T+1 Settlement System for Shares: SEBI

Why in News

Recently, **Securities and Exchange Board of India (SEBI)** allowed **stock exchanges to start the T+1 system** as an option in place of T+2 for completion of share transactions.

- It has been introduced **on an optional basis in a move to enhance liquidity.**
- **SEBI** is a statutory body established in 1992 in accordance with the provisions of the Securities and Exchange Board of India Act, 1992.

Settlement System

- In the securities industry, the **trade settlement period refers to the time between the trade date** that an order is executed in the market **and the settlement date** when a trade is considered final.
    - On the **last day of the settlement period,** the **buyer becomes the holder** of record of the security.

Key Points

- **About:**
    - If the stock exchange opts for the T+1 settlement cycle for a scrip, it will have to **mandatorily continue with it for a minimum 6 months.**
        - A scrip is a substitute or alternative to legal tender that entitles the bearer to receive something in return.
    - Thereafter, **if it intends to switch back to T+2, it will do so by giving one month's advance notice** to the market. Any subsequent switch (from T+1 to T+2 or vice versa) will be subject to a minimum period.
- **T+1 vs T+2 Settlement:**
    - In T+2, if an investor sells shares, the settlement of the trade takes place in two working days (T+2) and the broker who handles the trade will get the money on the third day, but will credit the amount in the **investor's account only by the fourth day.**
        - In effect, the investor will get the money only after three days.
    - In T+1, settlement of the trade takes place in one working day and the **investor will get the money on the following day.**
        - The move to T+1 will not require large operational or technical changes by market participants, nor will it cause fragmentation and risk to the core clearance and settlement ecosystem.

- **Benefits of T+1 Settlement:**
    - **Reduced Settlement Time:** A shortened cycle not only reduces settlement time but **also reduces and frees up the capital** required to collateralise that risk.
    - **Reduction in Unsettled Trade:** It also **reduces the number of outstanding unsettled trades** at any instant, and thus decreases the unsettled exposure to Clearing Corporation by 50%.
        - The narrower the settlement cycle, the **narrower the time window for a counterparty** insolvency/bankruptcy to impact the settlement of a trade.
    - **Reduction in Blocked Capital:** Further, 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 point of time.
    - **Reduction in Systemic Risks:** A shortened settlement cycle will help in reducing systemic risk.
- **Concerns of Foriegn Investors:**
    - Foreign investors have concerns **about operational issues** they would face while operating from **different geographies - time zones,** information flow process, and foreign exchange problems.
    - They will also find it **difficult to hedge their net India exposure in dollar terms** at the end of the day under the T+1 system.

Source: IE