SEC Proposes to Shorten Securities Settlement Cycle

During an Open Meeting on September 28, 2016, the U.S. Securities and Exchange Commission ("SEC") proposed a rule amendment to expedite the process for settling securities transactions.

Investors generally complete or "settle" their security transactions within three days. Rule 15c6-1 currently establishes "regular way" settlement as occurring no later than T+3 for most securities. This settlement cycle is known as T+3 (short for trade date plus three days): meaning that, when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three settlement days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day.

The settlement process for securities transactions has come a long way from days in which the system lacked a standard mandated cycle, and depended on messengers to deliver paper stock certificates by hand. In 1975, Congress asked the SEC to establish a national system for clearance and settlement of securities transactions. Keeping pace with technology and industry developments, in 1993, the SEC proposed to update the rule that specifies how quickly securities must settle after the trade date. The SEC is now considering industry led efforts to migrate to a shorter settlement cycle.

The SEC originally adopted Rule 15c6-1 in 1993 to establish a standard settlement cycle for most broker-dealer securities transactions, which, at the time, effectively shortened the settlement cycle for most securities transactions from five business days to three business days after the trade date.

The SEC has long considered that a shorter cycle reduces credit, market and liquidity risk that can occur with a longer settlement cycle. In 1993, with the adoption of Rule 15c6-1, the SEC explained the benefits of shortening the settlement cycle, which included reducing credit and market risk exposure to unsettled trades, reducing liquidity risk and encouraging greater efficiencies in clearance and settlement in order to facilitate a reduction in systemic risk for the US markets. In 2004, the SEC again contemplated further reductions in the settlement cycle. And now, the SEC has proposed amendment would shorten the settlement cycle to two days, or T+2.

The SEC Release is available here.

Key Provisions

Shorter settlement cycle – T+2.

- The SEC proposed to amend Rule 15c6-1(a) of the Exchange Act to shorten the standard settlement cycle for broker-dealer transactions from T+3 to T+2, subject to certain exceptions.
- As Proposed, Rule 15c6-1(a) would be amended to prohibit a broker-dealer from effecting or entering into a contract for the purchase or sale of a security (other than an exempted security, government security, municipal security, commercial paper, bankers' acceptances, or commercial bills) that provides for payment of funds and delivery of securities later than the second business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction.

Proposed Changes Would Impact Other Rules.

- The proposed amendments to Rule 15c6-1 would impact several SEC Rules, such as Regulation SHO, the

Financial Responsibility Rules (adopted pursuant to Sections 8, 15(c)(3), 17(a) or 17(e)(1)(A) of the Exchange Act), and Rule 10b-10 (regarding trade confirmations). For example, shortening the standard settlement cycle to T+2 would reduce the timeframes to effect a close-out under Rule 204 of Regulation SHO.

- FINRA has identified several FINRA Rules that establish or reference the T+3 settlement cycle that would need to be amended to reflect a T+2 settlement cycle. (See FINRA Reg. Notice 16-09).

Designed to Reduce Risk.

- The SEC cited a number of reasons for standardizing and shortening the settlement cycle, which included, among others, reducing credit and market risk exposure related to unsettled trades, reducing liquidity risk among derivatives and cash markets, encouraging greater efficiency in the clearance and settlement process, and reducing systemic risk for the U.S. markets.
- Compliance date remains under consideration, with September 5, 2017 as a possible date.

Action Requested

- The SEC seeks public comment on the proposed amendment to Rule 15c6-1(a) for 60 days following publication in the Federal Register.
- The SEC Release contains a general request for comment, as well as specific questions.