Gains from changes to the settlement cycle

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The paper

Balasubramaniam, Narayanan, Tremacoldi-Rossi, Yadav, 2023:

- There is a lot of interest worldwide in going to $T + 1$ settlement
- It is believed this will reduce risk and free up capital. How true is this?
- The authors exploit the US market-wide move from $T + 3$ to $T + 2$ (March 2017) and the Indian move (ongoing, phased).
- Nice gains in capital requirements in the US.
- The Indian natural experiment is nicer.

A little Indian back story

- Started out at BSE, fortnightly and unpredictable
- At first, NSE, weekly netting period + netting by novation at the CC
- Then NSE, rolling settlement, got to T+3
- Now pushing to shorter.

We think those early moves were rather important.

Means and variances

- We are seeing this idea in many domains: A delay is fine, as long as one can plan around it, what really matters is the unpredictability:
  - urban transit time
  - judicial delays
- The early moves in India reduced unpredictability. Smaller gains later on.

Shorter settlement delays will always yield gains?

- Intra-day netting is *good* for the ability to do liquidity provision on short time-horizons (as long as the risk management system is not badly done, and it can err in either direction)
- Once the transaction is complete, pieces of process have to be done to move money and securities
- This does involve some delays.

Simple solutions that are being adopted today

- E.g. at zerodha.com, you must fully prefund all your transactions
- This makes life convenient for the securities processing
- But convenience in securities processing should not be the only consideration
- What we want as society is a large number of people who are alert to financial prices, who see situations, and rapidly put on a big trade
- After the trade is completed, the person should have time to mobilise money or securities

Professional traders vs. economic agents who inhabit the world

- Economic agent inhabits the world:
  1. Is aware of developments in firms and industries
  2. Periodically puts on a spot / derivatives trade based on unfolding information
  3. And then mobilises the money / securities, sometimes based on borrowing
- Professional trader:
  1. Gathers up all the pieces required to trade ahead of time
  2. Money, securities
  3. The person knows she is going to trade
  4. Such a person is likely to do a simpler kind of trading.
- (Institutional investors above a minimum size have the ability to cope with any strange requirements).

When we create market infrastructure that is more difficult for the former, this can have adverse consequences.

The computerised nirvana is an island within India

- UPI and Google pay are nice systems. Most of India would not use them for high value transactions.
- Most of India is nervous about working in a browser.
- Slower settlement systems create an on ramp for a larger and more diverse participation into the financial markets.
- This can foster greater liquidity, liquidity resilience, and market efficiency.

Conclusion

- No practitioner wants tighter settlement cycles. There is no research demonstrating a problem.
- State coercion should be grounded in manifest harm; this smells more of a prestige project and the domestic politics of finance.
- Differentiate securities by institutional ownership and analyst coverage and there may be some interesting phenomena.

Thank you.

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