Operational challenges

The industry has proposed a move to shorten the settlement cycle for US equities to one business day (T+1) and perhaps this will be a first step toward broader coverage in other currencies, regions and exchanges. Proponents suggest that the immediate benefits of moving to a T+1 settlement cycle include reduced market risk and lower margin requirements, as well as significant cost savings.

When firms look at a move to T+1, it is essential that they fully comprehend required changes to the post-trade environment. **This is even more crucial for firms that have not reengineered legacy systems.** As operational efficiency and regulations bring technology to the fore, now is the time to overhaul dated technology and move away from practices like batch processing, which is still common in many companies.

A move to T+1 will certainly have its challenges: industry participants will have to align and implement the necessary operational and business changes. Beyond this step is regulation; individual firms do not have legal authority to enforce any such change, so the regulators will have a role to play.

T+1 will force the industry to get things right on trade date, which means more straight-through processing and less cumbersome or customised processes.

As the settlement lifecycle continues to shorten, not only do institutions require the centralizing of exceptions data on one dashboard but they must also question whether they can afford to not be running an exceptions-based trade processing operational model if they wish their business to be scalable.



"Firms must question whether they can afford to not be running an exception-based protocol if they wish their business to be scalable."

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Eliminating ongoing friction points

In a T+1 settlement cycle, if a trade is executed today, the confirmation or affirmation process must occur on trade date in order for the trade to settle the following day – mostly at the close of business in the region. There's very little time for the firm to identify a mistake.

This is one of the operational problems associated with T+1 that can be alleviated by our Salerio software. Salerio deals with confirmation, matching and settlement instructions management, helping the middle office deal with high volumes of trades that must be processed on trade date.

Salerio achieves this because users are only dealing with exceptions, thus enabling firms to process high volumes of transactions in the most time-efficient manner. Our software takes control, because as soon as the firm can send an instruction to the custodian, the custodian can issue notifications on the matching and settlement status of trades.

One logical implication of moving to T+1 is middle office teams will have to rush trades through and there are going to be more failed trades (at least initially). That said, a trade failure might not only stem from the shortened cycle; it could be that the settlement data is incorrect.



"Buy-side firms should constantly consider their middle office processes to see how they can improve it to handle increased volumes."

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Five key factors that impact middle office operations

When considering changes beyond middle office operational practices, there are many areas that require further thought for a lot of firms. Here we list five of the broader implications associated with trade processing functions.

1

TIMELY TRADE EXECUTION MANAGEMENT

Middle office teams often receive up to 80% of executed trades at the end of the day. There are trading conditions where it is essential to wait until the close of business in a market before passing on an executed trade record but that is not always the case. Initiatives and technology that enable firms to be more effective with intraday trade processing is essential to facilitate the move to T+1.

2

DATA MANAGEMENT AND ATTRIBUTES

Processes will be even more heavily dependent upon the accuracy of data attributes that support a transaction and the parties involved in the settlement functions. Standard Settlement Instructions (SSI) must be accurate and validated, leaving no room for error or misinterpretation.

3

COMMUNICATION STANDARDS

Today, there is a significant range of communication methods with custodians and settling parties and there is currently a lack of consistency. Timely T+1 settlement depends on a consistent messaging standard with data content that supports automation, streamlining trade processing immensely and accelerating the successful transition to T+1.

4

FOREIGN EXCHANGE

There are few foreign exchange markets that settle on T+1. The foreign exchange market must be synchronised with T+1 settlement cycles, in the longer term. For a fund manager, the management of cash positions will become heavily dependent on accurate settlement figures much earlier in the trade lifecycle, and this requires effective and timely upstream and downstream data provisioning related to executed trades. Assessing cash positions the day after trading will not be an option.

5

INDUSTRY EFFICIENCIES

The T+1 trade lifecycle requires better processes to support the settlement of trades, with improved processes associated with managing stock that is on loan. Recall management must be timelier and should commence as soon as a position is sold. The Settlement Discipline Regime introduced by the CSDR does not provide exemption for unsettled trades where parties fail to have available stock to deliver.

Food for thought

The move to T+1 is a step forward for the industry, but key questions remain for middle office or operational teams that must pick up the pieces:

- Does your current process avoid problems before they occur in the most effective way?
- Will your operational practices easily adapt to the pressures of a T+1 deadline?
- Does your trade processing technology enable you to proactively avoid trades from failing?
- Is your current trade processing operating model fit for the demands of T+1?
- Is your platform scalable enough to adapt to the demands of same-day processing activities?
- Are you prepared for custodians changing their Service Level Agreements?
- Are you prepared for your operating day to be extended as custodians change their deadline for the receipt of instructions?

Salerio and its modular structure will enable you to meet ALL of these challenges.



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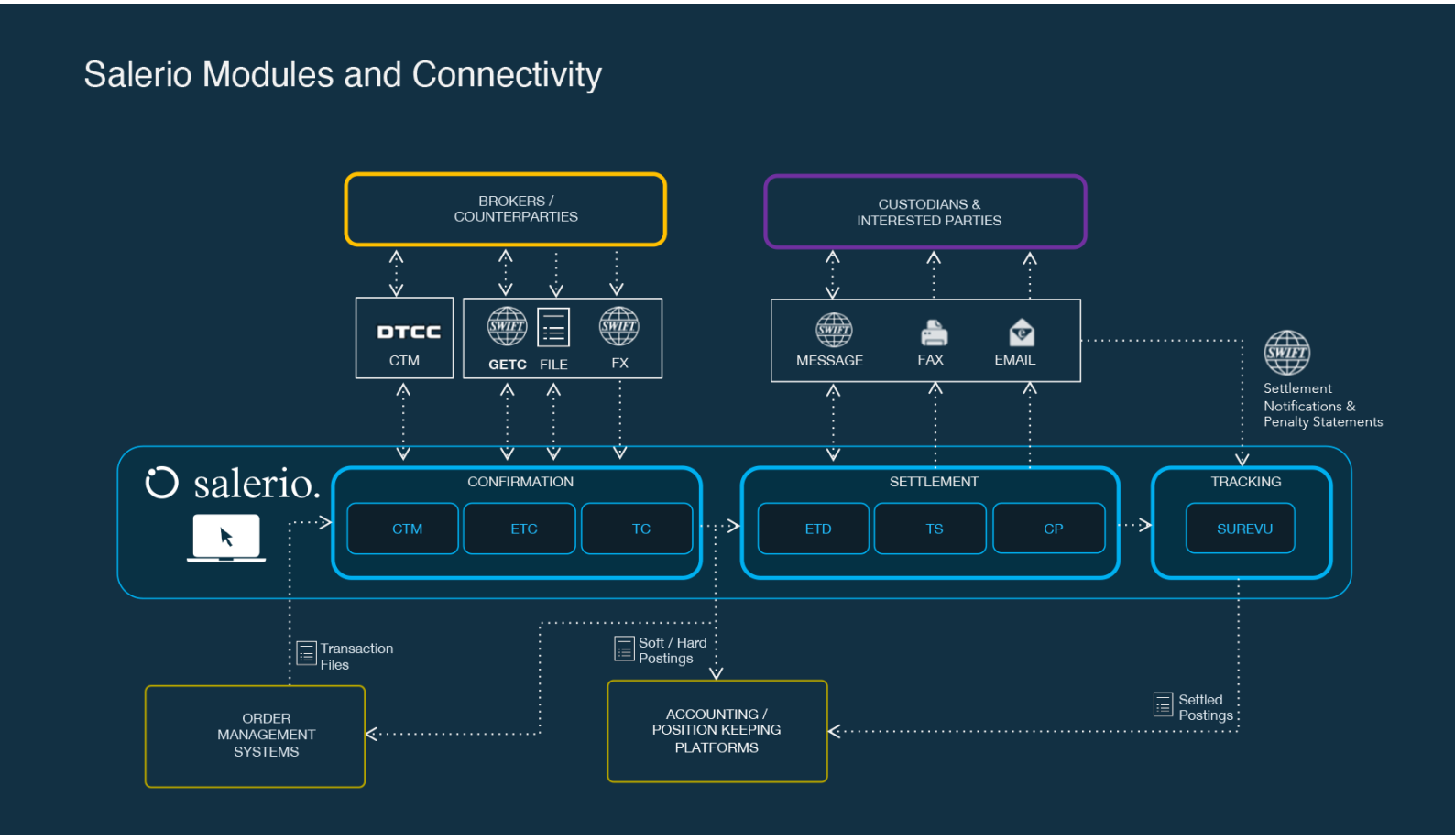
Salerio Modules and Connectivity

Salerio supports three business processes 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

With T+1, the operational area of focus will shift towards prompt, accurate processes and tools to ensure corrections have effectively been applied. This contrasts with priorities in the T+2 world of today. At present, once the middle office has sent instructions to custodians, its job is done because if there is a problem it will come to light the following day and settlement can still be concluded by T+2.

The implication for buy-side firms is that their operational lifecycle will be changing. Whilst there will be companies that say their goal is to get all trades confirmed on trade day, there will always be exceptions. With T+1, firms will not have the luxury of a middle day to complete the settlement process, so their goal must be to confirm and instruct settlement on trade day. That's where Salerio can assist.

Naturally, there will still be failing trades, because there is no longer a window where firms can be notified of problem areas before failure occurs. Minimizing the cost of failing trades will be essential for all firms and will become a critical area of focus. This is where our Salerio solution along with sophisticated failed trade management will significantly reduce settlement risk and associated costs.

Changes associated with the settlement lifecycle must not have a negative impact or make the risk of trade failure worse. The settlement process has many steps, and these cannot be simply overlooked in the race to a T+1 trading environment. Certainly, in the beginning there is a likelihood that there will be more trades failing whilst the world gets used to this process.

The most successful firms will be those that have the technology to swiftly deal with those potentially failing trades, managing the correction of those positions in the quickest possible time.

Such automation alleviates pressures on operational teams, mitigates operational and settlement risks, and reduces operational costs.



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