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T+1: Making STP a Reality

David Veal, Senior Executive: Client Solutions, corfinancial, suggests that the move to T+1 is the time for companies to consider whether straight through processing is a reality or a myth within their firm.

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1. Introduction

As investment management firms consider the forthcoming transition to T+1, the operational impacts of halving settlement timeframes come into focus.

Many asset management companies have multiple offices across the globe from which they trade, utilising a follow-the-sun principle. There has been a lot of debate about the challenges of T+1 in the US because there will be a lot less time to solve a problem trade from the location of execution. Indeed, AFME estimates that the shift from T+2 to T+1 will cut the available processing time post-trade by 83%.

Europe as a global location, however, has an advantage. From its central position, an asset manager in Europe can be reactive to the majority of trading activities from an operational perspective. It can manage and resolve issues that come out of Asia and still be present and available as the US market opens. **For approximately 75% of the day in the T+1 cycle, asset management in the UK and Europe is viable because of the region's position in the globe.**

If T+1 was already in place, could your firm cope?

When one considers the operational challenges if T+1 was already a reality, heads of operations must question whether their firm could cope. The answer might be different for each region (based on whether the firm is in the UK, Europe or North America). The issues are not just technological: they also impact operational staff and many other areas of the business.

Managing client money, not the asset manager's money

We see T+1 as a genuine Front Office issue because, from an asset manager's perspective, it's still about managing the client's money, not corporate money. That's why we think T+1 should be regarded as a Front Office business priority, not a Middle Office problem to be resolved.

Has STP finally arrived?

We believe that a key topic underpinning the whole concept of T+1 is straight through processing. It is time for companies to reflect on their real achievements with STP in their trade processing automation - is straight through processing a reality or a myth within their firm? We would advocate that with the advent of T+1, STP is now no longer a choice for firms trading in North America and Europe. Throughout this paper, we reflect on this when assessing the changes that are occurring in our not-too-distant future.

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2. The Impact Of T+1 In Europe

Exchanges in Europe will adapt to T+1 over time

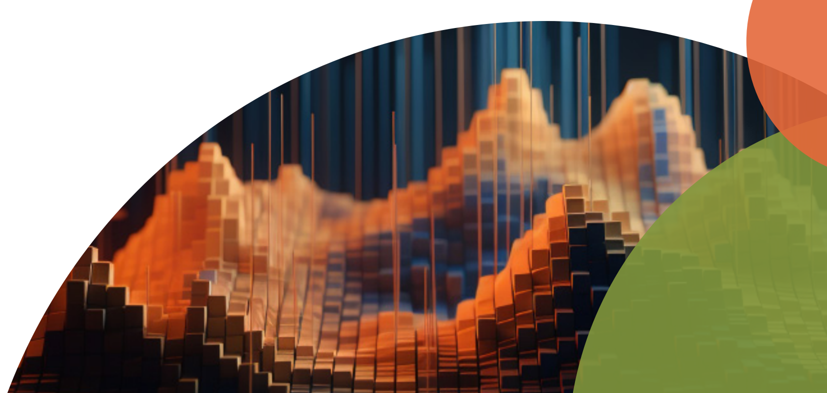
One of the key considerations associated with T+1 is that some settlement cycles will no longer match, a change that could increase a number of operational risks. The previous harmony of a T+2 world will be altered forever. If Europe begins to transition to T+1 inconsistently, it will result in fragmentation and destabilisation.

Although in October 2014 the Central Securities Depositories Regulation (CSDR) required over 20 European markets to shift from T+3 to T+2 simultaneously, can we assume that such a historic task will be repeated? Firms will have to assume that there will be no 'big bang' transition to T+1 across European countries, exchanges and asset classes. Some countries will be more prepared than others.

Getting 'T+1 safe'

Should firms that have a plan to prepare for T+1 in the US be encompassing greater change so that if or when T+1 arrives in Europe, they're ahead of the curve? Asset managers that enhance their Middle Offices assuming T+1 will exist in Europe as well as the US will be building an operating model that is 'T+1 safe'. Firms need to assess the risk of not taking T+1 in Europe seriously. It is also likely that two separate projects, T+1 in the US and T+1 in Europe, will cost more overall than just one T+1 project encompassing both regions.

Some operations teams might argue that the deadlines around collateral management and other procedural questions in Europe would prevent them from implementing a European solution at this time, but many could be working within a framework. Whatever technology is selected and whatever processes firms put in place, they can always ask the question: 'Would this also work for Europe?' And with the momentum for T+1 gathering pace in Australia and parts of Asia, perhaps firms should also be contemplating other key jurisdictions in terms of trade settlement.



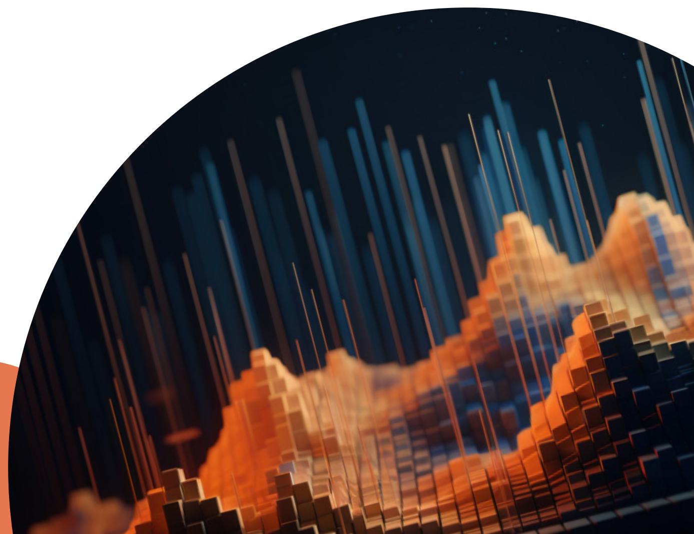
3. Operational Challenges

There are some key operational issues which firms must consider when implementing T+1 in North America and potentially Europe. These challenges are summarised below.

i) Existing legacy systems Many older applications are still reliant on batch processing or mainframe computers. For some firms using dated technology, all events and trades within a 24-hour period are captured and processed in a single batch. Even if the frequency of those batch runs was increased, many question whether this would be sufficient processing agility to handle T+1 effectively.

ii) Manual processes In some firms a reliance on manual processes persists. There are still organisations instructing by fax and deploying risk-laden processes to manage their trades. Engaging yet more staff to achieve T+1 would be a very expensive, short-term approach that ultimately would increase operational risk. Investment in automation and straight-through- processing is really the only viable solution.

iii) Reduced IT budgets The Back and Middle Offices have traditionally been the locations where staffing reductions hit hardest during an economic downturn, with the Front Office being much more resilient. With the cuts made to operations and technology teams and budgets over the last few years, it will be difficult for many firms to find the resources it needs to realise its T+1 goals.



4. How Far Can The Middle Office Be Stretched?

When firms reflect on the operational impact of T+1, many will inevitably return to the question: ‘How far can our Middle Office be stretched?’ The problem is that Middle Office operational limits are finite - particularly on a people level – and have been for some time. This is already the case for most firms when addressing T+1 in the US, but the problem is exacerbated when one considers Europe.

More activity in a day

Middle Offices are always regarded as a cost centre, not a profit-making division of a company. Over the last decade, many operational teams will agree that the Middle Office has been culled down to almost an absolute bare minimum, in many companies. It’s a very lean division already, so changes in the Middle Office that require more activity within a day cannot be easily addressed by simply requesting all staff to work longer; perhaps, 12 hours per day.

Considering shift work

At this stage, many asset managers will be establishing forums or working groups to understand their requirements under T+1, to then formulate internal procedures to support T+1 when it does go live. This might involve testing their operational team presence in the local market time for executed trades, so perhaps trialling support in US market hours to see how that might work in practice. Team shifts, accommodating a much longer working day, may well be the necessary endgame.

Indeed, the imperative to adapt operating models is an interesting yet challenging area for discussion. Changing local working hours is an easy statement to make, but every firm has a finite number of resources in their operational teams. Getting an even split between staff members would be key so that the workload naturally flows, requiring careful analysis and staff commitment to change.

T+1 impacting the Trading Desk

The difference with T+1 as opposed to most other regulation currently slated is that it will affect the traders. The fact that T+1 is impacting the Trading Desk will effectively push the issue up the operational agenda within most firms.

Whether it's within the context of the US or Europe, T+1 is therefore a company-wide, not just a Middle Office, problem.

Increasing pressures on the Middle Office

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5. Three Key Operational Requirements For T+1 Within Trade Processing

1

STP AT A HIGH RATE

Although many asset management firms are well automated in their collateral management processes, some are still managing aspects of these within spreadsheets. When reducing a settlement cycle, firms must seek to eliminate any form of manual processing, nonstandard instructions and the time taken to ingest and circulate data. This is where automation, STP of workflow and interactions with internal and external applications must be scrutinised.

Automating for STP should include the instantaneous processing of transactions.

2

SUPPORTING COLLATERAL AND CASH MANAGEMENT (INCLUDING FX)

The overall process of collateral management (positioning securities to ensure that a firm can meet its liabilities for the trades that are being undertaken) involves moving stock and cash around. How much stock and cash needs to be moved cannot be calculated until the firm has processed all of its trades.

By having a higher rate of STP, firms can more readily reach a position whereby they can start to effectively manage collateral, with less likelihood of wrongly estimating the collateral requirements. STP results in accurate data, and firms need accurate data to manage collateral and cash management.

3

MORE EFFECTIVELY MANAGED SETTLEMENT INSTRUCTIONS

One reason why firms need to effectively manage settlement instructions is because they can't afford to let T+1 make them breach the Settlement Discipline Regime (an element of the CSDR). Some commentators might argue that this is unimportant, but we believe that firms can't let T+1 increase their number of failed trades. The only reason to adopt T+1 is to make the world better, not worse.

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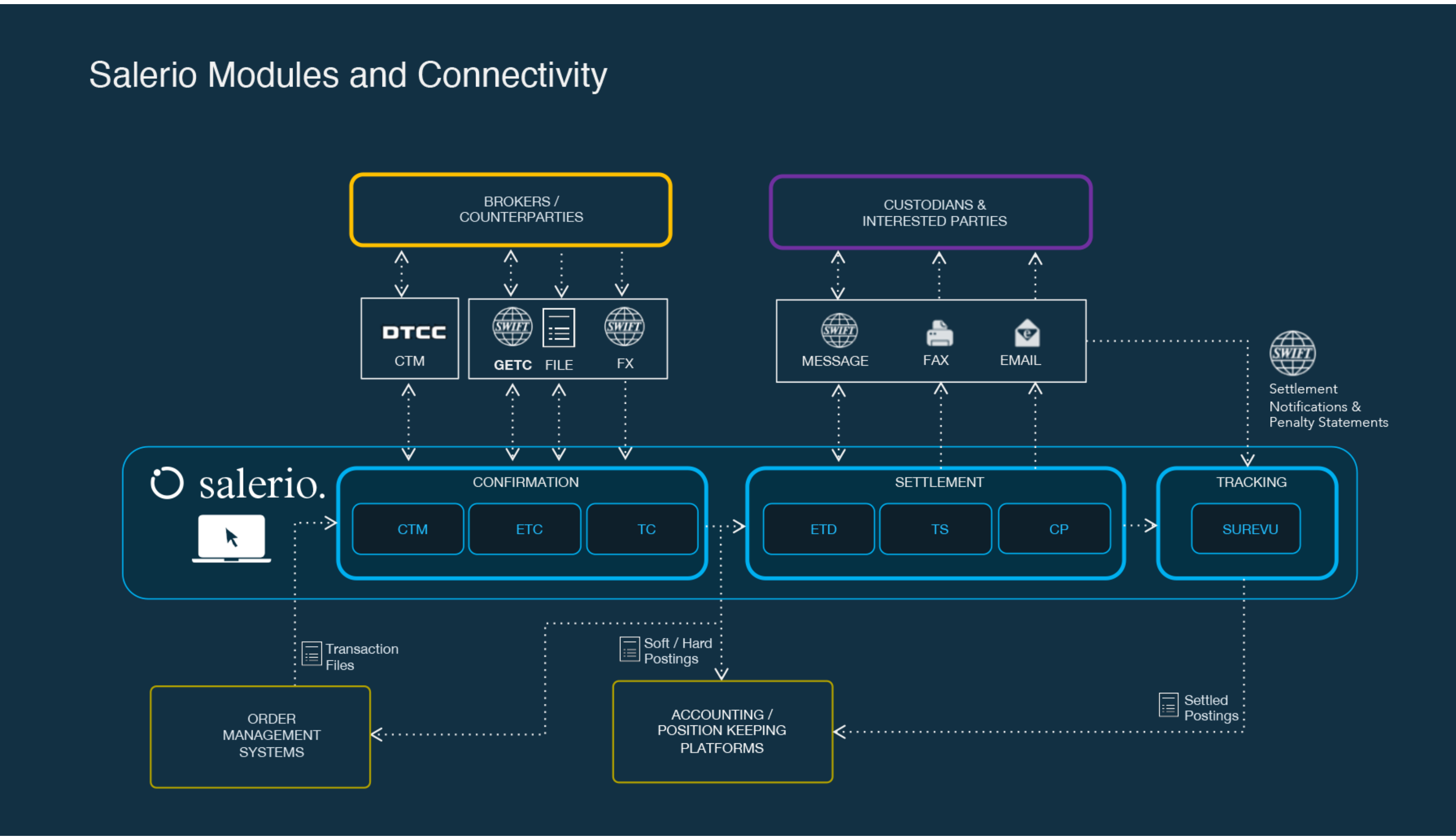
Salerio Modules and Connectivity

Salerio supports three business processes related to T+1 within the Middle Office: confirmation, settlement and tracking. Within those business functions are modules performing different tasks. Salerio integrates internal platforms (order management, accounting and position keeping) and information to external parties (brokers, counterparties, custodians and interested parties).



MODULES:

CTM: CENTRAL TRADE MATCHING & CONFIRMATION (SECURITIES)
ETC: LOCAL MATCHING (SECURITIES / EXCHANGE TRADED FUTURES)
TC: TREASURY MATCHING & CONFIRMATION (FX & MONEY MARKETS)
ETD: ELECTRONIC TRADE DELIVERY (SECURITIES MESSAGING)
TS: TREASURY SETTLEMENT (FX & MONEY MARKETS MESSAGING)
CP: CASH PROCESSING (PAYMENTS MESSAGING)
SUREVU: FAILED TRADE MANAGEMENT (including CSDR – SDR)

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Conclusion

Traders need to have more involvement in the transaction lifecycle

As stated previously, T+1 is more than a Middle Office problem. Any project associated with this change also encompasses the Front Office. From a budgetary perspective, positioning T+1 as an essential Front Office project will likely attract greater resources in most firms.

Whatever course of action firms take regarding T+1 in the US and Europe, there will be a greater need for traders and operations to work closer together. The Front and Middle Offices will be collaborating to ensure that data flowing through the DTCC is always accurate and trade data is precise, creating alerts when any data does not match. Traders will have more involvement in the transaction lifecycle process than ever before.

Making STP a reality

Better STP is an opportunity for firms, not a cost. What firms need is a solution that constantly enhances the lifecycle of a trade and creates incredibly high rates of straight through processing. In this way the proportion of unsettled trades is always falling, as the solution is constantly addressing problems and creating answers.

This is what Salerio does so well. When a trade fails, firms can fix the problem so the same parameters of the trade will then go through STP.

Salerio is the answer to true STP rates – no longer needing people to apply patches to a workflow that isn't the real deal.

Click here to learn more about corfinancial's post-trade settlement solution, Salerio.

Join other **high performing** investment firms as they prepare for T+1

- ASSET MANAGERS
- HEDGE FUND MANAGERS
- SECURITIES SERVICES
- SOVEREIGN WEALTH

- Achieve T+1 through genuine STP
- Remove manual tasks
- Spot trade issues before they blow up
- Scale easily
- Failed trade and penalty fees management

Click here to learn more about corfinancial's post-trade settlement solution, Salerio.

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ABOUT CORFINANCIAL

corfinancial provides software solutions and advisory services to banking and financial services organisations worldwide. The firm has offices in London, New York, and Boston.

There are five key problem areas corfinancial looks to solve through its primary software and service offerings:

BITA Risk provides Investor Profiling, Portfolio Analytics, ESG Management and Portfolio Monitoring solutions to wealth managers through the BITA Wealth application. Available as individual modules or as an end-to-end solution.

SureVu empowers buy- and sell-side firms to efficiently monitor and track security trades throughout the settlement lifecycle, enabling users to proactively manage and oversee settlement exposure.

salerio is a post-trade processing solution that enables asset managers, hedge fund managers and securities/fund services firms to automate the flow of securities and treasury trades from matching through settlement.

costars is an investment administration platform for third party administrators, fund supermarkets and wealth management companies.

paragon is a comprehensive front-to-back office fixed income portfolio accounting, processing, and reporting solution for banks.