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THERE IS LESS TO WORRY ABOUT THE T+1 TRANSITION NOW

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

Retail platforms are enthusiastic while FPIs work on operational tweaks needed for adapting to a faster cycle

On 8 November, about two months after the Securities and Exchange Board of India (Sebi) issued a circular on the matter, India’s market infrastructure institutions came out with a detailed roadmap to address concerns expressed by industry bodies and broker associations. Let us examine where we stand on various viewpoints and what’s still to be addressed.

Let’s begin with the biggest concerns. Sebi’s 7 September circular had enabled a T+1 framework for the settlement of trades within a day, by giving stock exchanges the option of offering stocks on a T+1 basis. While T+1 was broadly welcomed by all stakeholders, there were concerns around the possibility of potential one-upmanship, as game theory would suggest, between our two key exchanges. What if one of them put out all stocks on a T+1 basis while the other didn’t? Market participants were uneasy with the prospect of a scrip being available on a T+1 basis on one bourse and T+2 basis on another, as this could lead to errors. The roadmap puts an end to these worries, as the same stocks will now be available on T+1 basis on all exchanges as per the timetable set out in the announcement. The bottom 100 stocks (based on market capitalization) will be available for trading on T+1 basis from 25 February 2022, with 500 stocks in the next lowest group getting added on the last Friday of each month, starting March. This is a great solution, and there is now the much-needed clarity for all stakeholders.

Secondly, foreign portfolio investors (FPIs) wanted time for consultations with various stakeholders to understand the new framework and identify changes that would be needed in their systems and operational processes, whether for the dispatch of settlement instructions, booking of foreign exchange (forex) or getting people working in different shifts to meet the new requirements. Industry bodies felt that a go-live date of 1 January was a bit too soon and more preparatory time was needed. We also need to consider that December is generally a month in which info-tech departments in many organizations are in ‘freeze’ mode, and many people take time off to celebrate Christmas and New Year’s. The roadmap provides thought-through answers here, and as FPIs largely trade only in the top 500 stocks, it will be around October or November 2022 before FPIs get impacted. Thus, they have plenty of time to get ready for T+1.

Feedback on the T+1 roll-out has been quite positive from domestic clients, as compared with FPIs. Platform service providers have come to dominate the retail space in the past few years, and their senior leaders have welcomed the T+1 framework as they expect retail investors would benefit significantly. They did not want a delayed switchover. Here’s where the roadmap scores big, as T+1 is now going to be available in a phased manner that will meet the expectations of domestic stakeholders. Once all Indian stocks are available on a T+1 basis, investors, small and large, domestic and foreign, will gain from its efficiencies. For instance, we could see equity mutual funds pay out redemption proceeds one day earlier, which is a positive outcome. Also, from the point of view of clearing corporations, risk is significantly mitigated in the T+1 framework. Under the current T+2 protocol, FPIs that opt for early pay in (EPI) for purchases end up making payments to the clearing corporation within a day, whereas the stocks are often received a day later. FPIs would be more comfortable with the faster settlement cycle, as it reduces their counterparty risk in this context.

As for the issues for FPIs that remain open, the first is related to the trade confirmation deadline, which is 7:30pm India time as per the circular issued by clearing corporations on 14 October. We can expect to receive a request from FPIs for an extension of the trade confirmation deadline to, say, 9pm or 10pm, to give them a couple of more hours to comply with the new process. Even then, FPIs from some geographies such as Australia, Japan, Singapore or even US (West Coast) are going to find this challenging to cope with. Other FPIs that route settlement instructions via their global custodians will find themselves pressed for time, given the short gap available between the receipt of broker contract notes and the India custodian's likely deadline of 6:30pm for the receipt of settlement instructions. Changes in stakeholder behaviour would be needed too. The allocation process can be more efficient, perhaps, with broker contract notes sent out during trading hours. Such a change would require brokers to capture the allocation formula in their systems at the start of the day, say, to facilitate instant allocations once trades are executed in accordance with what fund managers need done.

The only other key open issue is around forex booking, which currently happens on the morning of the T+1 day. In the revised framework, FPIs would have to book forex late evening India time, by when sufficient liquidity is currently unavailable. Hopefully, liquidity will flow to time slots where demand is seen. Also India's bank regulator needs to address the concerns of bankers around US dollars in nostro accounts attracting provisions of the large exposure framework.

In summary, India's capital markets regulator Sebi and the country's market infrastructure institutions deserve praise for constructively absorbing all the feedback and producing a roadmap that can certainly work. It is now over to the various stakeholders to constructively absorb this roadmap and make it work.

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