April 11, 2022

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Shortening the Securities Transaction Settlement Cycle (File No. S7-05-22, RIN 3235-AN02)

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rule ("Proposal" or "Release").[2] The Proposal would shorten the settlement cycle for securities transactions, from the current standard of two business days after the trade date ("T+2") to one business day after the trade date ("T+1"). The Proposal would facilitate the transition to T+1 by eliminating an exception to the standard settlement cycle for certain firm commitment offerings, requiring "same day affirmation" for institutional trades, and requiring that central matching service providers ("CMSPs") establish policies and procedures for facilitating straight-through processing. A T+1 standard settlement cycle will reduce settlement risk, to the benefit of investors and market integrity, and Better Markets urges the SEC to adopt this standard without unnecessary delay. Better Markets also supports the SEC's careful consideration of whether further reducing the settlement cycle will result in additional benefits for investors and the markets.

BACKGROUND

In the 1920s, the standard settlement cycle—i.e. the time between when a trade is executed and when the securities and cash that make up the trade are delivered to the respective counterparties—was one day.[3] However, as securities markets grew larger and the infrastructure required to handle them became more complex, the time required to settle transactions increased, especially in light of the technological limitations of the time, until the typical settlement cycle

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

[2] 87 Fed. Reg. 10,436 (Feb. 24, 2022).

[3] Release at 10,437.

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was T+5 (i.e. settlement occurred 5 business days after the trade date).[4] However, it has long been recognized that when it comes to settlement of securities transactions "time equals risk." The delay between the execution of a securities transaction and its settlement introduces additional risk into the transaction for the counterparties and the broader markets. These risks include the possibility that one of the counterparties will default on its obligations or that the market value of the securities will move before settlement takes place.[5] Market participants manage these risks in a variety of ways. For example, the National Securities Clearing Corporation ("NSCC") helps brokers manage credit risk by guaranteeing the performance of each counterparty.[6]

However, these risk management tools themselves come with significant costs. In order to manage the risk of its clearing services, NSCC requires brokers to make margin deposits based on their risk of default.[7] At best, this means that brokers have to devote capital, which could be more productively used elsewhere, to meet margin deposit requirements.[8] At worst, such margin calls could put a serious financial strain on brokers individually,[9] and during periods of market volatility the combined impact of such margin calls could be increased systemic risk.[10]

In recognition of the risks and costs associated with an unnecessarily lengthy settlement cycle, reducing it has long occupied the attention of the SEC and market participants and observers. The SEC established a settlement cycle of T+3 in 1993 and further reduced it to T+2 in 2017.[11] This reduction in the settlement cycle has reduced risks and costs associated with settlement delays, but because there is still a delay associated with settlement, there are still significant risks and costs to markets and investors, perhaps most starkly illustrated by the trading frenzy surrounding GameStop and other so-called "meme stocks" in January 2021. As the price of GameStop and other meme stocks surged rapidly and unexpectedly over the course of January 2021, NSCC demanded that certain brokers with exposure to the stocks experiencing volatility deposit additional margin. This included Robinhood, the highly popular trading platform for retail investors, on which many shares of GameStop were being traded during the frenzy. Robinhood, unable to meet a $3 billion margin call by NSCC, suddenly halted buying in GameStop and other meme stocks on January 28, 2021.[12] This buying halt meant demand for affected stocks plummeted, resulting in a severe adverse impact on many investors—GameStop closed at $193.60 on January 28, 2021, down from its close at $347.51 the previous day and down even further from its intraday high that day of $483.41 According to lawsuits filed in response to Robinhood's actions, the price drop was a direct result of the buying halt because it triggered a sell-off that caused the share price of GameStop and other meme stocks to plummet. This left many investors

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4 Securities Transaction Settlement, 58 Fed. Reg. 52,891, 52,892 (Oct. 13, 1993).
5 Release at 10,447.
6 Release at 10,440.
7 Release at 10,482.
8 *See* Release at 10,482.
9 Release at 10,448.
10 Release at 10,448 ("In particular, in periods of market stress, liquidity demands imposed by the CCP on its participants, such as in the form of intraday margin calls, can have procyclical effects that reduce overall market liquidity.")
11 Release at 10,437.
12 Alexander Osipovich, *Clearinghouse Urges Faster Trade Settlement Amid GameStop Scrutiny*, WALL ST. J. (Feb. 24, 2021), https://www.wsj.com/articles/clearinghouse-urges-faster-trade-settlement-amid-gamestop-scrutiny-11614175201.

who had bought stock as the price was going up selling into a suddenly declining market, resulting in significant losses for retail investors who had "to choose between selling the [stocks subject to Robinhood's buying halt] at a lower price or holding their rapidly declining positions in the [stocks subject to Robinhood's buying halt]."[13] Indeed, by February 4, 2021, GameStop's stock had slid to $53.50, imposing "heavy losses" on retail investors.[14]

The Robinhood meme stock buying halt triggered renewed attention on the settlement cycle. The Depository Trust & Clearing Corporation ("DTCC"), NSCC's parent company, released a report in February 2021 explaining that moving to T+1 would result in significant benefits but "would not require large operational or technical changes by market participants" and that a transition to T+1 could occur by the end of 2023.[15] The industry then formed a steering committee and working group to study the transition to T+1, and in December 2021, Deloitte, DTCC, SIFMA (representing broker-dealers, investment banks, and asset managers), and ICI (representing registered funds) released a report outlining recommendations for transitioning to T+1 as early as the first quarter of 2024.[16]

OVERVIEW OF PROPOSAL

The SEC proposes to implement T+1 by March 31, 2024. To implement T+1, the SEC would:

- Require that broker-dealers ensure that contracts for the purchase or sale of securities provide for settlement no later than the first business day following execution;

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[13] Consolidated Class Action Complaint at 5, *In re January 2021 Short Squeeze Trading Litigation*, No. 21-2989-mdl-altonga (S.D. Fla. Jul. 27, 2021). Many suspected something nefarious in the Robinhood trading halt. Specifically, Robinhood sells a significant portion of its order flow to Citadel, a market-maker. In other words, Citadel is one of Robinhood's biggest customers. Citadel also separately operates a hedge fund. In the middle of the market volatility, Citadel's hedge fund made a significant investment in Point72, another hedge fund that was heavily short GameStop stock and that, accordingly, had suffered enormous losses as the price of GameStop rose. Thus, many speculated that Robinhood's buying halt was intended to benefit its customer, Citadel, although no evidence has emerged of this or any other manipulation or other wrongdoing related to the trading halt. *See* Jeff Kearns & Hema Parmar, *Robinhood, Citadel Reject Conspiracy Claims That They Halted 'Meme' Trades*, L.A. TIMES (Feb. 17, 2021), https://www.latimes.com/business/technology/story/2021-02-17/robinhood-citadel-reject-conspiracy-claims-they-halted-meme-trades.

[14] *See* Drew Harwell, *As GameStop Stock Crumbles, Newbie Traders Reckon With Heavy Losses*, WASH. POST (Feb. 2, 2021, 5:34 PM), https://www.washingtonpost.com/technology/2021/02/02/gamestop-stock-plunge-losers/.

[15] DTCC, ADVANCING TOGETHER: LEADING THE INDUSTRY TO ACCELERATED SETTLEMENT 5 (Feb. 1, 2021), https://www.dtcc.com/-/media/Files/PDFs/ White%20Paper/DTCC-Accelerated-Settle-WP2021.pdf; *see also* Release at 10,445.

[16] DELOITTE, DTCC, ICI, & SIFMA, ACCELERATING THE U.S. SECURITIES SETTLEMENT CYCLE TO T+1 (Dec. 1, 2021)), https://www.dtcc.com/ust1/-/media/Files/PDFs/T2/Accelerating-the-US-Securities-Settlement-Cycle-to-T1-December-1-2021.pdf.

- Ensure that, to the extent that a broker-dealer engages in an allocation, confirmation, or affirmation process for a customer, that this process is completed as soon as technologically practicable, and in any event no later than the end of the trade date;

- Require that registered investment advisers keep records relating to confirmations, allocations, and affirmations;

- Require that CMSPs implement policies and procedures to facilitate straight-through processing and provide the SEC with an annual report describing those efforts.[17]

In addition, although the SEC is not proposing any further reduction in the settlement cycle, it is also requesting comment on a possible future transition to T+0.

COMMENTS

I. THE PROPOSAL WILL REDUCE RISK TO INVESTORS AND MARKETS AND RESULT IN OPERATIONAL EFFICIENCIES

As explained above, it is well-established that the current T+2 settlement cycle introduces costs and risks to market participants and the broader markets. The delay between the execution of a transaction and its settlement raises the risk that a counterparty will not have sufficient cash or securities to settle the transaction, or will otherwise default on its obligations. This risk can be exacerbated because the market value of the securities is likely to change during the delay between execution and settlement. These risks can be mitigated through clearing arrangements, but clearing agencies such as NSCC require that members make margin deposits as part of their own risk management. These margin requirements are costly for brokers, and, as the GameStop frenzy illustrated, can be devastating for investors when their brokers are unable to meet their financial commitments. They can also contribute to financial instability.

There is broad agreement that shortening the settlement cycle from T+2 to T+1 will reduce these risks and costs.[18] There is also broad agreement that the benefits of T+1 will significantly outweigh the costs—as DTCC explained, many of the tools required for the transition to T+1 are already in place.[19] In other words, the costs, benefits, and potential unintended consequences of T+1 have been exhaustively explored—the benefits to investors, markets, and the broader public are clear, while the industry that would bear the bulk of the transition costs has itself explained that the transition is feasible and worthwhile.

Nevertheless, despite the obvious benefits, and relatively minimal costs, of transitioning to T+1, which have been widely acknowledged for some time, that transition has not yet occurred. As the SEC points out in the Release, this is likely because "when every market participant must

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[17] Release at 10,445-65.

[18] *See* Release at 10,445 (noting a DTCC estimate that moving to T+1 would result in a 41% reduction in margin requirements.)

[19] DTCC, ADVANCING TOGETHER: LEADING THE INDUSTRY TO ACCELERATED SETTLEMENT 5 (Feb. 1, 2021), https://www.dtcc.com/-/media/Files/PDFs/ White%20Paper/DTCC-Accelerated-Settle-WP2021.pdf.

bear the costs of an upgrade for the entire market to enjoy a benefit, the result is a coordination problem, where each market participant may be reluctant to make the necessary investments until it can be reasonably certain that others will also do so."[20] In other words, everyone may recognize that the current practice is inefficient and that changing the practice would be beneficial, but if no individual participant can realize the benefits without others making the transition, the transition is unlikely to be made.[21] As the Release explains, in such a situation a "regulatory intervention" is necessary to ensure that the public enjoys the benefits of the upgrade.[22] Thus, the SEC must mandate a T+1 settlement cycle, it cannot depend on the industry and other market participants to implement T+1 on its own initiative.

This also underscores the importance of mandating the other provisions the SEC is proposing to facilitate the transition to T+1, in particular the same-day affirmation requirement and the requirement that CMSPs facilitate straight-through processing. These provisions will be critical to ensuring a smooth transition to T+1. As the Release notes, only 68% of trades receive affirmations on the date of the trade, although same-day affirmation is considered industry best practice.[23] This increases the possibility that errors or exceptions will occur, which delays settlement.[24] This is bad enough for investors and the markets as it is, and continued failure to ensure same-day affirmation could hamper a smooth transition to T+1. Thus, the SEC's proposal to mandate same-day affirmation is essential, as it will spur the industry to finally make appropriate investments into improving this aspect of securities settlement.

Similarly, as the SEC recognizes, utilizing more "straight-through" processing, i.e. replacing manual processes with automated processing, would reduce risk and costs, and is necessary to facilitate the transition to T+1.[25] However, straight-through processing is still underutilized, with the industry still over-reliant on manual processes that can result in inefficiencies.[26] In other words, these are essential reforms to improve the functioning of the securities markets more generally, and specifically to facilitate a smooth transition to T+1. Thus, the SEC proposes to require that CSMPs enact policies and procedures to facilitate straight-through processing, and to provide annual reports to the SEC on those efforts. Again, this is a necessary provision that will ensure the industry makes the appropriate investments to improve securities settlement processing and facilitate a smooth transition to T+1.

II. THE PROPOSED COMPLIANCE DATE IS FEASIBLE AND SHOULD ONLY BE EXTENDED IF NECESSARY TO PROTECT INVESTORS AND THE MARKETS

The SEC is proposing to impose a compliance date for T+1 of March 31, 2024.[27] This is actually a longer timeframe than that initially contemplated by DTCC, which predicted that the

[20] Release at 10,476.
[21] Release at 10,476.
[22] Release at 10,443.
[23] Release at 10,453.
[24] Release at 10,453.
[25] Release at 10,457-58.
[26] Release at 10,457.
[27] Release at 10,464.

transition to T+1 could occur by 2023.[28] However, it is consistent with the industry working group report's timeframe, which recommended "migration from T+2 to T+1 for U.S. securities markets in Q1/Q2 2024."[29] In other words, the SEC's proposed compliance date is fully in line with what the industry, which will primarily bear the costs of the transition, has already anticipated. Accordingly, there would seem to be little credible basis for further pushing out the compliance date, especially in response to industry arguments of excessive burden. Accordingly, the SEC must only change the proposed compliance date (or extend it once established) if necessary to protect investors and the markets.

III. THE SEC SHOULD CAREFULLY CONSIDER WHETHER FURTHER SHORTENING THE SETTLEMENT CYCLE WOULD BENEFIT INVESTORS, THE MARKETS, AND THE PUBLIC INTEREST

The SEC is also seeking comment on further shortening the settlement cycle to require same-day settlement, i.e. T+0. Given that T+0 is the next logical step after T+1, and given that "time equals risk,"[30] it is entirely appropriate for the SEC to explore even further shortening the settlement cycle to further reduce the risk inherent in the delay between execution and settlement. At the same time, further reducing the settlement cycle raises a number of issues relating to operational risk, the pre-funding of market activities, and credit risk management that need to be carefully studied before T+0 is implemented.[31] Accordingly, we fully support the SEC's thoughtful approach to further reductions in the settlement cycle evidenced throughout the Release—explaining its understanding of the possible approaches to implementing T+0, the potential challenges, and broadly seeking comment on what a transition to T+0 would entail.[32]

As it continues its thoughtful approach, the SEC must ensure that it is prioritizing the interests of investors, the integrity of the markets, and the public interest. Similarly, while it will be essential for the SEC to closely consult with the industry (which would be responsible for implementing T+0, should it be deemed appropriate), the SEC must also ensure it is closely consulting with, and soliciting the views of, other stakeholders as it considers whether and when to make this transition. Put another way, the SEC must not let industry concerns about burden prevent or delay it from implementing T+0 at such time as it determines that T+0 would benefit investors and the markets.

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28 DTCC, ADVANCING TOGETHER: LEADING THE INDUSTRY TO ACCELERATED SETTLEMENT 5 (Feb. 1, 2021), https://www.dtcc.com/-/media/Files/PDFs/ White%20Paper/DTCC-Accelerated-Settle-WP2021.pdf.

29 Deloitte, DTCC, ICI, & SIFMA, *Accelerating the U.S. Securities Settlement Cycle to T+1* (Dec. 1, 2021)), https://www.dtcc.com/ust1/-/media/Files/PDFs/T2/Accelerating-the-US-Securities-Settlement-Cycle-to-T1-December-1-2021.pdf.

30 Release at 10,437.

31 Better Markets, *Selected Issues Raised by the Speculative Frenzy in GameStop and Other Stocks* (Mar. 26, 2021), https://bettermarkets.org/wp-content/uploads/2022/03/Better_Markets_White_Paper_Select_Issues_Raised_GameStop_03-26-2021.pd. ; *see also* Release at 10,465-75.

32 Release at 10,465-75.

CONCLUSION

We hope these comments are helpful as the Commission finalizes the Proposal.

Sincerely,

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