InsideOps | Insights for Operations Leaders in Asset Management

T+2 Settlement is Finally Here

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Asset Managers need to ask themselves this question—is my house in order?

Shortening the settlement cycle for equities, corporate and municipal bonds, exchange traded funds and certain mutual funds is once again front and center news in the United States. The Securities and Exchange Commission (SEC) has adopted an amendment to shorten the industry’s standard settlement cycle for most securities to two business days. The SEC’s amendment is intended to reduce counterparty risk, systematic risk and improve capital efficiencies. The transition from a T+3 settlement cycle to T+2 is scheduled for September 5, 2017.

Now that the question of "when" has been answered by the regulators, all operations leaders must consider the question—is my firm prepared for a transition to a shortened settlement cycle? It is important for operational leaders to approach this question strategically by defining an optimal state for T+2, but with an eye towards a T+1 settlement cycle.

The Challenge
At the highest level, in order to confirm a seamless transition to T+2, operations teams would need to complete the trade verification process (allocation, confirmation, affirmation) and deliver settlement notifications to custodians in a more compressed timeframe, ideally on trade date. While further down the road, a potential transition to T+1 would surely require more significant process changes and investment in technology in order to achieve near real-time processing on trade date.

Some investment management firms might already be well positioned. These firms largely leverage technology, maximize straight through processing (STP) capabilities, have a well-documented and standardized process and actively track and benchmark operational performance via management reporting metrics. Other firms will likely face greater challenges when migrating to a shortened settlement environment. These firms generally have disparate trade processes across the enterprise, an abundance of manual or batch processes, incomplete performance metrics and legacy technology that is not easily optimized. Regardless of each firm’s level of preparedness, operations leaders should demonstrate to their business stakeholders how they will be positioned to meet the challenges of a shortened U.S. settlement cycle.

Are You Ready?
To help determine whether you are ready for the potential changes, the first step is to review key performance indicators and measure the effectiveness of existing processes, procedures and technology. The goal of this assessment is twofold—to determine operational readiness and to develop a strategic roadmap. An operational assessment should begin with an in-depth current state analysis of the trade support function, followed by a gap assessment to future requirements, and finally the development of a strategic roadmap. Undertaking this initiative in a timely manner should allow operations leaders to plan for any necessary changes and/or incremental investments required to position themselves for T+2 (and, ultimately, T+1).

3 areas to review for readiness
Key Performance Indicators
The ability to compile and analyze key performance indicators on an on-going basis is a fundamental requirement for the trade support function. Optimal trade verification processes and technologies are critical to ensure that an investment manager is prepared for the transition to a shorter settlement cycle. Without metrics, operations leaders would be unable to determine
whether existing technology and staff are being leveraged appropriately or accurately quantify current performance. Performance metrics, such as same day affirmation (SDA) rates and confirmation rates by executing broker and instrument type, should be published and reviewed by management regularly. Metrics provide the ability to proactively quantify the core competencies of the trade support function, the effectiveness of existing technology and the timeliness and efficiency of trading counterparties.

Process and Procedures

Operations leaders should confirm that all existing processes and procedures are fully documented and understood. A key component of the current state analysis is to identify unique and complex processes used to support trade verification. These unique processes could be the direct result of internal or external factors, such as working with manual brokers/dealers or custodians. Therefore, it is important to understand and validate each one in order to determine whether there are opportunities for standardization and automation.

Technology

Validating the current technology infrastructure begins with capturing an inventory of platforms, applications and user developed tools which could result in a better understanding of how effectively technology is being used across the enterprise. Understanding the current technology infrastructure can also provide an opportunity to review the cost effectiveness and reliability of existing vendor solutions. In an environment of shrinking headcount and tighter budgets, operations leaders need to be aligned with the right vendors while striving for a minimal technology footprint that will facilitate STP of trade details from order management systems to counterparties, custodians and prime brokers.

What Needs to Change?

Operations leaders should leverage the current state analysis to determine where they stand today, which steps must be taken in order to be ready for the interim state of T+2 and the incremental steps necessary to reach a target end state for T+1. While assessing the gaps between current and future state, opportunities will likely surface as the following questions are asked:

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<tr>
<th>Domain</th>
<th>Key Questions</th>
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<tbody>
<tr>
<td>Technology</td>
<td>• Are there any barriers to STP and/or SDA that could be removed with technology?</td>
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<td></td>
<td>• Is the majority of internal workflow automated and exception based?</td>
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<td></td>
<td>• Have industry standards and best practices been adopted to help ensure automation with external parties (i.e., counterparties and custodians)?</td>
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<tr>
<td>Operating Model</td>
<td>• Will the current operating model help meet interim and long term future state needs?</td>
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<td></td>
<td>• Should operations be reorganized in order to maximize scale?</td>
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<td></td>
<td>• Would a Center of Excellence help to confirm best practices?</td>
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<td></td>
<td>• Does the staff have access to tools and knowledge to help resolve critical exceptions in the most efficient and timely manner?</td>
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Understanding the steps required to achieve the target end state, opportunity costs associated with each and their relative priority in terms of key enablers for T+2 versus T+1 are essential in forming a strategic roadmap.

How Do You Execute?

Development of a forward looking plan that utilizes a realistic view of the level of effort required to fill the gaps identified in the current state assessment will generally confirm firms are ready to meet effective date deadlines. As this industry-wide initiative comes into focus and industry leaders provide additional guidance, firms should incorporate these changes into strategic project plans and budgets. As with many changes that impact the entire industry, the demand for external resources increases while internal resources continue to juggle multiple priorities. Firms that are quick to recognize their existing limitations and plan accordingly to remedy those shortcomings will help smooth the transition to T+2 this September.

Conclusion

T+2 in the United States is now here and T+1 is highly likely to come down the road. The transition would require investment managers to accelerate post-trade processing. For some firms the transition and the impact to the business could be minimal while other firms may require strategic investments in both people and technology. Regardless of the level of automation or alignment to best practices, operation leaders need to understand the operational and technology gaps and develop a plan for remediating those shortcomings for a successful transition from T+3 to T+2 and, ultimately, to T+1.
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