Subject: Introduction of optional T+0 settlement and subsequent optional Instant Settlement, in phases, in addition to the existing T+1 Settlement Cycle in Indian Equities Cash Markets

1. Objective:

1.1. *The objective of this memorandum is to seek approval of the Board to introduce an optional T+0 settlement cycle, and subsequent optional instant settlement cycle, in addition to the existing T+1 settlement cycle, in secondary markets for equity cash segment, in order to facilitate the regulated market having instant settlement option for investors who may, in the absence of such option, be attracted to unregulated / less regulated markets like crypto markets. Thus, the objective is to maintain liquidity in the regulated markets for all classes of investors including FPIs. In addition this would also lead to low risk at the system level and improve efficiency.*

2. Background:

2.1. *Over the last few years, the Indian securities markets has seen robust growth in volumes, value of transactions, and in number of participants. This places further onus on SEBI to make markets more efficient and safer for all participants, including retail as well as foreign participants.*

2.2. *SEBI, in furtherance of its mandate for development of securities markets and investor protection, had shortened the settlement cycle from T+5 to T+3 in 2002, and subsequently to T+2 in 2003. Further, in 2021, T+1 settlement was introduced in a phased manner, and this was fully implemented from January 2023.*

2.3. *The significant evolution of India's payment systems in recent years, coupled with the technology, architecture, and capacity of our Market Infrastructure Institutions (MIIs) (Stock Exchanges, Clearing Corporations and Depositories), presents opportunities for further advancing equity market clearing and settlement timelines for those who wish to opt for such a facility.*

2.4. *India's payments and settlements ecosystem has long allowed for real time transfer of funds for all participants. The average Indian has rapidly embraced UPI and instant payment platforms. In addition, India's depository ecosystem has visibility of individual client level holdings in digital form, and so has the ability to effect instant transfer of securities. This feature is not present in other major jurisdictions. Put together, we have the ingredients to allow for instant settlement in equity transactions.*

2.5. *Increasingly, investors may show a preference for asset classes that claim to offer reliability, low-cost, and high speed of transactions. We run the risk of losing liquidity, particularly of retail investors, to less regulated markets and asset classes. To that extent, reducing settlement times and hence increasing operational efficiency of dealing in Indian securities can further draw in and retain investors in the securities markets.*

2.6. *The proposed optional T+0 settlement and subsequent optional Instant Settlement is only for equity cash segment and not for future and options segment. Also, trading session with T+0 settlement is envisaged to be shorter than the trading session having T+1 settlement . Further, in equity cash segment, there are delivery based and intra-day trades. Intra-day traders are expected to continue to trade in the T+1 settlement cycle since they would prefer a longer trading session. Thus, it is envisaged that only those investors doing early pay in delivery based trades are likely to participate in T+0 and instant settlement cycle.*

2.7. *Data shows that in 94% of individual delivery-based equity purchase transactions that are less than INR 1 lakh in value, the investor parts with the funds on the day of transaction (T+0) itself. However, she receives the securities into her demat account only on T+1.*

2.8. *For the period from April to December 2023, the overall delivery trades (in value terms) as a percentage of total trades was 57.7% at BSE and 44.4% at NSE. Further, individual investor delivery trades (in value terms) as a percentage of overall trades (both delivery as well as intraday) was 25.4% at BSE and 13.5% at NSE.*

2.9. *It is now envisaged that for equity cash segment, in addition to the existing T+1 settlement cycle, a shorter settlement cycle may be introduced as an option. Such an option can particularly be useful and targeted at the small individual investor, who as noted above,* *anyway pays-in the funds on T+0 itself. An optional shorter settlement cycle will also allow such investors selling securities to obtain funds on the same day.*

2.10. *It is also noted that the efficiency gains for investors from any shift towards optional T+0 and eventual optional instant settlement would also imply lower float balances and therefore lower hidden float income for market intermediaries such as brokers and custodians. As a result, the ecosystem will also move to a more transparent framework where intermediary charges and fees are more explicitly identified and disclosed. Also, fraud risk at the hand of intermediaries would come down, making the ecosystem safer.*

3. Consultation

3.1. Working Group of Stock Exchanges, CCs and Depositories: *In order to examine the feasibility and associated legal, operational, technological and market implications of the proposed introduction of optional T+0 / optional Instant settlement facility, a working group of NSE, BSE, ICCL, NCL, CDSL and NSDL was formed by SEBI. The final report of working group was submitted to SEBI on December 07, 2023.*

3.2. Public Consultation: *Based on the recommendations of the WG, a consultation paper was issued on December 22, 2023 (**Annexure-A**) soliciting public comments on the proposal of optional T+0 and optional instant settlement of trades. In total, response from 28 market participants were received. The table containing public comments on various proposals and comments of SEBI on the same is placed at **Annexure-B**.*

3.3. Deliberations with Brokers: *In order to understand the views of brokers (large and small) on the proposed optional T+0 and optional instant settlement cycle, views of brokers forum were solicited by the Working Group and discussions were also held by SEBI with broker forums and some brokerage firms.*

3.4. Deliberations in Risk Management Review Committee (RMRC) of SEBI: *Based on the public comments and the report of the WG, the proposal of optional T+0 and optional instant settlement of trades was discussed in the RMRC in its meeting held on February 19, 2024. The*

Committee deliberated on the agenda and noted that shortening the settlement cycle will further strengthen the risk management framework of the CCs and the overall equity market ecosystem. The Committee recommended proceeding with the proposal for introduction of optional T+0 and optional Instant Settlement of Trades in addition to the existing T+1 Settlement Cycle in Indian Securities Markets for Equity Cash Segment.

4. Benefits of the Proposed Mechanism

4.1. For Clients

i. The option is expected to provide flexibility in terms of faster receipt of funds to the sellers of securities, and faster credit of securities to the buyers. This is particularly expected to be useful for small individual investors, the majority of whom, in any case, are already paying on T+0 itself.

ii. The option strengthens investor protection by enhancing the control of the investor over the securities and funds, since both funds and securities would be credited into the clients' account directly for those who are trading through blocked amount using UPI facility ("UPI Clients"). Further, for other modes of payment, as is the current process, the funds/ securities would first be credited into the bank account/ securities pool account of the clearing member, which would then be credited to the client bank account/ demat account, quicker by a day in comparison to current timelines.

iii. The option will likely lower float balances and therefore lower hidden float income for market intermediaries such as brokers and custodians. As a result, the ecosystem will also move to a more transparent framework where intermediary charges and fees are more explicitly identified and disclosed.

4.2. For the Securities Market Ecosystem

i. Shorter settlement timelines would naturally reduce pre-settlement risk. In addition, for the optional T+0 cycle, to the extent that blocking of funds and securities precedes trading, settlement risks would be reduced as well. In the proposed instant settlement cycle, both pre-settlement and settlement risk would be virtually eliminated. All of this would reduce risks for market participants, Clearing Corporations (CCs), and the overall equity market ecosystem.

ii. *Shorter settlement cycle will free up capital for investors in the securities market, thereby enhancing the overall market efficiency.*

iii. *This would also help preserve liquidity in securities markets by retaining investors who would otherwise be attracted towards less regulated markets like crypto markets, which often claim to have a shorter settlement time horizon.*

iv. *Providing the option for instant settlement will help establish Indian equities as an asset class that offers transactions in a reliable, low-cost, and instant manner. In fact, this would firmly establish Indian equities as fundamentally superior in this respect to emerging alternative asset classes like crypto assets that often misleadingly claim to have such characteristics.*

5. Potential Concerns around the Proposed Mechanism – Possible liquidity fragmentation & associated issues

5.1. *Some market participants have expressed concerns that two different trading segments, viz. T+0 or Instant settlement cycle, and T+1 settlement cycle, may:*

i. *lead to liquidity fragmentation and affect efficient price discovery. Their concern is that while some individual trading volumes could shift to the shorter settlement cycle, institutions – such as Foreign Portfolio Investors (FPIs) that operate across time zones could face difficulties in making such a shift. Such institutions fear that this would limit them to T+1 cycle alone, which would have less liquidity on account of the individual shift. The concern expressed is that FPIs could lose up to 34% of the counterparty volumes.*

ii. *result in divergence in the price of same security across the T+0 or instant settlement cycle, and the T+1 settlement cycle.*

iii. *increase the transaction cost as the cost of arbitrage for trading in T+0 / Instant settlement and T+1 settlement cycle requires the payment of STT, Stamp duties, exchange fees, SEBI fees, brokerage, and GST. It is observed that the cost of arbitrage would be around 30-35bps.*

5.2. *All brokers may not be ready to participate in the T+0 / Instant settlement cycle given that the optional T+0 settlement and subsequent optional instant settlement entails system and technological changes at the end of the brokers.*

6. Mitigation of Potential Concerns

6.1. *This proposal is a protection against the potential concerns. As discussed in 4.2(iii), in fact the current proposal is designed to protect against the possible migration of retail investors to the crypto markets.*

6.2. *The proposed optional T+0 and eventual instant settlement are proposed as optional segments for both investors and TMs. Given this optionality, investors will naturally look to buy and sell in the segment that offers them the best price. This natural interest (where sellers look for the higher price and buyers look for a lower price) will itself act as guardrails to ensure that stock prices across the two segments do not diverge significantly.*

6.3. *In addition, there will be participants who can access both T+0 (or instant settlement) and T+1 markets, and they would bridge price and liquidity gaps between the two segments. It may also be noted that as a parallel, foreign exchange markets have settlements value 'today', value 'tomorrow', and value 'spot' and the presence of swap providers and arbitrageurs ensures that liquidity and prices transmit across all settlements seamlessly.*

6.4. *Note that we already have two large cash equity exchanges, and all major stocks are traded on both exchanges simultaneously. A combination of investor interest and arbitrages as described above, ensures that the prices on the two exchanges do not diverge significantly.*

6.5. *In addition, we propose to further address the small residual risk of divergence of prices between the two segments (T+0 or Instant settlement cycle, and T+1 settlement cycle) by instituting price bands that limit the price in T+0 (or instant) segment to within ± 100 basis points of the price in the T+1 segment. This 100-basis points proposal considers the current Securities Transaction Tax (STT) and other statutory levies, as outlined by respondents in the public consultation.*

6.6. *On the potential concerns of institutions, particularly FPIs, that they may have less liquidity in the T+1 segment, all the arguments provided above serve as mitigating factors. In addition, the following data points may be noted:*

i. *During April 2023 to December 2023, around 19.9% of FPIs cash market trades (in value terms) were matched with individual domestic investors on NSE.*

ii. *On NSE cash equity segment, around 38.5% of all individual domestic trades were delivery-based, and the balance were intra-day trades (without delivery). We expect that only some delivery-based individual trades are likely to shift to shorter settlement cycles, since intra-day traders would prefer to operate in the longer trading hours offered in T+1 settlement.*

iii. *From the above, it is inferred that during the said period, around 7.6% of FPI trades were matched with individual domestic (for delivery) investors. Even assuming that 50% of such individual investor (for delivery) volumes were to shift to the optional shorter settlement cycles, barely 3.8% of FPI counterparty volumes would be at stake.*

6.7. *With respect to the readiness of the TMs to participate in the T+0/ instant settlement, it may be noted that the facility is optional for both investors and TMs.*

7. Proposals and Rationale

Considering the recommendations of WG, public comments, recommendations of RMRC and internal deliberations, the following are proposed:

7.1. Phase wise implementation of optional T+0 and subsequent optional instant settlement cycle

7.1.1. Phase 1: *An optional T+0 settlement cycle (for trades till 1:30 PM) with settlement of funds and securities to be completed on the same day.*

Phase 2*: An optional immediate trade-by-trade settlement of funds and securities may be carried out. After the implementation of phase 2 (i.e. optional instant settlement), the mechanism of optional T+0 settlement implemented under phase 1 will be discontinued.*

7.2. Operational details of Phase 1: Optional T+0 settlement

7.2.1. Eligible Investors and Securities

7.2.1.1. *The eligible investors and securities for T+0 Settlement shall be as under:*

(i) All investors (including those that operate through a custodian) are eligible to participate in the optional shorter settlement cycle segments if they are able to meet the process and risk requirements. The framework and process flow for institutions operating through custodians to participate in the optional segments is under active discussion between the stakeholders. As an offshoot, such a refreshed process flow may also help significantly reduce the pre-settlement and settlement risk in the T+1 settlement ecosystem.

(ii) To begin with, the bottom 100 out of the top 500 scrips in terms of market capitalization may be made available for introduction of T+0 settlement. In each subsequent month, the next bottom 100 scrips from the remaining list may progressively be made available for T+0 settlement. The exchanges shall co-ordinate to publish a common list of securities and calendar for migration under T+0 settlement.

(iii) The surveillance measures applicable in T+1 settlement cycle shall be applicable to securities in T+0 settlement cycle.

(iv) Securities under trade-for-trade settlement and trading in periodic call auction sessions shall not be permitted for T+0.

7.2.2. Trading

7.2.2.1. *The mechanism for trading under T+0 settlement is proposed as under:*

(i) Exchange shall create a separate series/ group/ scrip code for T+0.

(ii) Price Band: The price in the T+0 segment will operate with a price band of ±100 basis points from the price in the regular T+1 market. This band will be re-calibrated after every 50 basis points movement in the underlying T+1 market.

(iii) Trade Timings: For T+0, there shall be one continuous trading session from 09:15 AM to 1:30 PM. No pre-open/ special pre-open/ block/ auction/ post close sessions will be allowed in this segment.

(iv) No trading will be allowed on settlement holiday/ ex-date of corporate action (including scheme of arrangement).

(v) Client code modifications will be permitted till 1:45 PM.

(vi) T+0 prices will not to be considered in index calculation/ settlement price computation. There shall be no separate close price for securities based on trading in T+0 segment.

(vii) The operational guidelines for implementation will be issued by the MIIs, in consultation with SEBI.

7.2.3. <u>Risk Management</u>

7.2.3.1. *The risk management framework for T+0 settlement is proposed as under:*

(i) Risk management will be done on a post-trade basis, as is done currently.

(ii) In case of UPI clients, the funds UPI block created by the investor or securities belonging to such investors that are re-pledged to CC shall be considered towards the margin requirements of the respective client. In case of shortfall, proprietary collateral of the TM/ CM shall be utilized towards margin requirements.

(iii) In case of other permitted clients, the margins shall be checked against the collateral allocated by the clearing member as per prevailing practice.

(iv) There shall be no pre-trade validation of funds or securities for T+0 orders, just as there is currently no pre-trade validation in the T+1 segment.

7.2.4. <u>Clearing and Settlement</u>

7.2.4.1. *The process for clearing and settlement of trades in T+0 segment shall be as under:*

(i) In case of UPI Clients, a single net funds obligation, and a single net obligation per security may be arrived at for each client. The netting of obligations will be at client level, without any offset across clients.

(ii) In case of other permitted clients (non-UPI), net obligations at member level may be arrived at as per the existing framework.

(iii) A new settlement type to be introduced at the CCs and Depository level for settlement of T+0 transactions.

(iv) <u>Pay-in</u>

a. Early Pay-In (EPI) of securities using block mechanism shall be mandatory for delivery in the T+0 market, under the new settlement type. The depositories shall provide details of the unique client code (UCC) for securities early pay-in to the CCs. CCs will match early pay-in against actual sale obligations. In case of excess EPI, CCs shall reverse the same.

b. *EPI transaction files will be shared by depositories with the CCs at pre-defined fixed time intervals.*
c. *In case of UPI Clients: To conduct funds pay-in, the CC shall debit the UPI blocks created by the clients by sending necessary instruction to its sponsor banks. In case of shortfall of UPI block, i.e., the amount being inadequate to meet the obligation at client level, the obligation shall be devolved on the member who will be responsible for settling the same through clearing bank account. In case of devolvement, any securities pay-out due to the client will be provided to client demat account with auto-pledge to the CM's client unpaid securities pledgee account (CUSPA). CC shall provide the details of TM ID and /or CM ID along with the auto pledge Flag for CUSPA.*
d. *In case of other permitted Clients: The net funds pay-in (including devolvement) shall be collected from the clearing bank account of the clearing member as per the existing mechanism.*
e. *The CC shall receive securities pay-in from the depositories after reversal of excess early pay-in.*

(v) Pay-out

a. *In case of UPI Clients: The CC shall provide funds pay-out directly to the designated primary bank account of the client, subject to the fulfilment of securities pay-in obligations. In case of securities pay-out, the CC shall credit the same to the primary demat account of the client. In case of primary demat account of client is closed or frozen, securities pay-out will remain in CC pool account.*
b. *In case of other permitted Clients: The funds/securities pay-out shall be provided to the clearing bank account/depository pool account of the clearing member.*
c. *In case of securities shortfall, there shall be a direct close-out at 110 % of the highest price of the day in T+0 session. In case of UPI clients, such close-out amount shall be recovered from UPI blocks of the client, if any, and any residual amount shall be devolved on the clearing member. In case of other permitted clients, the same shall be collected from the clearing bank account of the clearing member.*

7.3. Operation details of Phase 2: Optional Instant Settlement

7.3.1. Eligible Investors and Securities

7.3.1.1. *The eligible investors and securities under instant settlement mechanism shall be as under:*

(i) All clients.

(ii) To start with all securities available under Phase 1 will be made available under Phase 2 i.e. top 500 scrips based on market capitalization would be available under optional instant settlement.

7.3.2. <u>Trading:</u>

7.3.2.1. *The mechanism for trading under instant settlement shall be as under:*

(i) In case of instant settlement, only limit orders shall be allowed, so that adequacy of prefunding can be validated by the CC against the limit price.

(ii) Trading hours shall be from 09:15 AM to 03:30 PM, i.e. identical to T+1 segment.

(iii) Since settlement will be conducted on trade-by-trade basis without any time gap, client code modifications would not be possible.

(iv) Instant settlement prices may not to be considered in index calculation/ settlement price. There shall be no separate close price for securities based on trading in instant settlement segment.

(v) Other provisions w.r.t. price band, restriction of trading on certain securities and days as applicable to T+0 settlement shall also be made applicable to instant settlement mechanism.

(vi) Before implementation of the proposal, mock trading and stress testing of the systems at the MIIs shall be done to ascertain its readiness.

7.3.3. <u>Risk Management</u>

7.3.3.1. *The risk management framework for instant settlement would be as under:*

(i) An Application Program Interface based interface shall be built between depositories and CC to facilitate real-time intimation of early pay-in for validations, and to carry out instant settlements.

(ii) All orders placed on the exchanges will be first sent to CCs for validation of prefunding.

(iii) In case of buy orders, the CC will check availability of adequate pre-funding to cover the trade value along with other charges (such as STT, stamp duty, TM specified charges, etc.). In case of UPI clients, the pre-funding shall be validated against the UPI block created by

the client. In case of non-UPI clients and proprietary trading, the pre-funding shall be validated against the funds early pay-in done by the member and allocated to the respective entity. In case of custodian clients, the funds early pay-in shall be allocated at Trading member – Custodial Participant (TM-CP) code level.

(iv) In case of sell orders, the CC will check and ensure that early pay-in of securities has been completed. In case of custodian trades, the securities early pay-in shall also be required to be allocated at TM-CP code level.

(v) Only the orders that are successfully validated by CCs shall be allowed for matching.

(vi) Any order modification (involving price/ quantity change) would need to be validated by the exchanges once again with CC.

(vii) In case of any order cancellations, the same shall be transmitted by exchanges to CC.

7.3.4. <u>Clearing and Settlement</u>

***7.3.4.1.** The process for clearing and settlement of trades in instant settlement segment shall be as under:*

(i) Funds pay-in or pay-out for UPI Clients:

a) After each trade, the CC shall send a single instruction to the sponsor bank to debit the UPI block and

b) CC shall instruct its sponsor banks to provide funds pay-out to credit the primary bank account of the seller.

(ii) Funds pay-in/ pay-out for other permitted Clients:

a) CC will utilize the funds early pay-in towards the obligation.

b) CC will provide funds pay-out to the clearing bank account of the member.

(iii) Securities pay-in or pay-out for UPI Clients: After each trade, the CC shall send a single instruction through API to the depository to debit securities from the early pay-in done by the seller and credit to the primary demat account of the buyer. For pay-in, depositories will create hop-skip entries in TM/CM account as applicable.

(iv) Securities pay-in or pay-out for other permitted Clients: After each trade, the CC shall send instructions through API to the depository to debit securities from the early pay-in done by the seller and credit to the pool account of the clearing member of the buyer. For pay-in depositories will create hop-skip entries in TM/CM account as applicable.

(v) *Since the settlement is taking place on trade-by-trade basis and the client may execute sell trades throughout the day, the remaining securities early paid-in by the client will not be released upon part debit against a trade. The remaining quantity of securities early pay-in done by clients will be released by the CC after the end of the instant settlement market. Thus, against an early pay-in, there can be multiple debits throughout the day for multiple sell trades of client, and any excess remaining after all such trades will be reversed after market close.*

(vi) *In case the above transfers require an inter-depository transfer, i.e., if the seller has done early pay-in of securities in one depository and the primary demat account of the buyer is in another depository, the inter-depository settlement shall be handled by the depositories.*

(vii) *In case any trade involves inter-CC settlement (i.e., the buyer is clearing through one CC and the seller is clearing through another CC), then the CCs will provide pay-out in each other pool account/clearing bank account. The receiving CC shall complete the onward settlement to the client. This will introduce an additional leg in some settlements but would not impact the investors.*

8. *Specific public comments against the proposals mentioned above were received during public consultation. The gist of public comments against the proposals and response of SEBI is placed alongside as* ***Annexure – C****.*

9. ***Proposals for consideration and approval of the Board***

9.1. The Board is requested to consider and approve the following:

9.1.1. *Proposals at paragraph 7 above. The above decisions may be implemented through a circular.*

9.1.2. *The Board may authorize the Chairperson to take steps to implement the proposals with consequential, incidental and appropriate changes, as may be required in this regard.*

Annexure–A: *Available on SEBI website on the following URL:*

https://www.sebi.gov.in/reports-and-statistics/reports/dec-2023/consultation-paper-on-introduction-of-optional-t-0-and-optional-instant-settlement-of-trades-in-addition-to-t-1-settlement-cycle-in-indian-securities-markets-_80204.html

Annexure–B: *This has been excised for reasons of confidentiality.*

Annexure–C: *This has been excised for reasons of confidentiality.*