T+1, the FX ecosystem and CLS:

What a difference a day makes

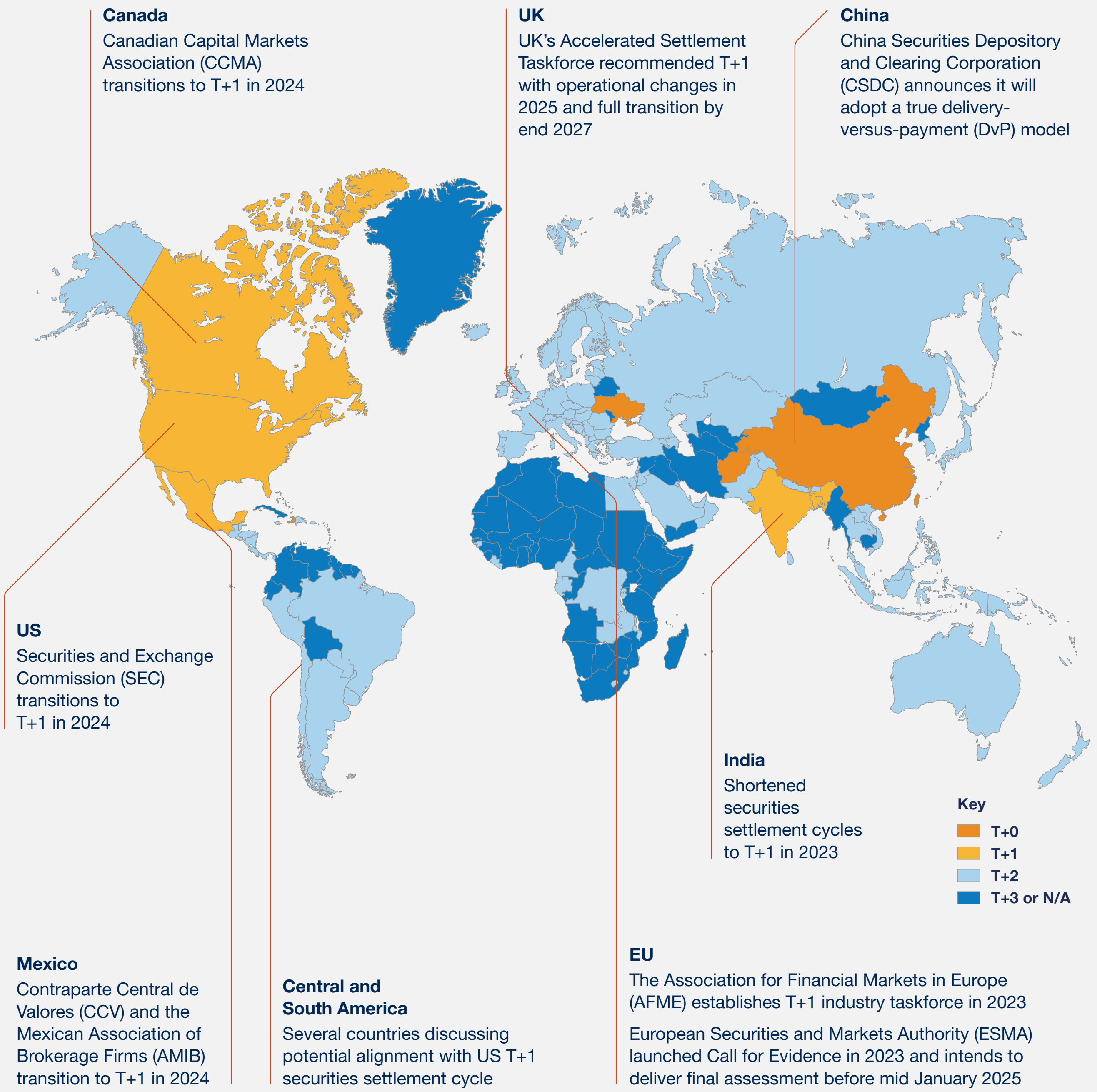
The global financial landscape is set to undergo significant transformation as the settlement cycle in the securities market shortens from T+2 to T+1. To the extent currencies must be exchanged to fund cross-border securities purchases, the shorter securities settlement cycle will limit the time allowed for the corresponding FX settlement cycle. CLS has been actively engaging with sell- and buy-side clients and industry bodies to better understand the implications of the T+1 shift on the FX community.

Global momentum toward T+1

Over the past 50 years, securities settlement cycles have shortened substantially, and this trend appears to have accelerated in recent years. When stock exchanges were established over 200 years ago, T+14 was the typical settlement period.

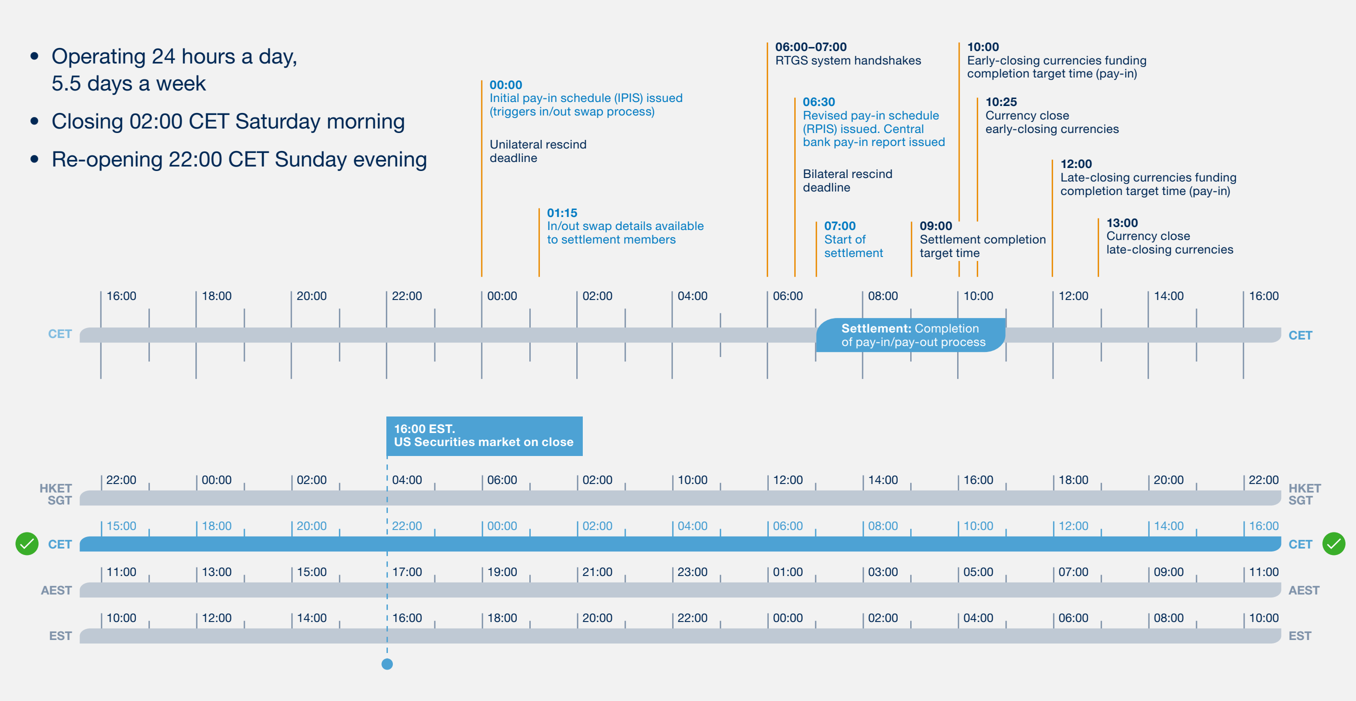
Between the 1970s and 1990s, the settlement cycle shrank to 7, 5 and then 3 days. T+2 became the rule for securities in 2014 for the European Union and in 2017 for the US. The shift towards T+1 is now gaining momentum worldwide (figure 1).

Figure 1: **Adoption of T+1 in the securities market**



Source: CLS and Swift; swift.com/news-events/news/work-friction-drivers-towards-seamless-securities-settlement

Figure 2: **CLSSettlement operational timeline**



How T+1 impacts cut-off times in FX

In May 2024, the US and Canada shortened their settlement cycles from T+2 to T+1. This compression impacts financial markets worldwide, given that almost 20% of securities and 16% 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 T+1 securities trade in the US, potentially forcing them to make and settle an FX trade same-day (T+0) in Europe and Asia, respectively. In other words, the shift to T+1 for securities requires shifting to T+0 for FX, at least for some parts of the business.

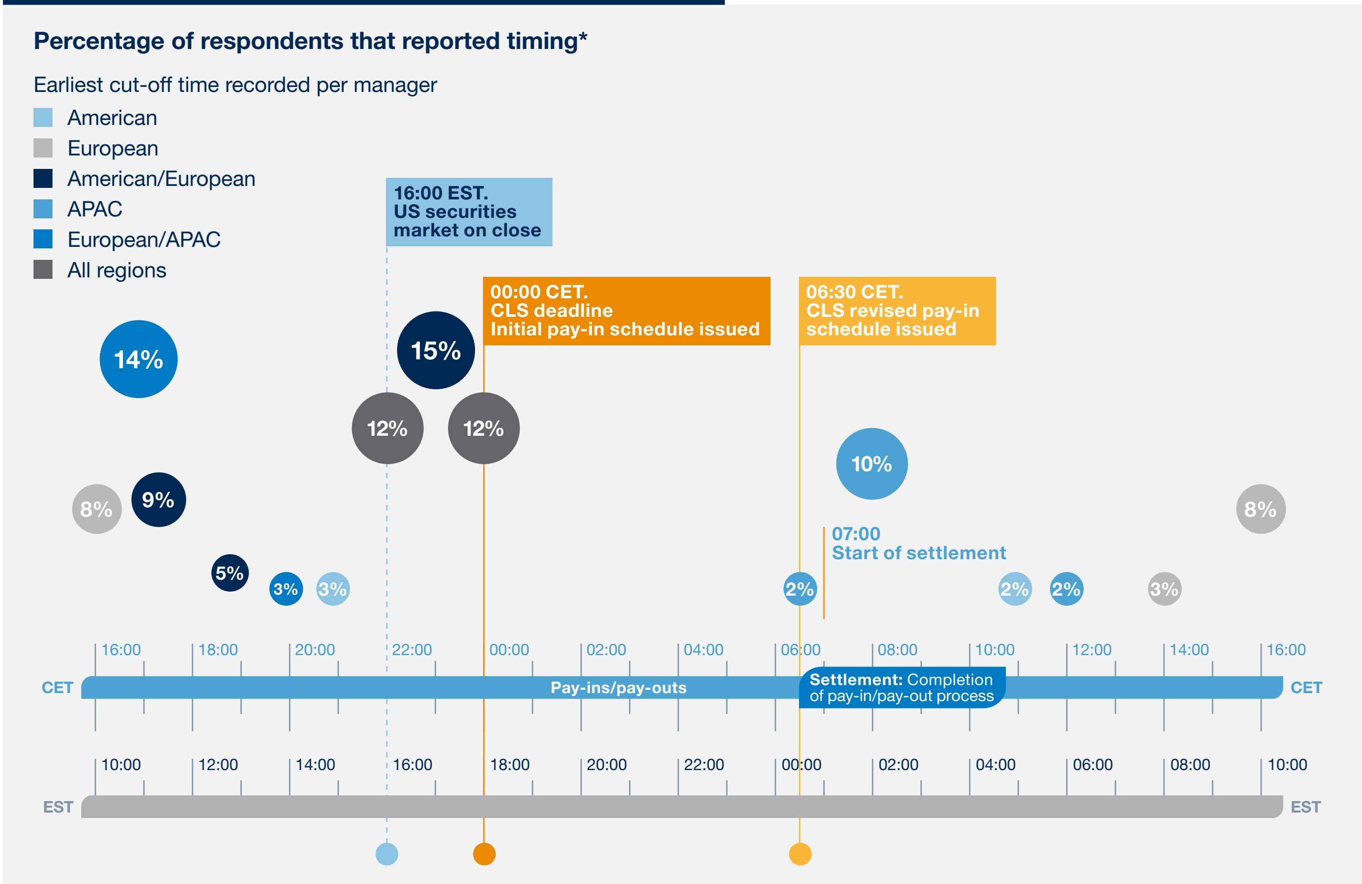
CLSSettlement offers FX settlement risk mitigation through payment-versus-payment (PvP) settlement and liquidity optimization through multilateral netting. In a T+1 world, the service may not be usable for a small fraction of securities-related cross-border currency trades.

In the US example, when the US equity market closes at 16:00 EST (22:00 CET), time is limited for the associated currency trading. To align to the T+1 securities schedule, FX instructions should be submitted to CLS by the beginning of the day of settlement – 00:00 CET on day T+1 (the initial pay-in schedule (IPIS) deadline) – to enable securities settlement on day T+1. In extremis, there is a reduced window of only two hours to arrange the submission to CLS (figure 2). Time constraints may prevent market participants from using CLSSettlement for these trades, which could in turn lead to increased FX settlement risk (if they settle without PvP) and higher liquidity needs (due to less multilateral netting).[2]

1 Department of US Treasury, "Foreign Portfolio Holding of US Securities", 30 June 2022.
2 Multilateral netting in CLSSettlement yields significant liquidity benefits for CLS settlement members, resulting 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 the total value of their payment instructions on a typical day. This tremendous reduction in overall funding requirements makes considerable liquidity available to the FX market and beyond. Removing transactions from CLSSettlement would diminish the pool for multilateral netting and thereby tend to reduce the liquidity savings.

The involvement of custodians may heighten the challenge of not meeting the CLS deadline, both at jurisdictional and global levels. For parties that access CLSSettlement indirectly through CLS settlement members – representing approximately 20% of CLSSettlement average daily value (ADV) – it is the custodian settlement member that handles all payment instructions and funding. Custodians may set cut-off times for their clients well ahead of midnight CET to ensure adherence to CLS's deadlines (figure 3).

Figure 3: **Asset manager outreach – custodian cut-off times**



* Percentages indicate the percentage of asset manager respondents in a given region that reported the indicated time as their earliest cut-off time.

Impact on CLS without any market adjustment

To quantify the potential impact of the move to T+1, CLS first analyzed its own transaction data and found that approximately 1% of CLSSettlement's ADV (USD6.6 trillion) is executed on a T+1 basis, comprising volumes where one side is USD and a fund is a party to the trade (figure 4). Therefore, the value that may need to move to T+0 is likely to be approximately 1% of CLSSettlement's ADV, assuming no changes to participants' trading and operational processes.

The EU and UK time zones work more favorably with CLS's timeline (with a settlement window between 07:00 and 12:00 CET), and CLS found that the impact on the euro area and the UK may not exceed 0.4% and 0.1% of CLSSettlement's ADV, respectively.

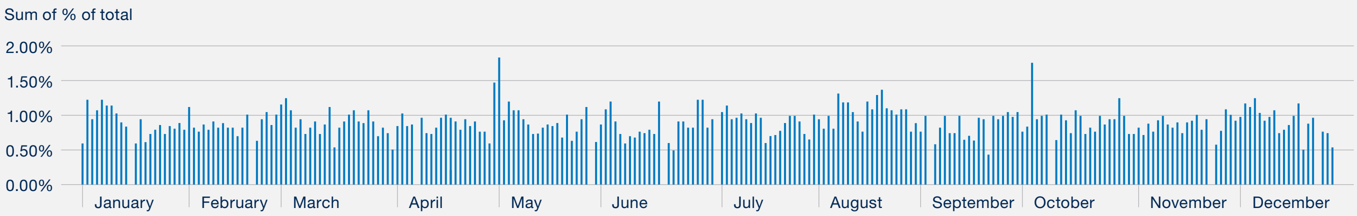
Figure 4: **CLS transaction data analysis – USD, EUR and GBP**

1% **CLS analysis of its transaction data showed that a value equivalent to approximately 1% of the CLSSettlement average daily settlement value (ADV) is executed on a T+1 basis,** comprising volumes where one side is USD and a fund is party to the trade.

0.4% ADV executed by funds on a T+1 basis involving EUR

0.1% ADV executed by funds on a T+1 basis involving GBP

Distribution across 2023 by % of T+1 buyside transactions for settlement



Source: CLS data, April 2023

Impact on CLS due to anticipated market changes

CLS engaged extensively with both buy- and sell-side market participants to understand the challenges T+1 securities settlement poses to the FX trade lifecycle. CLS outreach indicated that asset managers are exploring various execution options to minimize impact while still relying on CLS to mitigate settlement risk, even if there are no changes to custodian cut-offs or CLS deadlines (figure 5).

- **Estimate and execute FX at time of securities execution (T+1):** Approximately 11% of asset managers plan to estimate and execute their FX transactions at the time of securities execution, with a subsequent 'true-up' of FX requirements once the equity trade is confirmed.
- **Execute FX post-equity trade confirmation (T+1, including pre-fund):** Just over 17% of asset managers intend to execute FX transactions T+1 after the securities trade confirmation.
- **Maintain current FX processes:** 20% of asset managers expect no changes to their current FX processes, with the majority of settlement risk still being mitigated through CLS.
- **Open new locations:** A small segment (2%) of asset managers is considering opening new locations to manage the shortened settlement cycle.

In essence, CLS estimates that only around half of the 1% of CLSSettlement ADV (i.e., ~USD33 billion) could eventually be impacted by the move to T+1. FX transactions would be executed next day, or T+0, once the US security trade has undergone the full post-trade process. These FX transactions, now being same-day, may need to be settled outside CLSSettlement on either a gross or net bilateral basis.

Figure 5: **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%	!

Analysis around changes to CLSSettlement deadlines

CLS has reflected on what steps could be taken to support the ecosystem and address these challenges, acknowledging that from a CLSSettlement ADV perspective, the affected flows are comparably small.

CLS assessed the feasibility of extending the 00:00 CET IPIS deadline. A survey amongst CLS settlement members showed that over 40% of settlement members, representing approximately 50% of CLSSettlement's ADV, may need to undertake system development to accommodate a move in CLS's IPIS deadline, with considerable implementation time.

In addition to the required adaptations on the settlement member side, any material changes affecting the risk posed by CLS could require regulatory engagement and a comprehensive risk assessment supported by detailed modelling and analysis.

What's next?

Based on CLS's own analysis and outreach to both buy- and sell-side market participants, the overall impact of the shortening of settlement cycles in the US securities market to CLSSettlement business appears to be limited to approximately 0.5% of its USD6.6 trillion ADV.

Additionally, while an extension to CLS's midnight CET IPIS deadline could allow more time to submit payment instructions, over 40% of settlement members would require system development to accommodate the change, with considerable time to implement.

Consequently, CLS has not made any operational changes to CLSSettlement in advance of the T+1 rollout at the end of May 2024,[3] maintaining the midnight CET deadline for the submission of instructions to be settled next day. However, settlement members can still submit their trades up to 06:30 CET for settlement that day.

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 market. As the industry moves forward, prioritizing execution and operational efficiency across the asset manager and fund community will remain a focal point, and CLS offers several additional products to support market participants (figure 6).

Figure 6: **Additional CLS products to support market participants**

CLSTradeMonitor	CLSNet
Helps asset managers: • 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 through automation and straight-through processing by removing manual interventions from the netting calculation process • Reduce funding and the number of payments required by facilitating payment netting • Improve intraday liquidity • Adhere to the 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.

3 cls-group.com/news/update-on-the-potential-change-to-clssettlement-timelines-following-the-move-to-tplus1-securities-settlement/

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

FX Global Code

Using CLS products and services plays an integral part in helping you comply with the FX Global Code. Find out more at cls-group.com

Trusted by thousands of counterparties within the global FX ecosystem, CLS makes FX safer, smoother and more cost effective. Trillions of dollars' worth of currency flows through our systems each day.

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Hong Kong
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New Jersey

info@cls-group.com
cls-group.com