T+1, the FX ecosystem and CLS:

What difference has a day made so far?

The global financial landscape underwent significant transformation in May 2024 as the settlement cycle in the US and Canadian securities markets shortened from T+2 to T+1. CLS carried out extensive analysis and engagement prior to the transition and has been monitoring events since.

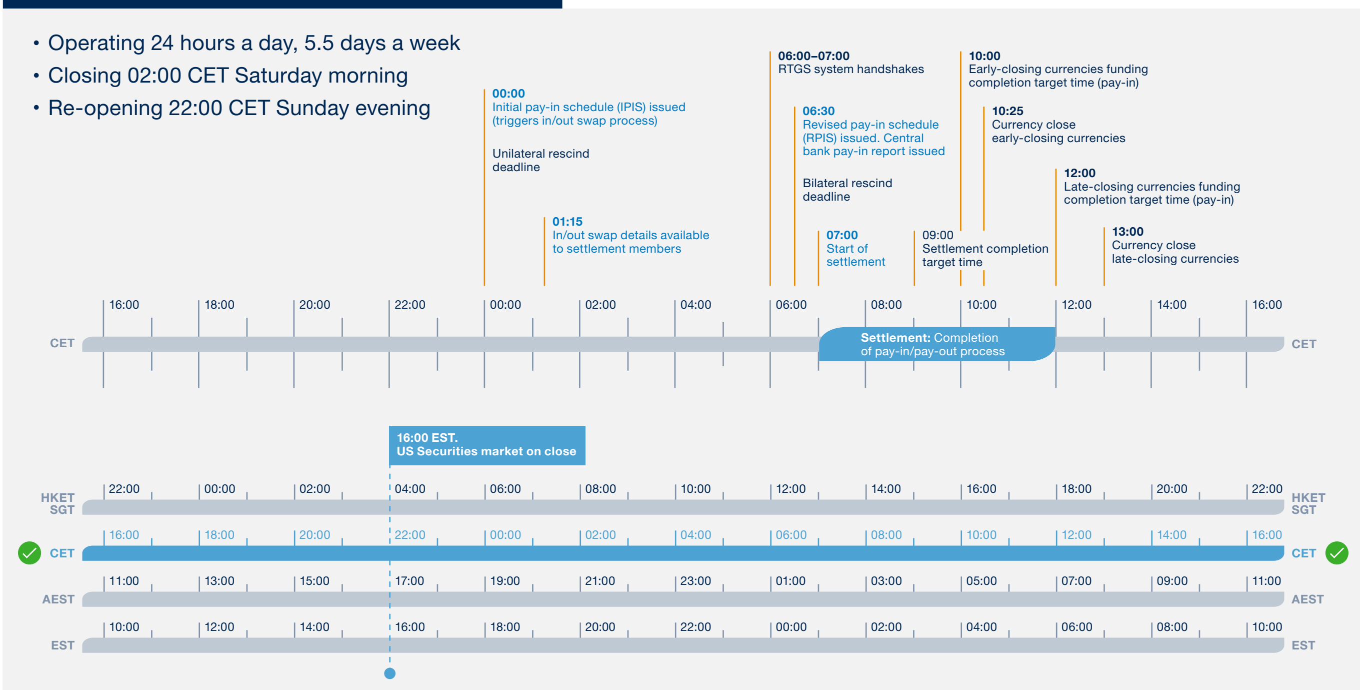
History and background

In May 2024, the US and Canadian securities markets transitioned to a T+1 settlement cycle. This latest round of settlement cycle shortening signifies a major shift in the financial landscape. The move towards T+1 settlement cycles is gaining momentum worldwide, and other jurisdictions are planning to shorten their settlement cycles over the coming years.

The impact of T+1 on FX cut-off times

The contraction in settlement cycles in the US and Canadian securities markets impacts financial markets worldwide, given that almost 20% of securities and 17% of equities are held outside the US.[1] Time zone differences mean European and Asian investors and asset managers have much less time to mobilize currency to fund a US or Canadian securities trade if it settles on a T+1 basis. This is because US and Canadian securities trades are typically executed towards the end of the business day in Asia and Europe. Some feared that requiring these securities to settle the following day could force investors to execute and settle a foreign exchange (FX) trade on a same-day (T+0) basis. In other words, there was concern that the shift to T+1 for securities settlement could require shifting to T+0 for FX, at least for some parts of the FX market. As such, in a T+1 world, services such as CLSSettlement may not be usable for a small fraction of securities-related cross-border currency trades.[2]

Figure 1: **CLSSettlement operational timeline**



1 Department of US Treasury, "Foreign Portfolio Holding of US Securities," 30 June 2023.
2 CLSSettlement offers FX settlement risk mitigation through payment-versus-payment (PvP) settlement and liquidity optimization through multilateral netting.

Pre-transition engagement and analysis

To assess the potential impact of T+1 on CLS and its settlement members, CLS carried out extensive analysis and engagement prior to the transition in May 2024.

Looking at transaction data first, CLS found that about 1% of CLSSettlement's average daily value (ADV, USD7 trillion) was linked to non-US investment funds trading in US securities and executing FX on a T+1 settlement basis. This segment of the market could have been most impacted by the transition to T+1. Further outreach to the asset manager community indicated that about half of these values could potentially miss the CLSSettlement cut-off time of midnight CET for settlement the following day, unless participants (in this case, asset managers using nostros to provide the required liquidity to use CLSSettlement) changed their trading and operational processes.

EU and UK time zones work more favorably with CLS's timeline, as transactions can be submitted for next-day settlement up until midnight CET, largely overlapping with the business day in the EU and UK. The maximum impact of European and UK securities markets moving to T+1 settlement was therefore estimated to be no more than 0.4% and 0.1% of CLSSettlement's ADV, respectively.

CLS also engaged with buy- and sell-side participants to better understand the challenges impacting the broader FX lifecycle. CLS found that while participants were exploring several different execution options to adapt to the shorter securities settlement window, they would largely still rely on CLS to mitigate FX settlement risk even if there were no changes to custodian cut-off times or CLS deadlines (figure 2).

CLS examined the feasibility of an extension to its midnight CET initial pay-in schedule (IPIS)[3] calculation deadline, which could have allowed more time to submit payment instructions. When settlement members were surveyed, over 40% said lengthy system development would be required to accommodate this change.

In light of the analysis, CLS opted not to make any operational changes to CLSSettlement ahead of the T+1 rollout, keeping the existing instruction submission deadline of midnight CET for next-day settlement.

Figure 2: **Feedback from asset manager community using CLSSettlement**

Execution options	Feedback	Majority of risk can be mitigated through CLS
Estimate and execute FX at time of equity execution (T+1), and 'true-up' FX requirement once equity trade confirmed (T+0)	11%	✓
Execute FX once equity trade confirmed (T+1) inc. pre-fund	17%	✓
No change to current FX processes required	20%	✓
Opening new location	2%	✓
No response/other solutions	50%	!

[3] CLS initial pay-in schedule (IPIS) calculation is sent to CLSSettlement members just after the midnight CET cut-off to allow them to review their net pay-in obligations for trades being settled the next business day.

Post-transition observations

After the May 2024 transition, CLS continually monitored impact so that it could address any emerging issues in partnership with settlement members and the wider FX market.

As mentioned, initial calculations projected that the move to T+1 could slightly reduce ADV, but following the transition, CLSSettlement ADV actually trended higher (figure 3).

The increase in ADV and the pattern of submissions in CLSSettlement suggests changes to custodian cut-off times that may potentially allow more T+1 instructions from funds to be submitted later in the day. In July and August 2024, T+1 values submitted to CLS between 19:00 CET and midnight increased 42%, as compared to the six-month period between October 2023 and March 2024.

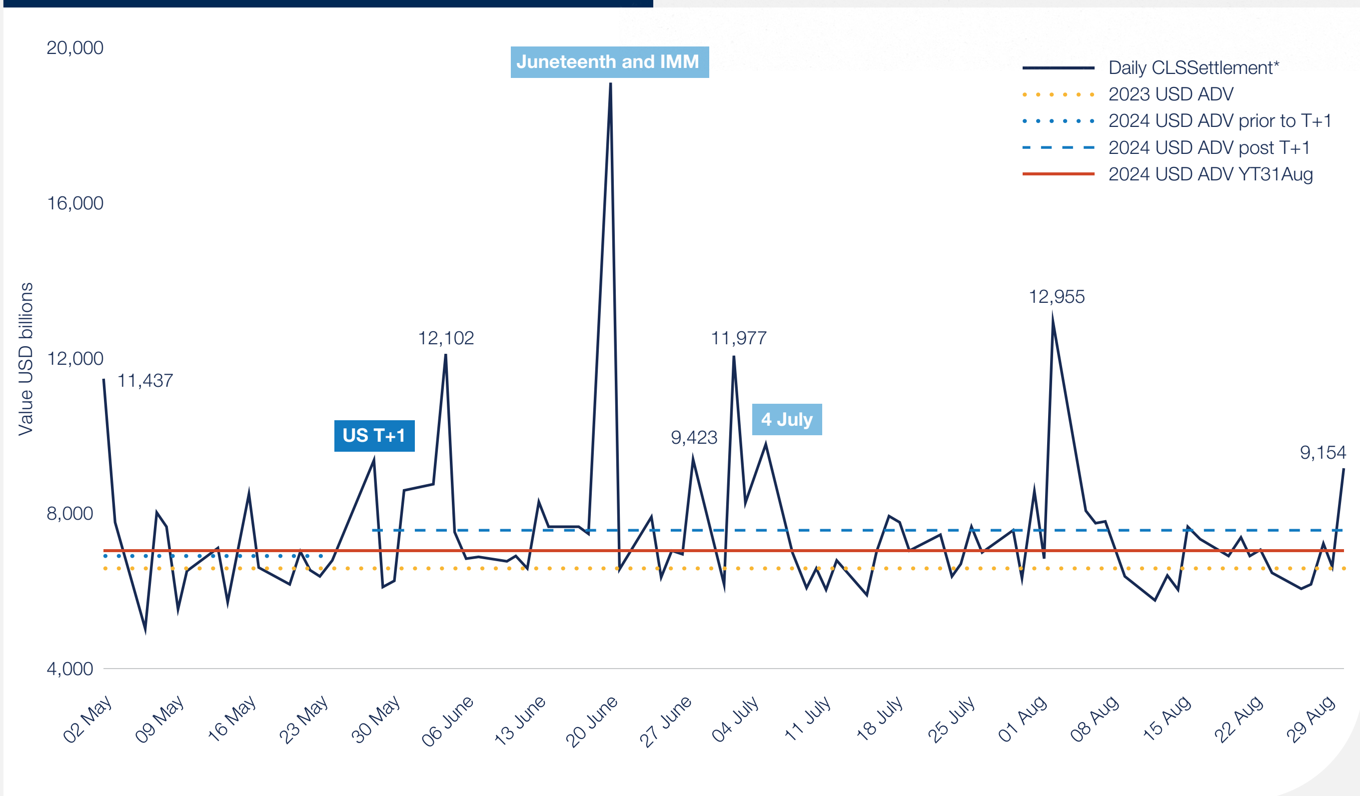
Before the transition, some asset managers asked their relationship banks for a facility to provide more FX liquidity at the close of the US trading day. So far, CLS has not received any indication of such a facility being used. CLSMarketData liquidity profiles for spot value showed a similar trend, suggesting that FX business following the transition generally remains unchanged.

Figure 3 shows CLSSettlement daily values since the beginning of May 2024. The chart highlights the T+1 transition date, the record seen with the coincidence of the Juneteenth holiday and the June International Money Market (IMM) date, and the post 4 July concentration.

Settled values spike on the day after US public holidays, as FX instructions that would have otherwise settled on the holiday tend to roll over to the following business day. Quarterly IMM days[4] also typically see higher settled values. The coincidence of the Juneteenth holiday and the June IMM date therefore led to a particularly large spike observed on 20 June this year.

In 2023, CLSSettlement ADV closed the year at USD6.6 trillion. In 2024, before the T+1 transition, ADV was USD6.98 trillion. Since the transition, ADV has moved up to USD7.6 trillion. This took the 2024 ADV year-to-end-of-September to USD7.18 trillion. CLSSettlement values have trended higher in 2024, including post-transition, indicating little to no notable impact as a result.[5]

Figure 3: **CLSSettlement values May – August 2024**

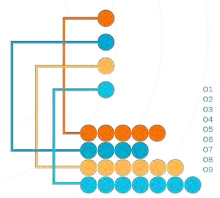


[4] IMM dates are the four quarterly dates of the year (third Wednesday of March, June, September, and December) when futures and option contracts mature or terminate.
[5] Although there was no notable impact from a CLSSettlement perspective, both sell- and buy-side participants reported several challenges, for example around funding, headcounts, and securities lending because of the T+1 transition. See Citi_Securities_Services_Evolution_2024.pdf: citibank.com

Figure 4: **Additional CLS products that support market participants**

CLSTradeMonitor	CLSNet
Helps buy- and sell-side participants: • Focus on exceptions through a near real-time exception management dashboard • View the status of trade instructions submitted to CLS across multiple custodians and brokers in one centralized platform • Identify and resolve issues as they arise, which is crucial in a time-compressed environment	**Helps buy- and sell-side participants:** • Gain post-trade efficiencies by removing disputes and manual interventions from the net calculation process • Mitigate operational and settlement risk by automating net calculations and facilitating net payment instructions • Reduce funding costs and the number of payments required • Improve intraday liquidity requirements • Adhere to FX Global Code
Product overview	**Product overview**
CLSTradeMonitor is a post-trade monitoring and reporting tool that provides a single view of all trade instructions submitted to CLSSettlement and CLSNet regardless of custodian.	CLSNet is a standardized, automated bilateral payment netting calculation service for over 120 currencies. It is available to buy- and sell-side participants, and it supports FX spot, tom/next day, forwards, same-day, non-deliverable forwards and swaps.

CLS will continue to monitor the T+1 transition's impact and will address any emerging issues in collaboration with its settlement members and the wider FX community. Prioritizing execution and operational efficiency across the asset manager and fund communities will remain a focus as the industry moves forward, and CLS continues to offer several additional products to support market participants (figure 4).



What could the future hold, T+...?

The T+1 journey is far from over, with other jurisdictions already in the planning stages of transitioning. The UK plans to move by the end of 2027[6]. In October 2024 ESMA, the European Commission's DG FISMA (Directorate-General for Financial Stability, Financial Services and Capital Markets Union), and ECB-DG MIP (Directorate-General for Market Infrastructure and Payments) released a joint statement. It announced the agreement to establish a governance structure, incorporating the EU financial industry, as soon as possible to oversee and support the technical preparations of any future move to T+1.

As T+1 continues to gain traction across the securities industry, the question arises: what is next after T+1? Is a further shortening to T+0 on the horizon? A recent Citibank survey found a significant increase in institutions in the securities market expecting a move to real-time settlements within a decade.[7] However, a report from the Securities Industry and Financial Markets Association (SIFMA) and Depository Trust and Clearing Corporation (DTCC) published in September noted, "Despite the success of the industry's move to T+1, moving to T+0 is not simply the next step in the process."[8] There are several important challenges to consider, including whether to reduce multilateral netting benefits in order to shorten settlement cycles.[9]

In the FX market, the move to T+1 in securities has intensified the debate around shortening settlement cycles in FX trading.[10] Beyond the adjustments made for funding shorter securities settlement, is there a desire for T+0 or same-day FX settlement on a larger scale?[11]

Innovative initiatives, such as wholesale central bank digital currencies (CBDC) experimentation[12] that focus on FX PvP use cases, often share a common goal: 'instant settlement' of CBDCs on a 24/7 basis.[13] However, it is yet to be determined whether this is desirable at scale for the wholesale FX market in the foreseeable future.[14] Instant settlement would vastly increase liquidity requirements for FX market participants because it would eliminate the time window for the netting of payments to reduce the total funding required, effectively leading to a hundred-fold increase in liquidity requirements[15] for most of the world's largest banks.[16] If markets were to move further toward instant settlement, multiple short settlement cycles that still provide some netting benefit, may be more suitable.

CLS will continue to monitor developments in the T+1 transition and closely follow the ongoing debate around the shortening of settlement cycles in the FX market.

6 The UK Accelerated Settlement Taskforce, Technical Group published its draft recommendations report and consultation in September 2024. See uk-ast-technical-group-draft-report-and-recommendations.pdf
7 See Citi_Securities_Services_Evolution_2024.pdf: citibank.com. The survey found that the number of respondents expecting a move to real-time, atomic settlements within a decade has risen from 13% to 40%.
8 T+1 After Action Report: sifma.org
9 See McLaughlin, Dennis, The Trade-off Between Shorter Settlement Times and Multilateral Netting Benefits in Deferred Net Settlement (December 4, 2023); Journal of Financial Market Infrastructures, Vol. 11, No. 1, 2023.
10 See fx_ecosystem_05_fx_settlement_instant_still_distant_apr2024pdf.pdf: cls-group.com
11 Instant and same-day settlement is possible today in the FX market, though the volume of trades is low. A recent survey conducted with several CLS settlement member banks found that 8.4% of their overall trade flow was same-day.
12 2023 survey from Bank for International Settlements found that 94% of central banks are exploring CBDCs. See Embracing diversity, advancing together – results of the 2023 BIS survey on central bank digital currencies and crypto.
13 See cls_opinion_piece_cbdc_the_fx_game_changer_19mar2024.pdf: cls-group.com
14 At this time, it is not clear if there is a market desire or ability to move at scale, in a networked manner, to T+0 and a world of instant settlement. See GFXD, July 2023, mag-accelerated-fx-settlement-final-july-2023.pdf: gfma.org
15 An increase in banks' CLSSettlement liquidity requirements, not their global FX activity.
16 Whereas settlement in CLSSettlement occurs on a gross basis, the corresponding funding process takes place on a net basis, delivering huge liquidity efficiencies. Funding requirements for each CLSSettlement member are based on a multilateral net calculation of the expected positions in each CLS-eligible currency. This multilateral netting results in liquidity savings of approximately 96%. Pay-in obligations can be further reduced using an optional in/out swap tool. As a result, CLS settlement members fund only around 1% of daily settled value.

For more information please email info@cls-group.com

FX Global Code

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