New T+1 Settlement Cycle

written by iasexam.com | 28/01/2023

Context- The New T+1 settlement cycle has come into effect.

Key Highlights

- T+1 settlement plan means that trade-related settlements must be done within a day, or 24 hours, of the completion of a transaction.
- For instance, under T+1, if a customer bought shares on Wednesday, they would be credited to the customer's demat account on Thursday.
- As many as 256 large-cap and top mid-cap stocks, including Nifty and Sensex stocks, will come under the T+1 settlement.
- After China, India will become the second such country in the world to start the 'trade-plus-one' (T+1) settlement cycle in top listed securities.

Changes

- Upto 2001, stock markets had a weekly settlement system.
- The markets then moved to a rolling settlement system of T+3, and further to T+2 in 2003. T+1 is being implemented despite opposition from foreign investors.
- However the United States, United Kingdom and Eurozone markets are yet to move to the T+1 system.

Advantages

- **Share delivery**: In the T+1 format, if an investor sells a share, they will get the money within a day, and the buyer will get the shares in their demat account within a day.

- **Operational efficiency:** The shorter trade settlement cycle which is set to be implemented augurs well for the Indian equity markets from a liquidity perspective. The shift will further boost operational efficiency as the rolling of funds and stocks will be faster.
- **Faster fund remittances:** It will also help investors in reducing the overall capital requirements with the margins getting released on T+1 day, and in getting the funds in the bank account within 24 hours of the sale of shares.
- **Safer markets:** A T+1 settlement cycle not only reduces the timeframe but also reduces and frees up capital needed to collateralise that risk.
- **Reduced unsettled trades:** A shortened settlement cycle reduces the number of outstanding unsettled trades at any point of time, and thus decreases the unsettled exposure to Clearing Corporation by 50 per cent. The narrower the settlement cycle, the narrower the time window for a counterparty insolvency or bankruptcy to impact the settlement of a trade.
- **Systematic risks:** The capital blocked in the system to cover the risk of trades will get proportionately reduced with the number of outstanding unsettled trades at any such point of time.
- Systemic risk depends on the number of outstanding trades and concentration of risk at critical institutions like CCPs, and becomes critical when this magnitude of outstanding transactions increases.

Disadvantages

- There are certain operational issues faced by foreign investors, as they operate from different geographies.
- Other issues include
  - Time zone differences,
  - Information flow processes, and
  - Foreign exchange problems.
- Foreign investors also find it difficult to hedge their net India exposure in dollar terms at the end of the day under the T+1 system.