Ibec Global

Expert Spotlight Series

As part of our Ibec Global Expert Spotlight series, we are excited to publish a succinct contribution from Brian Ruane, Senior Executive Vice President at BNY Mellon, on how T+1 settlement and central clearing of U.S. Treasuries is transforming U.S. market infrastructure. Brian explains the importance of the recent shift towards T+1 settlements in the U.S. and the steps businesses must take to be ready. This was one of the topics that emerged at our recent Ibec Global CEO dinner in New York City that we believe will be central to U.S. and global market infrastructure discussions going forward.

Brian Ruane,

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How T+1 Settlement & Central Clearing of U.S. Treasuries is Transforming U.S. Market Infrastructure

Financial market infrastructure in the United States (U.S.) is undergoing significant transformation and modernization with rule changes designed to improve the resiliency and liquidity of the U.S. equity, corporate bond, and Treasury markets. In 2024 the Securities & Exchange Commission (SEC) in the U.S. will roll out a shortened settlement cycle for equities and corporate bonds that reduces the standard settlement cycle for most routine securities trades from two business days after the trade date to one business day after the trade date, or from T+2 to T+1 in common parlance. By mid-2026, additional rule changes adopted by the SEC will significantly expand central clearing in the U.S. Treasury market. These reforms will have significant impact on the functioning of U.S. markets and the way in which market participants transact, clear, settle and finance their activity globally.

Regulators have indicated quicker T+1 settlement for equities, bonds, unit investment trusts and other financial instruments will help reduce risk and improve data accuracy across the financial system. While there are several potential benefits to this new ruling, the transition may present challenges for investment funds across several dimensions including liquidity management, operations, technology, communications, and compliance. Market participants may need to invest in upgraded systems and technology to handle faster settlements. Investors, particularly those in non-U.S. time zones, may also need to consider new trade execution and financing solutions. Efficient communication will be important between fund managers, brokers, and custodians as coordination between these parties is essential for timely settlement, accurate record-keeping and to ensure compliance with regulatory reporting, documentation, and investor communications requirements.

The U.S. Treasury market is generally understood to be the largest, safest, and most liquid securities market in the world, with more than $28 trillion securities outstanding, but has experienced bouts of disruption in the past. These episodes, as well as the significant growth in the national debt, have driven regulators to consider a range of potential options to improve the market's resiliency, most notably an expansion of central clearing. The central clearing rule adopted by the SEC in December 2023 will reassemble the U.S. Treasury market, requiring more trades to go through a clearing house or Central Counterparty (CCP). Currently, the only Treasury CCP is the Fixed Income Clearing Corporation (FICC), a subsidiary of The Depository Trust and Clearing Corporation (DTCC), a financial services company that provides clearing and settlement services for the financial markets. CCPs reduce counterparty credit risk and facilitate the clearing of market transactions by effectively becoming the buyer to every seller and the seller to every buyer. This rule will change the market significantly and require market participants to reassess how they operate in Treasury markets.

One of the first steps that market participants must take to prepare is assessing which of their transactions must be centrally cleared. Under the rule, CCP members would be required to centrally clear all repurchase agreement (repo) and reverse purchase agreement (reverse repo) transactions, all purchase and sale transactions with other dealers, and all purchase and sale transactions when acting as an interdealer broker. Notably, most purchase and sale transactions between dealers and clients are not in scope, nor are securities lending transactions.

Once market participants have assessed their eligible transactions, it is important to determine the proper access model and provider for them to centrally clear their transactions. There are several potential models for market participants to access the FICC, including becoming a member directly, or indirectly accessing central clearing through various agent or "sponsored" membership models designed for clearing client transactions.

After determining their access model, market participants may need to adjust their risk management processes to meet these new requirements, as margining and collateral management processes could change significantly. We believe dealers and their clients are likely to seek to optimize their collateral management processes as trades shift from bilateral to centrally cleared and margin requirements increase. These can be managed bilaterally or via triparty, which can simplify complex back-office processes and optimize the use of collateral and liquidity. Once implemented, these changes will have a significant impact on the Treasury cash and repo markets, as they will change the economics of many transactions. Transaction costs will increase as clearing costs go up for market participants that do not centrally clear their transactions today, while improvements in risk management seem posed to increase the market's resilience by decreasing counterparty credit risk in case of a market shock or counterparty failure. For the repo markets, netting which enables offsetting the value of multiple positions or payments due to be exchanged between two or more parties, should lower some balance sheet costs for dealers, but higher margin and sponsorship costs are likely to raise the cost of funding and leverage.

The move to T+1 and expanded central clearing is transforming U.S. financial markets and all market participants will be required to adapt. Experience dictates when market participants proactively prepare for market structure changes, they can create opportunities to invest and grow.

Brian Ruane is a Senior Executive Vice President and a member of BNY Mellon's Executive Committee. BNY Mellon's Clearing and Collateral Management services provide a full suite of triparty collateral management, institutional clearance, settlement, execution, and financing solutions supporting U.S. Treasuries, equities, bonds and international settlement in markets around the globe.