



FINANCIAL  
SERVICES  
ROUNDTABLE

Via <http://www.sec.gov/rules/proposed/shtml>

December 5, 2016

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

Re: Amendment to Securities Transaction Settlement Cycle [File No. S7-22-16]

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Dear Mr. Fields:

The Financial Services Roundtable<sup>1</sup> (“FSR”) respectfully submits this letter in support of the amendments proposed by the Securities and Exchange Commission (the “SEC”) to Rule 15c6-1 to shorten the settlement cycle for secondary market transactions in equities, corporate and municipal bonds, unit investment trusts, and financial instruments comprised of these products (the “Proposal”).<sup>2</sup> FSR believes that the Proposal is an important step in the efforts by the financial services industry and its regulators to shorten the settlement cycle from three business days after trade date (“T+3”) to two business days after trade date (“T+2”).

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<sup>1</sup> As *advocates for a strong financial future*<sup>TM</sup>, FSR represents the largest integrated financial services companies providing banking, insurance, payment and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America’s economic engine, accounting directly for \$92.7 trillion in managed assets, \$1.2 trillion in revenue, and 2.3 million jobs.

<sup>2</sup> Amendment to Securities Transaction Settlement Cycle, 81 Fed. Reg. 69,240, 69,247 (Oct. 5, 2016).

FSR fully supports these efforts because a shorter settlement cycle will align the U.S. with other major markets as well as mitigating operational and systemic risks for all participants in the securities markets. We note, however, that the shorter settlement cycle will impact market participants, particularly retail investors and urge the SEC and other regulators to exercise some leniency with respect to certain close-out rules during the initial period after implementation. FSR also requests that the SEC work with banking regulators to ensure that they amend their equivalent rules sufficiently in advance of the T+2 implementation date.

With regard to matching the settlement timeframe in other markets, we note that trades in the European Union have settled on T+2 since October 2014.<sup>3</sup> Hong Kong and South Korea also have T+2 as their settlement cycle.<sup>4</sup> Canada proposes to transition to T+2 on the same timeframe as the United States,<sup>5</sup> and it is expected that Japan will join the United States once T+2 becomes its standard.<sup>6</sup>

Industry participants agree that the move to a T+2 settlement cycle should reduce systemic risk as well as risks to individual industry participants. A cost-benefit study commissioned by Depository Trust & Clearing Corporation (“DTCC”) concluded that a T+2 settlement cycle would mitigate operational and systemic risks by:

- “lessening member firm capital and margin requirements at the clearing agency by reducing risk exposure;
- reducing the additional margin and liquidity needs that can happen during times of economic volatility; and

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<sup>3</sup> See EUROPEAN COMMISSION, COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT COD 2012/0029 (Mar. 7, 2012), available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0022&from=EN>.

<sup>4</sup> See, e.g., Hong Kong Exchanges and Clearing Limited, “HKEx to Introduce T+2 Finality on 25 July” (July 7, 2011), available at <https://www.hkex.com.hk/eng/newsconsul/hkexnews/2011/110707news.htm>; BANK FOR INTERNATIONAL SETTLEMENTS, PAYMENT, CLEARING AND SETTLEMENT SYSTEMS IN KOREA (2011), available at [https://www.bis.org/cpmi/publ/d97\\_kr.pdf](https://www.bis.org/cpmi/publ/d97_kr.pdf).

<sup>5</sup> Canadian Securities Administrators, “Canadian securities regulators seek comment in advance of move to T+2 settlement cycle” (Aug. 18, 2016), available at [http://www.osc.gov.on.ca/en/NewsEvents\\_nr\\_20160818\\_csa-release-canadian-securities-seek-comment.htm](http://www.osc.gov.on.ca/en/NewsEvents_nr_20160818_csa-release-canadian-securities-seek-comment.htm).

<sup>6</sup> See, e.g., Japan Securities Dealers Association, “Move to T+2 Settlement in Japan,” available at [http://www.jsda.or.jp/en/activities/research-studies/files/t2\\_en\\_cyukan\\_201603.pdf](http://www.jsda.or.jp/en/activities/research-studies/files/t2_en_cyukan_201603.pdf).

- decreasing counterparty risk by moving trades more quickly to settlement, enabling capital to be freed up faster for reinvestment and reducing credit and counterparty exposure.”<sup>7</sup>

The SEC in the Proposal identified several of these benefits as well as pointing out that settlement failures should become less prevalent over time.<sup>8</sup> The most significant benefit the SEC identified is a reduction of exposure to credit, market, and liquidity risk for the investors as well as quicker access to capital and a reduced need to borrow funds for mismatched settlement cycles across markets. The Financial Industry Regulatory Authority and the Municipal Securities Rulemaking Board in their rule proposals also described similar positive impacts.<sup>9</sup>

FSR agrees that these benefits will accrue to all market participants and wishes to emphasize the reduction in systemic risk from a shorter settlement cycle. We do, however, want to note three particular rules relating to close-out requirements on unsettled trades that will also have shorter timeframes because they are tied to the standard settlement cycle. FSR wishes to stress that industry regulators should apply a certain degree of leniency with respect to these three rules for an appropriate period after implementation of the amendment to Rule 15c6-1 with respect especially to trades by retail customers as they take some time to become accustomed to the shorter period within which to settle their trades. A discussion of the three rules follows:

*Exchange Act Rule 15c3-3(m).* Under Exchange Act Rule 15c3-3(m), if a broker-dealer executes a long sale for a customer and if for any reason the broker-dealer has not obtained possession of the securities from the customer within ten business days after the settlement date, then the broker-dealer must purchase securities of like kind and quantity

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<sup>7</sup> FINRA, Regulatory Notice 16-09: Shortening the Settlement Cycle for Securities to T+2 (Mar. 2016), available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-16-09.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-09.pdf), *construing* Depository Trust & Clearing Corporation (“DTCC”), DTCC Recommends Shortening the U.S. Trade Settlement Cycle (Apr. 2014), available at <http://www.dtcc.com/~media/Files/Downloads/WhitePapers/T2-Shortened-Cycle-WP.pdf>.

<sup>8</sup> See Amendment to Securities Transaction Settlement Cycle, 81 Fed. Reg. 69,240 (Oct. 5, 2016).

<sup>9</sup> According to FINRA, “public investors would likely benefit from reduced counter-party risk and reduced delays in settlement. Alternatively, costs associated with meeting the shortened settlement cycle may be passed on, in part or in whole, to investors.” FINRA, Regulatory Notice 16-09: Shortening the Settlement Cycle for Securities to T+2 (Mar. 2016), available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-16-09.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-09.pdf). The MSRB highlights the importance of consistency across markets, noting it “believes that all market participants benefit from a consistent settlement cycle across equity securities, corporate bonds and municipal securities—an outcome that the MSRB draft amendments would support.” MSRB, Regulatory Notice 15-22: Request for Comment on Changes to MSRB Rules to Facilitate Shortening the Securities Settlement Cycle (Nov. 10, 2015), available at <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2015-22.ashx>.

in order to close-out the transaction.<sup>10</sup> Since a settlement will occur one business day earlier after Rule 15c6-1 is amended, in effect the broker-dealer will have one less day to obtain possession of the securities; that is, 12 business days instead of 13 business days.

The rule is intended to stop customers from effectively borrowing securities from a broker-dealer while claiming to make a long sale. With the shorter timeframe, broker-dealers will have to close-out the customer sooner, possibly to the detriment of the customer.

*Regulation SHO.* SEC Regulation SHO establishes standards intended to curb unethical practices related to selling short.<sup>11</sup> Of greatest relevance to settlement date are the closeout provisions of Rule 204. Regulation SHO Rule 204 requires members of a clearing agency to close-out open short positions at the clearing agency within time periods keyed off of the standard settlement cycle. In particular, a broker-dealer that has a fail-to-deliver position at such clearing agency must close-out such fail before the open on the day after the settlement date, where the position resulted from one or more short sales, and settlement date plus three days for a position resulting from one or more long sales.<sup>12</sup> A shortened the settlement cycle necessarily compresses the timeframe for the broker-dealer to comply with such regulation. Again, the shorter time frame may impact customers who do not make timely deliveries.

*Regulation T.* In order to regulate extensions of credit by brokers-dealers, Regulation T of the Board of Governors of the Federal Reserve System imposes, among other obligations, initial margin requirements and payment rules on certain securities transactions.<sup>13</sup> Of particular relevance in this context, Regulation T requires a broker-dealer to cancel or otherwise liquidate a customer position if the customer has not settled the transaction in full or posted the required margin with respect to the trade that created the position within one “payment period.” For these purposes, Regulation T defines the term “payment period” as the number of business days in the standard securities settlement cycle in the United States plus two business days.<sup>14</sup> Similarly, the “payment period” is relevant for when a creditor must obtain full cash payment for customer purchases in a cash account.<sup>15</sup> A decrease in the settlement cycle would similarly decrease the “payment period” for Regulation T purposes, which means that market

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<sup>10</sup> See 17 CFR § 240.15c3-3(m).

<sup>11</sup> See 17 CFR § 242.200 *et seq.*

<sup>12</sup> See 17 CFR § 242.204. The rule provides different timeframes for restricted stock and bona fide market making. Although the rule does not presume a T+3 settlement cycle, participants will have one less day to comply with the requirements if the industry moves to a shortened T+2 settlement cycle.

<sup>13</sup> 12 CFR Part 220.

<sup>14</sup> See 12 CFR §§ 220.4(c)(3), 220.2.

<sup>15</sup> See 12 CFR § 220.8(b).

participants would have one fewer business day to pay for trades and satisfy margin calls. This result has similar implications for investors as the shorter timeframe under Exchange Act Rule 15c3-3(m) and may result in broker-dealers' requiring customers to maintain liquid assets in their accounts in order to timely meet these obligations.

While FSR expects that market participants will adapt to the shorter settlement cycle and its impact under the rules mentioned above, we urge the SEC and industry regulators to show leniency with respect to problems that may arise under the rules mentioned above until the changes flow through the system and market participants become accustomed to the shorter timeframes.

*Federal Banking Agencies.* FSR notes that both the Federal Deposit Insurance Corporation (the "FDIC") and the Office of the Comptroller of the Currency (the "OCC") have rules about settlement cycle for banks that are virtually identical to rule 15c6-1.<sup>16</sup> We request that the SEC coordinate with both the FDIC and the OCC on changes to their rules that match the Proposal.

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FSR appreciates the opportunity to submit comments on the Proposal. If it would be helpful to discuss FSR's specific comments or general views on this issue, please contact me at [REDACTED], or Felicia Smith, Vice President and Senior Counsel for Regulatory Affairs at [REDACTED].

Sincerely yours,



Richard Foster  
Senior Vice President and Senior Counsel  
for Regulatory and Legal Affairs  
Financial Services Roundtable

*With a copy to:*

The Honorable Mary Jo White, Chair  
The Honorable Kara Stein  
The Honorable Michael Piwowar  
*Members, United States Securities and Exchange Commission*

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<sup>16</sup> The FDIC's rule is found at 12 CFR § 344.7(a). The OCC's rule is found at 12 CFR § 12.9(a).