integrated, real-time platforms will be able to accelerate their lending and trading at a time when others may be hesitant – creating opportunities to grow market share.

Challenges & Opportunities of the Accelerated Settlement Cycle and Future Proofing for T+0

Watch the Webinar

Racing Ahead on T+1 – What firms should be focusing on

Read the article

T+1 – Global Opportunities, Threats and How You Can Future Proof for T+0

Watch the video