



T+1: HAVE WE PROVEN A POINT OR MANY? MOVING TO LOWEST RISK AND TO BE PRODUCT DRIVEN MARKET

Viraj Kulkarni
PIVOT Management Consulting (OPC)

Many from our genre would recall a song we sang while in school, “**Hum honge kamayab, hum honge kamayab, ek din**”. The next gen grew up to the lines “**Apna time ayega**”.

In early 2000s on multi-level numerous engagements with Foreign Institutional Investors, we were repeatedly reminded of how India's Capital market settlements system was risky specially as pay in pay out were on different days, banking system was evolving.

In less than 2 decades, India with its more than 100 million investor base(current), in over 20000 pin codes, with over 5500 listed stocks, multiples of SROs (Exchanges Depositories, Clearing Houses) multiple variants of intermediaries- emerged out of T+ endless to successfully migrate to T+1 settlements- to being a world leader at that!

Hum ho gaye kamayab! Apna time aa gaya!! Atmanirbhar is what we say. Compliments to SEBI, RBI, the Exchanges, Clearing House, Intermediaries, Depositories, Banks for making a dream come true. Here is a look at what T+1 means.

India's Market Cap presently is approximately \$3.3 Trillion which translates approximately to 1.5 Bn trade average volume per day. Almost 25% growth happened in the last 18 months. Projections indicate the Market Cap is set to breach the \$5 Trillion, aided by significant inflows, advent of GIFT City, ever-growing investors, IPOs, increasing number of HNIs besides India attractiveness amongst others. Capital market inflows (including FPI) are interest free, generates employment, revenue amongst others. It's important to nurture this space.

Developments in Secondary markets require significant gearing up on multiple fronts besides Regulatory, market intermediaries, market segments, availability of quality resources etc. A move to T+1 significantly raises the gearing. Key focus remains- reduce costs, improve ease of doing business, risk management, greater investor protection, improved liquidity and increased STP.

SEBI introduced T+2 in equity markets in 2003. Beside risk management, it led to significant growth. India's Stock Exchanges, Clearing Corporations and Depositories used technology driven solutions to de-risk settlements, clearing

house settlements (at 99.99% it is amongst the highest worldwide) with no major settlement defaults in last 2 decades. Subsequent developments like interoperability, margining etc. significantly reduced risks, costs and led to greater STP.



IN LESS THAN 2 DECADES, INDIA WITH ITS MORE THAN 100 MILLION INVESTOR BASE(CURRENT), IN OVER 20000 PIN CODES, WITH OVER 5500 LISTED STOCKS, MULTIPLES OF SROS (EXCHANGES DEPOSITORIES, CLEARING HOUSES) MULTIPLE VARIANTS OF INTERMEDIARIES- EMERGED OUT OF T+ ENDLESS TO SUCCESSFULLY MIGRATE TO T+1 SETTLEMENTS- TO BEING A WORLD LEADER AT THAT!



Of the over \$3.3 Trillion Market Cap, \$2.1 Trillion is Custodied for Institutional Investors; of this over \$600 Billion is by the over 10,900 Foreign Portfolio Investors (FPIs); MFs Custody is of over \$380 Billion of AUC. India's \$2.1 Trillion Institutional Assets under Custody forms small part of the global over \$100 Trillion of Asset Under Custody (AUC). US holds the largest share of AUC, mostly held by local institutions.

September 2021, SEBI announced the plans to migrate to T+1 settlement cycle. It stunned the global markets as well as invited curiosity besides queries, excitement, and concern.

The two leading Stock Exchanges/Clearing Corporations issued modalities wrt introducing T+1, effective Feb 2022. Clearing Corporation require custodians to confirm the trades by 7.30 hours IST on T+1, failing which, obligation to settle trade would devolve on contracting brokers as hand delivery. The tight time frame potentially increases the size and no's of fails vs what existed in early 90s (when Hand delivery was in vogue for an altogether different reason).

Introduction of T+1 in India, can be bucketed into three aspects

- Opportunities
- Challenges
- Likelihood

Opportunities:

- I. India is the only country where over 3500 stocks have migrated to T+1 with remainder stocks to be migrated by January 2023 while successfully running the T+2 Settlement. Thereby slicing the risk exposures like never before
- II. India migrates from a Risk containment market to becoming a product driven market, creating more opportunities
- III. It leads to faster liquidity (saving of one day)
- IV. Reduce one day's funding costs
- V. Leads to more digital driven solutions
- VI. Leads to consolidation of volumes into fewer Intermediaries
- VII. Increased focus on Digitization reduced manual interventions and eliminating inefficiencies
- VIII. Risk Containment improved as Investors confidence grew
- IX. Retail investors have accepted the change
- X. It may also lead to increased weight age for Indian stock Market in Global ratings
- XI. Potential for India based entities to export best practices and knowledge transfer to develop other markets!
- XII. It infuses confidence in the investors, of India's capability and ability to protect investors interest while exponentially growing volume.

Challenges:

- I. **FPIs:** India dedicated funds are limited/India allocation also form part of the emerging markets funds. The over 10,900 FPIs accounts as of October 10th, 2022, are concentric of large and mostly mid-sized funds, whose investment decisions are strongly influenced by various factors especially costs. T+1 has the potential to impact such Funds with respect to trade allocations, risk exposures, confirmations, Reg exposures, costs (local as well as cross border), allocation of trade by Fund Manager, time zone and logistical challenges relating to communications with various market intermediaries operating in India.

T+1 may lead to concentration risk as the FPIs may reduce the number of brokerage firms and other intermediaries. These are driven by operational, cost factors and challenges associated with adapting the new settlement regime.

FX costs may increase as liquidity in INR-FCY market by evening of T will be impacted. FPIs may find T+1 confirmation demanding.

- II. **Mutual Funds:** Purchase/sell happens through multiple brokerages. These will have to be reduced for operational efficiency. End of day / Post trade activity (wrt trade allocations/confirmations starts at 15.30 hours and goes beyond 19:00 hours), this will have to be considerably

tightened. They undertake cash flow management function on T (T+1 for early pay-in in T+2 regime), fund custodians on T+1 early morning. Longer working hours, to align with exchange/ clearing house requirements and calculating NAV would add costs, stress, and operations risk.

- III. **Brokers (especially those engaged in institutional trades):** May experience higher percentage of obligation fails by custodians (lack of timely correctly matched instructions from client) resulting in more expensive hand delivery settlements/auctions. This requires significantly higher funding requirements, additional headcount, longer working hours, invest significantly in STP processing, leading to increased costs, potential defaults and revised higher allocations for system up gradation and associated risk management tools.

- IV. **Retail Investors:** Currently pre-fund their trades with early pay in being the preferred route. However increased costs at brokers may get passed to them, potentially resulting in increased investment costs. Cascading effect of auctions (20% plus cost approximately) will be on all buy side vs. the Clearing Corp.

- V. **Custodians/Global Custodians:** FPI, Global Custodian and local Custodian could be in different time zones. Process and Technology requirements will need immediate enhancement to ensure client confirmations to global custodians onwards to local custodians, to meet the significantly shortened deadline. Since over 70% of FPI business is through global custodians they have escalated that increased complexities (including regulatory and operational risks) would potentially lead to higher costs of servicing India settlements. Custodian activities in India will significantly rise as tighter time norms will add greater monitoring, more tasks, extended work hour amongst others. This may force custodians to review the fee structure and potentially increase cost of servicing and cost of doing business in India.

- VI. **Exchanges and Clearing Corporations:** Will have to turn around obligation statements at shorter notices, adding stress to system, risk grids, costs etc. Defaults adds potential stress to Guarantee Fund. **To the credit of the clearing corporations, in the last 9 months they have risen to the occasion and delivered T+1 and T+2 flawlessly. Compliments to them.**

Likelihood:

- i. Initially ticket size may potentially reduce as investors would like to be exposed to lower risks and obligations. This may impact inflows, revenues of Exchanges etc.
- ii. Globally G-sec and equity Settlements follow different paths, given inherent nature of investors/products/STP levels. While it's possible to do T+0 in G-sec, T+1 in equity remains a challenge globally, even in USA
- iii. FX risk, costs will exponentially increase. Current choice between ToM vs cash, may move to cash in T+1 market, increasing cost and liquidity issues

- iv. FPI inflows likely to slow down; some FPIs may adopt watch mode, though India is still the most attractive emerging market
- v. Changes in Standard Operating Procedures (SOPs), internal control, development/ installation of technology solutions, training, etc. will need a look in and translate to additional forced activity spread over 4-6 months. The cost and timelines can't be quantified
- vi. FPIs and MFs tend to hold most stocks for longer durations and thus a deep dive on the merit of T+1 may yield that not all segments have significant benefits
- vii. Overseas investors / Global Custodians may prefer other emerging markets, which are relatively are in line with their system and Service capabilities, lower in costs
- viii. Tax firms will have to provide tax certificates at shorter notices, increasing costs and commitments. It paves way for digitization of processes at their end
- ix. Shortage of trained personnel has led to an almost 25% increase in costs across the industry. This move will add to longer hours of work, higher attrition, higher costs of staffing in an already staff starved/ high attritions market
- x. Many Institutions in India/overseas still follow COVID protocol attendance. A normalcy (including return of office) is expected only by January 2023.

Making T+1 effective may need:

- I. Trading hours change: Commence at 09.00 hours and close at 15.00 hours (currently closes at 15.30 hours), to lower the stress and costs
- II. Settlement of transactions on basis of confirmation, rather than sighting of funds as is required by RBI
- III. Re-composition and realignment of Servicing Teams at market intermediaries to ensure Query/Resolution TAT
- IV. Allow short selling by institutional investors under certain defined circumstances
- V. Multiple avenues to raise cheaper working capital to broking community and investors
- VI. Aligning messaging platforms like SWIFT, in domestic segment
- VII. Allow outsourcing of all activities by Custodians. SEBI Circular states non-core (not defined) activities can be outsourced while being silent on the specifics.
- VIII. TDS Certificates wrt remittances - Shift from daily to weekly model
- IX. Develop active and deep Sec lending solution
- X. Shift reporting requirements from Daily to Weekly
- XI. Increase emphasis on digitization
- XII. Develop high quality resources trained in Capital Markets. Current shortage is at least 25,000 headcounts
- XIII. Limited banking license (matter listed by RBI in 2014) to Non- Bank Custodians as Stockholding, Edelweiss, Orbis, SBI-SG. This increases STP, significantly reduces settlement risk (Currently they settle approx. 18-22% of total volumes)
- XIV. Concentrate on reducing the lines of costs (over 25)

To conclude: While moving to T+1 is attractive and well-intentioned, the above key factors merit consideration and resolution, to the advantage of all/majority of stakeholders, especially Institutional Investors, Custodians, Broking Community and Government. The envisaged rollout time frame requires an open discussion and review by all stakeholders especially FPI's with ability to modify if needed. Concerns of the global and cross border players and investors have to be considered in the light of the fact that they operate in T+2 / T+3 scenario. While USA plans to rollout T+1 in 2024, the above-named segments would need to upgrade their strategies, policies, processes, systems, head count to address the needs of T+1 markets. **Herein it provides India the window to share with the world on how to migrate to T+1. Besides technology transfer India can also engage in providing knowledge transfer to other markets.**

India should aim at introducing more products, enabling FPI inflows to grow from \$600 Billion AUC to \$1.50 Trillion, as it expands its share in the global financial markets. India would need to showcase and have a significant outreach to the global investment community, of T+1 rollout to gain their confidence, their perspective of the new risk containment regime (a ask in the early 2000's). In the short run introducing T+1 is likely to yield limited gains while burdening market participants with more obligations.

We recommend rolling out T+1 especially stocks traded in by FPI and Institutional investors to post March 2023 learning from the experiences of the rolled out, given the upcoming holiday season and Turbulence in Europe (accounts for over 3200 FPIs).

India has proven a significant point and how. By leading from the front and **rolling out T+1 without resorting to any of the international or global processes. A truly ATMANIRBHAR initiative.** While basking on this monumental change lets focus on making it work profitably, responsibly to the benefit of all.

Compliments again to Ministry of Finance, SEBI, RBI, Exchanges, Depositories, Clearing Corporations and all the intermediaries.

Viraj Kulkarni: PIVOT Management Consulting (OPC), is an instance of ATMANIRBHAR! India based PIVOT is Asia's largest Consultants in Custody space. Besides Custodians, its clients include Exchanges, Depositories, FPIs, PE, Cross Border segments. PIVOT launched successfully the first of its kind Training courses in Custody and Fund Accounting. Its specialist verticals include Custody, Fund Accounting, Client servicing, Broking, Operations. Located in India, Cyprus and soon in Luxembourg, PIVOT is a founding member of TSSAG, the Global Association of Consulting firms. With over 200-man years of senior management experience and expertise, the India leadership team is Viraj Kulkarni (Founder), R. Anand, Hemant Nagar, Jaydeep Jayakar, Piyoosh Gupta and Jignesh Mehta. Viraj Kulkarni in May 2022 was inducted into the GC hall of Fame as a Global Custodian (GC) Legend, the only India based Legend amongst the 346 Globally across 100 countries. This is the highest recognition in Custody for Global Contributions. PIVOT Cyprus is amongst the who's who of Cyprus.