T+1 Settlement Cycle FAQ (U.S.)

March 3, 2022

The following Q&A will help you understand changes required to support the T+1 Settlement Cycle transition and facilitate meaningful conversations with your service providers, brokers and internal staff. We will continue to update the document as more information becomes available. If you have any questions, please email them to your relationship manager.

What is happening?

The Securities Industry and Financial Markets Association (SIFMA), the Investment Company Institute (ICI), and The Depository Trust & Clearing Corporation (DTCC) established an Industry Working Group (IWG) to accelerate the U.S. securities settlement cycle from trade date plus 2 (T+2) to trade date plus 1 (T+1) in the first half of 2024. On February 15, 2023, the Securities Exchange Commission (SEC) approved changes to modify Rule 15c6, *Shortening the Securities Transaction Settlement Cycle,* from trade date plus two (T+2) to trade date plus one (T+1). The SEC received over 3,000 comments, where most advocated for the shorter settlement cycle and supported a longer period to implement the change from the proposed March 31, 2024 compliance date. The industry widely promoted a conversion over the Labor Day weekend, September 2, 2024. In a vote of 3 to 2 the **SEC approved a May 28, 2024 compliance date.**

In the final rule the SEC excludes security-based swaps and adopts shortening the settlement cycle for firm commitments priced at 4:30 p.m. EST from T+4 to T+2. The rule promotes the completion of allocations, confirmations and affirmations by the end of trade date between broker-dealers and institutional customers.

The commission adopted new rule 15c6-2, which requires broker-dealers to enter into written agreements with their clients or enforce policies and procedures that are reasonable designed to achieve same day trade allocations, confirmations and affirmations by the end of trade date. In addition, the commission is enhancing the rule for Investment Advisors to retain the associated records subject to 15c6-2.

The SEC is also adopting new Rule 17Ad-27 to require clearing agencies that provide a central matching service to establish written policies and procedures designed to achieve straight through processing (STP) and file an annual report about their progression in achieving STP, which will be made available to the public on Edgar.

Why are the Industry Working Group (IWG) and the SEC reducing the settlement cycle?

The industry has been discussing the eventual migration to a shorter settlement cycle since the move from T+3 to T+2, which was implemented on September 7, 2017. In addition, the SEC has highlighted two recent events that increased market volatility: In March 2020 following the outbreak of the COVID-19 pandemic and in January 2021 following the heightened interest in certain “meme” stocks. These two episodes have highlighted potential vulnerabilities in the U.S. securities market that shortening the standard settlement cycle could help mitigate. Accordingly, the SEC approved a transition to a T+1 standard settlement cycle. They also believe that achieving settlement by the end of trade date (“T+0”) could benefit investors by further reducing the amount of time investors are exposed to their counterparties and related systemic risk. While the SEC is not a T+0 standard settlement cycle at this time, they sought industry feedback to better understand the challenges that market participants may need to address and resolve to achieve T+0.

What operational areas will be impacted?

All operational teams are impacted by this change and industry participants must update their procedures and systems to adopt the shorter settlement cycle.

- **Trade Processing**
- **Middle Office**
- **Settlement Systems**
- **Securities Lending**
- **Asset Servicing**
- **Broker-dealers**
- **Client Onboarding**
- **Collateral Management**
- **Funding & Treasury**
- **FX**
- **Staff Operating Hours**
- **Regulatory Reporting**
- **Enterprise**

How will trading procedures be impacted?

The trade life cycle will be compressed from T+2 to T+1. This means financial institutions will have less time to process trade confirmations, allocations and affirmations. All trade affirmations will need to be sent to DTCC by 9:00 PM ET on trade date (TD). As a result, Northern Trust will amend its current cut-off times to align with the shorter settlement timeframe. Northern Trust will announce the new cut-off times in due course through the Atlas Bulletin and on its website.

Institutions with an investment book of record held outside of the U.S. will need to consider the funding ramifications from a move to T+1. When planning for their settlement needs, such firms may need to purchase USD earlier or change the settlement cycle of the foreign exchange they execute.

Organizations should review their current settlement process for mutual funds and other pooled investment vehicles. In many instances these types of products have a T+2 settlement cycle and their trading schedules will need to be updated to T+1 to reduce operational issues. In addition, firms that operate non-U.S. mutual funds with exposure to U.S. securities should consider the potential cash management impact for the misalignment of the fund settlement with the underlying securities trade life cycles.

In the final Rule 15c6, the SEC requires registered investment advisers (RIAs) to maintain trade confirmation, allocation, and affirmations with date and timestamps. The “investment adviser recordkeeping rule is designed to ensure that registered investment advisers that are parties to contracts under Rule 15c6-2 to retain the records to achieve same day trade matching. Therefore, the SEC does not approve Northern Trust as a keeper of these records on your organization’s behalf. RIAs should prepare for this record keeping burden appropriately.

Why should I review my standing settlement instructions?

Maintaining and updating Standing Settlement Instructions (SSI) are key components for timely affirmations and settlements. Clients should review their existing SSIs and validate they have the correct counterparty SSIs. Incorrect SSIs will result in late trade matching and could result in unnecessary fails. All trades will need to be matched on T+0, which means less time to resolve settlement issues. Trades must be submitted to DTCC before their 9:00PM EST cut-off time.

How will securities lending be impacted by the move to T+1?

The industry is changing the “best practice” securities lending recall cutoff time from 3:00PM EST on T+1 to 9:30PM EST on T. Firms that manage their own direct lending programs will need to work with their service providers to align to this earlier recall process.

The T+1 settlement cycle will impact trading practices around the expiration dates of voluntary corporate actions. In many instances, the issuer may often provide a Guarantee of Delivery feature that allows investors to purchase securities on the offer’s expiration date and still participate in the offer while their securities are in the process of settling. This is referred to as the cover/protect period where unsettled purchases are instructed as a protect and then covered once they settle, which is aligned with the standard settlement cycle. In a T+2 settlement cycle, the cover/protect period is often expiration date plus two (2) trading days. In a T+1 settlement cycle, the cover/protect period will be the expiration date plus one (1) trading day.

The current timing for issuing a securities recall from the borrower must be changed to align with the new T+1 settlement, which cannot begin until the trade execution is received by Northern Trust.

Will there be any changes for corporate actions?

In a T+1 environment, ex-date and record date will be the same, commonly referred to as “regular way ex-date.” With regular way ex-date, due bills are not necessary as any trade entitled to the dividend will settle on record date. However, due bills are required for any ex-date that is not a regular way ex-date. The exchanges set ex-dates and typically will set a later ex-date (e.g., day after payment date) for stock or large cash dividends that exceed 25% of the value of the stock. This practice helps to maintain market values because in a regular way ex-date, the price will typically drop by the value of the dividend on ex-date; however, the proceeds would not be paid until later. This undervalues the stock and impacts portfolio modeling and purchasing power. Any irregular ex-date will still require a due bill. Organizations must adjust the ex-date period for regular way ex-date and modify the due bill period calculation for regular way and irregular ex-dates.

To prepare for the migration to T+1 settlement, DTCC needs to review and modify the interim accounting process to account for the shortened period and verify that income entitlement and tracking processes (e.g., due bill fails tracking, stock loan income tracking and repo income tracking) are adjusted and functioning properly. Firms should review their entitlements process.

The Industry Working Group (IWG) published on August 1, 2022, T1 Industry Implementation Playbook and DTCC T+1 Test Approach: Detailed Testing Framework to help firms set up their own change programs, which highlighted some key considerations:

- Organizations should test with their data providers to ensure continuity with down-stream processing.
- Organizations should review standardization with settlements on the underlying ADRs (American Depositary Receipts) on global markets and cross-currency funding.
- Eligible positions must be established based on T+1 ex-dates for mandatory events and income, including dividend reinvestment processes.
- Organizations must update client notifications for voluntary events.
- Ex-date calculations must be shortened to record date minus one.
- Mandatory warrants and rights distributions must be based on a T+1 ex-date.
- Changes to client messaging and reporting requirements should be considered.

Will there be any changes to the FX process?

Currently there are no anticipated changes to FX systems since the applications currently support same day FX. However, Northern Trust is reviewing the current cut-off times and any changes will be announced through Atlas Bulletins and updated on our website.

Are there any currency pairs that are causing you concern regarding equities settling on T+1?

Currently there are no concerns with currency parings. However, institutions that are domiciled outside of the U.S. will need to consider the funding requirements for their trading activity and they must adjust to the shorter settlement timeframe. This would mean that some institutions may need to prefund their trading activity if their current operations cannot support same day FX on trade date or FX settlement in the U.S. on T+1 to align with the equities market.

Will Northern Trust still accept third party FX?

Yes, Northern Trust will still accept third party FX for accepted currencies. All third-party FX for funding trade activity must adopt to the shorter settlement cycle and counterparties will need to update their procedures.

Will T+1 trades still be able to settle through Continuous Link Settlement (CLS)?

Yes, they will need to be instructed to Northern Trust and matched by the counterparty promptly on T+0.

Will Canada's move to T+1 cause any additional issues?
No. The change program has identified enhancements to securities lending and trade processes, which were expected.

Do you believe either the U.S. or Canada will introduce penalties for late settlement?
No, there has not been any indication from the regulators that penalties will be introduced.

Is your organization considering implementing new technologies to handle T+1 settlement?
No new technologies are being considered at this time. Rather, opportunities to improve current technology and operational efficiencies are in focus.

When is Northern Trust expecting the SEC to approve the final rule?
The final rule was approved on February 15, 2024.

When is T+1 to be implemented?
The industry has requested a delay in the implementation date from March 31, 2024, to September 2, 2024 (Labor Day holiday). However, the sec approved a **May 28, 2024 (Memorial Day holiday) compliance date**, which is a three-day weekend in the U.S.

Are other markets considering a move to T+1 settlement cycle?
Yes, other markets are considering moving to T+1. India completed their transition to T+1, which we have highlighted in Northern Trust's Atlas Bulletins. This was completed in February 2023.

In Europe, the Association for Financial Markets in Europe (AFME) published a white paper that covers the key considerations, similar to those outlined in the U.S. AFME has called for an industry task force to assess the risk, benefits, cost and challenges for moving to a shorter settlement cycle.

Canadian Capital Markets Association (CCMA) published information on July 31, 2022, entitled Let's Talk T+1, which highlights key tasks that provide the basis to move to T+1 on May 27, 2024.

Other markets are considering the move as well. Northern Trust is closely monitoring regulatory developments globally and anticipates formal announcements. We are working closely with our sub-custodians to ensure a smooth transition for all global settlement changes.

How has Northern Trust engaged with the industry in its efforts to prepare for the move to T+1?
There is regular engagement with industry groups at the Northern Trust enterprise and Asset Servicing business unit levels. Northern Trust plays an active role in a number of industry forums and working groups addressing T+1, including the Association of Global Custodians (in which Northern Trust serves as a co-chair of its T+1 Working Group), the Investment Company Institute (ICI) and the Securities Industry and Financial Markets Association (SIFMA). The Asset Servicing transition program is evaluating the outcomes of the industry forums to align Northern Trust's program with best practices for converting to T+1 settlement.

How will the program keep clients and relationship staffed informed?
The program has established an active communication strategy with stakeholders across our business and our clients, which will be distributed through our established communication channels: Our website, nt.com, regulatory forums, client meetings, Atlas Bulletins and other distribution channels.

What are the next steps?

Northern Trust has reviewed the IWG playbook and has incorporated the industry considerations and the test approach in our change program. A summary of the components of the playbook are as follows:

- Overview of the T+1 transition: Contains timelines, milestones, and guidelines for market participants to assist in the planning, development, testing, and migration to a T+1 settlement cycle.
- Primary areas of focus: Provides suggested activities across a number of business areas, including trade processing, asset servicing, documentation, securities lending, prime brokerage, and funding and liquidity.
- Next steps: Details considerations for firms in the planning and execution of these impact assessments and implementation considerations, including:
    - response to regulatory changes;
    - industry testing (DTCC hosted a testing meeting on November 15, 2022); and
    - business readiness for migration.

Organizations should start their own impact assessment to determine which, if any, of their internal processes will need to be changed, which include but are not limited to:

- existing batch and manual processes;
- trade confirmation, allocation and affirmation processes;
- SSI review to ensure accuracy;
- engaging with your brokers and other service providers to assess any downstream impacts; and
- setting up your own change program.

Additional communications will be sent through our normal distribution channels. If you have any questions, please reach out to your relationship staff at Northern Trust.

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