

CLIENT MEMORANDUM

SEC Shortens Standard Settlement Cycle to T+2

March 27, 2017

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On March 22, 2017, the Securities and Exchange Commission (the “SEC”) adopted an amendment to Rule 15c6-1(a) under the Securities Exchange Act of 1934 (the “Exchange Act”) to shorten the standard settlement cycle for most broker-dealer transactions from three business days (T+3) to two business days (T+2) after the trade date.¹ The amendment is intended to “enhance efficiency, reduce risk, and ensure a coordinated and expeditious transition by market participants to a shortened standard settlement cycle.”²

In the rule’s accompanying release, the SEC noted that the financial markets have expanded and evolved significantly since 1993, when the settlement cycle was established at T+3, and that those changes warrant shortening of the standard settlement cycle to T+2.³ In addition to reducing credit, market, liquidity and systemic risk, the SEC views the shortening of the settlement cycle to T+2 as consistent with the SEC’s broader focus on enhancing the resilience and efficiency of the national clearance and settlement system and the role that certain systemically important financial market utilities play

¹ *Amendment to Securities Transaction Settlement Cycle*, Securities Exchange Act Release No. 80,295 (Mar. 22, 2017) at 22; available [here](#) (“Adopting Release”).

² See “SEC Adopts T+2 Settlement Cycle for Securities Transactions,” SEC Press Release (Mar. 22, 2017), available [here](#) (“Press Release”).

³ Adopting Release at 7.

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in concentrating and managing related risks.⁴ In their comments at the SEC meeting on March 22, 2017, Acting Chairman Piwowar and Commissioner Stein both commented on the unusually strong level of consensus surrounding the move to T+2, underscoring the wide array of support the proposal has received among regulators and industry participants, including buy-side and sell-side firms and service bureaus.

The compliance date for the rule change is September 5, 2017, which matches the migration date recommended by the industry.⁵ To assist with the industry's preparation for the implementation of a T+2 settlement cycle, the SEC has established an e-mail address – T2settlement@sec.gov – that can be used by the industry or members of the public to submit follow-up inquiries to SEC staff regarding the move to T+2 settlement.⁶

I. Background

The Standard Settlement Cycle is the process by which the securities industry completes trade settlement for equities, corporate bonds, municipal bonds, and certain other securities. "Clearance and settlement" refers generally to the activities that occur following the execution of a trade. The timeline for this process (a "cycle") is described in terms of the number of days after a trade that settlement occurs (e.g., T+2, T+3, etc.). The SEC originally adopted Rule 15c6-1 in 1993 to establish a standard settlement cycle for broker-dealer transactions, setting it at T+3.⁷

For a number of years, the broker-dealer industry and other interested market participants have strongly supported shortening the standard settlement cycle, and various industry groups and members have taken affirmative steps to encourage and facilitate a smooth transition to T+2 through advocacy, practical preparation, and testing.⁸ A wide array of financial services advocacy groups have argued that the transition to T+2 will expose market participants to fewer operational risks and increase transactional efficiency across securities markets.⁹

II. Adopted Rule

The SEC adopted the amendment as proposed.¹⁰ As amended, paragraph (a) of Rule 15c6-1 under the Exchange Act will prohibit a broker or dealer from entering into a securities contract that settles later than the second business day after

⁴ Adopting Release at 10.

⁵ Adopting Release at 69.

⁶ Press Release.

⁷ Adopting Release at 9.

⁸ See, e.g., *Amendment to Securities Transaction Settlement Cycle*, SIFMA Comment Letter File No. S7-22-16 (Dec. 5, 2016), available [here](#).

⁹ See, e.g., Letter from Paul Schott Stevens, President & CEO, ICI, and Kenneth E. Bentsen, Jr., President & CEO, SIFMA, to Mary Jo White, Chair, SEC (June 18, 2015).

¹⁰ Adopting Release at 5.

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the date of the contract, subject to certain exceptions enumerated in the rule. The rule allows a broker-dealer to agree that settlement will take place in more or less than two business days, provided that such an agreement is express and reached at the time of the transaction.¹¹

The prescriptions of Rule 15c6-1(a) cover all securities except exempted securities, government securities, municipal securities, commercial paper, bankers' acceptances, or commercial bills.¹² It is noteworthy that mutual fund shares fall within the relevant definition of "security" pursuant to Section 3(a)(10) of the Exchange Act, because while open-end funds generally settle on a T+1 basis, certain retail funds typically settle on a T+3 basis, and the liquidity rule contemplates a T+3 cycle." Such transactions that settle on a longer settlement cycle will be affected by the amendment shortening the standard settlement cycle to T+2.¹³

The rule also provides exemptions for: (i) transactions in limited partnership interests that are not listed on an exchange or for which quotations are not disseminated through an automated quotation system of a registered securities association; (ii) contracts for the purchase and sale of securities that the SEC may from time to time, taking into account then existing market practices, exempt by order; and (iii) contracts for the sale of cash securities priced after 4:30 p.m. that are sold by an issuer to an underwriter pursuant to a firm commitment offering registered under the Securities Act of 1933 or the sale to an initial purchaser by a broker-dealer participating in such offering.¹⁴

III. Effect On Other SEC Rules

In the Adopting Release, the SEC also offered observations about other SEC rules that will be affected by the amendment to Rule 15c6-1, noting that the amendment could have ancillary consequences for how market participants comply with other existing regulatory obligations.¹⁵ These changes relate to SEC rules that require market participants to perform certain regulatory obligations on the settlement date, within a specified number of business days after the settlement date, or are otherwise keyed off the settlement date.

Regulation SHO

Of note, shortening the standard settlement cycle to T+2 would reduce the time frames to effect a close-out under Rule 204 of Regulation SHO. Rule 204 provides that a participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by the settlement

¹¹ Adopting Release at 76.

¹² 17 CFR 240.15c6-1(a).

¹³ Adopting Release at 11.

¹⁴ 17 CFR 240.15c6-1(b) and (c).

¹⁵ Adopting Release at 50.

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date, or if a participant has a fail to deliver position, the participant shall, by no later than the beginning of regular trading hours on the applicable close-out date, immediately close-out the fail to deliver position by borrowing or purchasing securities of like kind and quantity.¹⁶ Under the T+3 standard settlement cycle, the close-out for short sales was required by the beginning of regular trading hours on T+4. However, the Rule 15c6-1 amendment effectively reduces this close out from T+4 to T+3.

Financial Responsibility Rules Under The Exchange Act

Certain provisions of the SEC's broker-dealer financial responsibility rules reference explicitly or implicitly the settlement date of a securities transaction.¹⁷ For example, paragraph (m) of Exchange Act Rule 15c3-3 uses the settlement date to prescribe the time frame in which a broker-dealer must complete certain sell orders on behalf of customers.¹⁸ As another example, settlement date is incorporated into paragraph (c)(9) of Exchange Act Rule 15c3-1, which explains what it means to "promptly transmit" funds and "promptly deliver" securities.¹⁹ The concepts of promptly transmitting funds and promptly delivering securities also are incorporated in other provisions of the financial responsibility rules.²⁰

Exchange Act Rule 10b-10

Rule 10b-10 requires that a broker-dealer send a customer a written confirmation disclosing information relevant to the transaction "at or before completion" of the transaction.²¹ Generally, Rule 15c1-1 defines "completion of the transaction" to mean the time when: (i) a customer is required to deliver the security being sold; (ii) a customer is required to pay for the security being purchased; or (iii) a broker-dealer makes a bookkeeping entry showing a transfer of the security from the customer's account or payment by the customer of the purchase price.²² While the confirmation must be sent "at or before completion" of the transaction, SEC rules do not require that the customer receive a confirmation prior to

¹⁶ 17 CFR 242.204(a). Under the current T+3 standard settlement cycle, the close-out for short sales is required by the beginning of regular trading hours on T+4. If a fail to deliver results from a long sale or a sale from bona fide market making activity, the participant must close-out the fail to deliver position by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date (i.e., T+6). 17 CFR 242.204(a)(1) and (a)(3), respectively.

¹⁷ The term "financial responsibility rules," for purposes of the Adopting Release, includes any rule adopted by the SEC pursuant to Sections 8, 15(c)(3), 17(a), or 17(e)(1)(A) of the Exchange Act, any rule adopted by the SEC relating to hypothecation or lending of customer securities, or any rule adopted by the SEC relating to the protection of funds or securities.

¹⁸ 17 CFR 240.15c3-3(m).

¹⁹ 17 CFR 240.15c3-1(a)(2)(i), (a)(2)(v).

²⁰ For example: paragraphs (k)(1)(iii), (k)(2)(i), and (k)(2)(ii) of Rule 15c3-3, paragraph (e)(1)(A) of Rule 17a-5, and paragraph (a)(3) of Rule 17a-13.

²¹ 17 CFR 240.10b-10(a).

²² 17 CFR 240.15c1-1(b).

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settlement. Accordingly, the SEC noted that the amendment leaves broker-dealers with a shorter time frame to comply with the requirements of Rule 10b-10 in a T+2 settlement cycle.²³

IV. Rule Changes Across Other Regulatory Regimes

In response to the amendment adopting the T+2 settlement cycle, corresponding rule changes have been made or are expected across other regulatory regimes, including other federal regulators and self-regulatory organizations (“SROs”). The Municipal Securities Rulemaking Board, New York Stock Exchange, Financial Industry Regulatory Authority, NASDAQ, and The Depository Trust Company have each either finalized or begun to finalize rule changes regarding the transition to T+2, as have the Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency. Industry participants should monitor communications from these organizations closely in the coming months for guidance about regulatory updates related to T+2.

To assist in this monitoring, Willkie Farr & Gallagher is coordinating with SIFMA to track amendments and revisions to rules and regulations from various SROs and other regulators. The chart can be accessed [here](#).

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March 27, 2017

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²³ Adopting Release at 50.