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Client Alert

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SEC Adopts Amendment to Shorten Settlement Cycle for Securities Transactions

On March 22, 2017, the US Securities and Exchange Commission (the SEC) unanimously voted to adopt an amendment to Rule 15c6-1(a) under the Securities Exchange Act of 1934 to shorten the standard settlement cycle for most broker-dealer transactions. Specifically, the amendment shortens the settlement cycle from three business days after the trade date (T+3) to two business days after the trade date (T+2).[1] According to SEC Acting Chairman Michael Piwowar, "rarely is an issue as commonsensical or broadly supported as this one."[2]

The settlement cycle is the time period between when a trade is executed and when the security is transferred to the buyer and the money is transferred to the seller. During the settlement cycle, each party to a trade faces the risk that its counterparty may fail to meet its obligations to deliver the money or securities. According to the SEC, by reducing the settlement cycle by one day, to T+2, the amendment will reduce market participants' exposure to unsettled trades and decrease counterparty default risk, market risk, liquidity risk, credit risk and overall systemic risk. The SEC also expects a shorter settlement cycle to improve capital efficiency and enhance the efficiency of the clearance and settlement process.

Piwowar explained, "[a]s technology improves, new products emerge, and trading volumes grow, it is increasingly obvious that the outdated T+3 settlement cycle is no longer serving the best interests of the American people… . The SEC remains committed to ensuring that U.S. securities regulation is reflective of modern times, and in shortening the settlement cycle by one day we aim to increase efficiency and reduce risk for market participants."[3]

The SEC proposed the amendment on September 28, 2016. The final rule, effective September 5, 2017, adopts the amendment as proposed.

Amended Rule 15c6-1(a)

The SEC adopted Rule 15c6-1(a) in 1993 to establish T+3 as the standard settlement cycle for most broker-dealer transactions.[4] The final rule amends Rule 15c6-1(a) to prohibit broker-dealers from entering into contracts for the purchase or sale of a security (other than certain exempted securities) that provide for payment of funds and delivery of securities later than the second business day after the date of the contract. Rule 15c6-1(a) allows broker-dealers to agree that settlement will take place in a period longer than the standard settlement cycle if expressly agreed to by the parties at the time of the transaction (the

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[1] SEC, Amendment to Securities Transaction Settlement Cycle, Release No. 34-80295 (Mar. 22, 2017), available at https://www.sec.gov/rules/final/2017/34-80295.pdf.

[2] SEC Acting Chairman Michael S. Piwowar, Statement at Open Meeting Regarding Amendment to Shorten the Trade Settlement Cycle (Mar. 22, 2017), available at https://www.sec.gov/news/public-statement/piwowar-open-meeting-032217.

[3] Press Release, SEC Adopts T+2 Settlement Cycle for Securities Transactions (Mar. 22, 2017), available at https://www.sec.gov/news/press-release/2017-68-0.

[4] SEC, Securities Transactions Settlement, Exchange Act Release No. 33023 (Oct. 6, 1993), 58 FR 52891, 52893 (Oct. 13, 1993).

so-called “override provision”). The final rule reiterates the SEC’s position that the override provision of Rule 15c6-1(a) is intended to apply only to unusual transactions.

According to the SEC, the amendment means that when an investor buys a security, the brokerage firm must receive the payment from the investor no later than two business days after the trade is executed, and when an investor sells a security, the investor must deliver the security to the brokerage firm no later than two business days after the trade is executed.

Rule 15c6-1(a), as amended, will apply the T+2 settlement cycle to the same securities transactions currently covered under the rule, such as stocks, bonds, municipal securities, exchange-traded funds, certain mutual funds and limited partnerships that trade on an exchange. The amended rule will not apply to certain categories of securities, such as exempted securities, government securities, municipal securities, commercial paper, bankers’ acceptances or commercial bills.

The amended rule also continues to exempt certain new issues of securities. Specifically, Rule 15c6-1(a) and Rule 15c6-1(c) provide an exemption for contracts for the sale of securities that are priced after 4:30 p.m. Eastern Standard Time on the date that such securities are priced and that are sold by an issuer to an underwriter pursuant to a firm commitment offering registered under the Securities Act of 1933 or sold to an initial purchaser by a broker-dealer participating in such offering. Any secondary resale of such securities must be settled within the standard settlement cycle. Furthermore, Rule 15c6-1(d) provides an extended settlement provision specific to primary firm commitment offerings. Specifically, Rule 15c6-1(d) provides that parties to a contract shall be deemed to have expressly agreed to an alternate date for payment of funds and delivery of securities at the time of the transaction for a contract for the sale for cash of securities pursuant to a firm commitment offering. Rule 15c6-1(d) applies if the managing underwriter and the issuer have agreed to such date for all securities sold pursuant to such firm commitment offering and the parties to the contract have not expressly agreed to another date for payment of funds and delivery of securities at the time of the transaction. Thus, the amended rule will apply primarily to secondary market trading.

Next Steps

The amended Rule 15c6-1(a) will take effect on September 5, 2017. In the final rule, the SEC noted that the securities industry has already started preparing for a transition to T+2 by that date.

The final rule also directs the staff of the SEC to study, among other things, the impacts of moving to a T+2 settlement cycle and the possibility of further shortening the standard settlement cycle beyond T+2. According to Commissioner Kara M. Stein, “while movement to a T+2 standard settlement cycle is an improvement from the current T+3 standard, more can and should be done. At this very moment, technological, operational, and communications improvements exist that could enable T+1 and end-of-the-day settlement cycles.”[5] The staff is required to submit the report to the SEC within three years of the amendment’s compliance date.

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[5] Commissioner Kara M. Stein, Statement at Opening Meeting on the Final Rule Amendment to Shorten the Transaction Settlement Cycle (Mar. 22, 2017), available at https://www.sec.gov/news/public-statement/stein-open-meeting-032217.