

Reducing Risk in Clearance and Settlement



The Securities and Exchange Commission proposed to reduce risks in the clearance and settlement of securities. Specifically, the proposed changes would:

- Shorten the standard settlement cycle for securities transactions from two business days after trade date (T+2) to one business day after trade date (T+1);
- Eliminate the separate T+4 settlement cycle for firm commitment offerings priced after 4:30 p.m.;
- Improve the processing of institutional trades by proposing new requirements for broker-dealers and registered investment advisers intended to improve the rate of same-day affirmations; and
- Facilitate straight-through processing by proposing new requirements applicable to clearing agencies that are central matching service providers (CMSPs).

Why This Matters

Reducing time between the execution of a securities transaction and its settlement reduces risk. The standard settlement cycle for securities transactions was shortened from T+5 to T+3 in 1993, and from T+3 to T+2 in 2017. In each past instance, shortening the settlement cycle promoted investor protection, risk reduction, and increases in operational efficiency.

Two recent episodes of increased market volatility – in March 2020 following the outbreak of the COVID-19 pandemic, and in January 2021 following heightened interest in certain “meme” stocks – highlighted potential vulnerabilities in the U.S. securities market that shortening the standard settlement cycle and improving institutional trade processing can mitigate.

In the future, it may be beneficial to further shorten the standard settlement cycle beyond T+1. The proposal solicits comments on potential paths to and challenges associated with achieving a same-day settlement cycle.

How the Rules Apply

The proposed amendment to Exchange Act Rule 15c6-1(a) would prohibit a broker-dealer from effecting or entering into a contract for the purchase or sale of a security (other than exempted securities) that provides for payment of funds and delivery of securities later than the first business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction. If the proposal is adopted, a T+1 cycle would be implemented by March 31, 2024.

Additional proposed rules would improve the processing of institutional trades by accelerating the confirmation and affirmation of such trades between broker-dealers and their institutional customer. First, proposed Exchange Act Rule 15c6-2 would prohibit broker-dealers from entering into contracts for the purchase or sale of a security (other than exempted securities) with their institutional customers unless those contracts require that the parties complete allocations, confirmations, and affirmations as soon as technologically practicable and no later than by the end of the trade date. Second,

proposed amendment to Advisers Act Rule 204-2 would require registered investment advisers that are parties to contracts under Rule 15c6-2 to make and keep records of confirmations received and allocations and affirmations sent. Third, proposed Exchange Act Rule 17Ad-27 would require a clearing agency that is a CMSP to establish, implement, maintain, and enforce policies and procedures that facilitate straight-through processing and describe in an annual report its current procedures, progress, and the steps it intends to take to facilitate straight-through processing of institutional trades.

The proposed deletion of Exchange Act Rule 15c6-1(c) would promote a uniform approach to the settlement of primary and secondary offerings. Paragraph (c) establishes a T+4 settlement cycle for firm commitment offerings placed after 4:30 p.m. Originally, this helped market participants manage prospectus delivery obligations. Since the rule was adopted, the “access equals delivery” standard for most such obligations has eliminated the basis for this separate settlement cycle. Paragraph (d) of Rule 15c6-1 would continue to provide for an extension of the settlement period when necessary.

What’s Required

For Broker-Dealers:

- Ensure contracts for the purchase or sale of a security (other than exempted securities) provide for payment of funds and delivery of securities no later than the first business day after the date of the transaction.
- Ensure contracts with customers that have agreed to engage in an allocation, confirmation, or affirmation process require completion of any of those processes by as soon as technologically practicable and no later than the end of the day on trade date.

For Registered Investment Advisers: Keep records of each confirmation received, and any allocation and each affirmation sent, with a date and time stamp for each allocation (if applicable) and affirmation that indicates when the allocation or affirmation was sent to the broker or dealer under any contract an adviser is party to under Exchange Act Rule 15c6-2.

For CMSPs:

- Establish, implement, maintain, and enforce policies and procedures that facilitate straight-through processing.
- Submit an annual report via EDGAR to the Commission that describes: (a) its current policies and procedures for facilitating straight-through processing; (b) its progress in facilitating straight-through processing during the twelve-month period covered by the report; and (c) the steps it intends to take to facilitate straight-through processing during the twelve-month period that follows the period covered by the report.

Additional Information:

The public comment period will remain open for 60 days following publication of the proposing release on the SEC’s website or 30 days following publication of the proposing release in the Federal Register, whichever period is longer.