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June 16, 2004

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Concept Release: Securities Transactions Settlement

Dear Mr. Katz:

The Securities Industry Association ("SIA")[1] appreciates the opportunity to comment on the Securities and Exchange Commission ("SEC" or "Commission") Concept Release on methods to improve the safety and operational efficiency of the U.S. clearance and settlement system, and to help the U.S. securities industry achieve straight-through processing ("STP") (the "Concept Release").[2] SIA has been leading an industry-wide effort over the last four years to reengineer the securities processing infrastructure to take advantage of new technology, to become safer and more efficient, and to respond to continuing growth in volume, increased global trading, and more complex products and market structure. We believe the Commission release will help to focus these efforts.

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[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated an estimated $209 billion in domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)

[2] Securities and Exchange Commission Release Nos. 33-8398; 34-49405; IC-26384, March 11, 2004, 69 FR 12922.

To prepare a response to the Commission's request for comment, SIA formed a Task Force composed of members of various SIA STP committees (the "Task Force") that have been involved in this process. The views of the Task Force are set out below.

I. Overview

The Concept Release focuses on three areas: changes to the confirmation/affirmation process; benefits to the industry of shortening the settlement cycle; and immobilization and dematerialization of securities certificates. The Commission believes it is timely to request comment on these issues to help continue the ongoing dialogue concerning the safety, reliability, and efficiency of the U.S. clearance and settlement system. The Concept Release states that people who invest in the securities markets want to know that their product will be delivered on time, at the agreed upon terms, and that they will not lose their funds and securities because of insolvency, mismanagement, or operational difficulties.[3]

SIA strongly agrees that public trust and confidence in our markets must be the industry's highest priority. For this reason, SIA, under the leadership provided by the SIA Board of Directors and its STP Steering Committee ("Steering Committee" or "Committee"), has been diligently pursuing a portfolio of projects with the ultimate goal being the seamless integration of systems and processes to automate the trade process from execution to settlement without manual intervention or data entry, so-called STP. The STP initiative is a formidable undertaking, consisting of a series of discrete but interrelated automation projects requiring a concerted effort by all market participants—regulators, exchanges, clearing corporations, depositories, securities firms, banks, institutional asset managers, vendors, and transfer agents. STP will provide benefits to investors and the industry through risk reduction, streamlined and efficient processing, improved functionality and service, greater capacity, and cost efficiencies.

In March of this year, the SIA Board of Directors reiterated its strong commitment to the STP effort by appointing an executive team to plan and prioritize industry-wide technical and operations projects through 2010.[4] Key elements of the Board's focus were the goals of same-day affirmation/matching for institutional trade processing and the elimination of physical certificates. SIA welcomes and encourages SEC support in achieving these goals. SIA does not support shortening the settlement cycle at this time. We believe most of the benefits of a shorter settlement cycle can be realized with implementation of STP. Therefore, the Task Force urges the Commission to work with the industry to facilitate STP and consider shortening the settlement cycle

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[3] *Id.* at 4.

[4] *See* http://www.sia.com/press/2004_press_releases/html/pr_stpefforts.html.

only when same-day affirmation/matching, elimination of physical certificates, and other STP milestones have been achieved.

As discussed in more detail below, the Task Force:

- Supports same-day affirmation/matching and believes this should be implemented in **phases,** but further believes it will not be accomplished without a Commission rule (recognizing, too, that the Commission would have to work to harmonize all regulations, particularly those applicable to the buy-side community, to ensure that all market participants are held accountable for compliance);
- Believes the focus should be on the goal of same-day affirmation/matching and not on the means, *i.e.,* we do not believe that use of a central matching utility should be required;
- Believes the focus should be on achieving STP, *i.e.,* we do not support shortening the settlement cycle at this time;
- Recommends that the Commission revisit the existing requirement for delivery of a final prospectus prior to or simultaneously with the confirmation, which would accommodate settlement of offerings in a T+3 environment but, more importantly, would be one of several necessary prerequisites to any further shortening of the settlement cycle; and
- Believes the Commission should promote dematerialization of physical certificates as the ultimate goal; immobilization should continue to be pursued but only as a stepping stone towards complete dematerialization.

II. Background

In 1999, after the successful conversion from T+5 to T+3 settlement for securities transactions and in anticipation of increasing trade volume, SIA convened a committee to explore the feasibility of further reducing the settlement cycle to T+1 by 2005 (“SIA STP/T+1 Committee” or “Committee”). After three years of evaluation, consensus-building, and intervening regulatory mandates, *i.e.,* decimalization, business continuity planning, and compliance with the USA Patriot Act, SIA determined to shift the principal focus of the initiative from shortening the settlement cycle to achieving industry-wide STP.

An assessment of the costs and benefits of moving to an STP environment versus a change in the settlement cycle from T+3 to T+1 indicated that the industry and investors would be better served by replacing the goal of T+1 settlement with a set of STP goals to be achieved over several years. Because many of the systems changes required for T+1 and STP overlap, it was difficult to evaluate the costs of moving to T+1 versus the costs of STP. The incremental risk reduction of moving the settlement cycle from T+3 to T+1, however, appeared to be relatively modest in light of the high costs associated with such a move. While a shorter settlement cycle would be expected to decrease the gross amount of unsettled trades subject to credit or market risk, it could increase operational risk by reducing the time available to correct errors prior to settlement. A compressed settlement cycle without these attendant risks could be feasible, however, once certain specific STP goals are achieved.

Building on the work of the SIA STP/T+1 Committee, in 2002, the SIA shifted its focus to coordinating, monitoring and facilitating the implementation of agreed-upon industry-wide STP improvements in order to achieve an industry-wide STP environment. The STP Steering Committee set out to accomplish this goal in two phases. First, given the magnitude of the project and recognizing that agreement and participation of all constituencies within the industry would be necessary, the Committee formed subcommittees to evaluate the risks, benefits, costs, and overall feasibility of implementing the STP projects identified as beneficial to the market. Second, the Committee developed a process to help direct the implementation of the stated projects and goals through a formal project implementation structure comprising the appropriate committees, subcommittees, work groups, and industry experts.[5]

Since its formation in 1999, the Committee has made significant progress in supporting STP initiatives. Hundreds of dedicated industry volunteers have worked to forge consensus and set the stage for a reengineering of the clearance and settlement process. One committee developed a White Paper recommending a new institutional transaction processing model. A subcommittee published an institutional trade processing and matching utility user requirements document, which establishes baseline expectations for U.S. matching providers. Another subcommittee created a "Code of Practice" to outline the benefits of matched affirmed confirmations and conformance guidelines. Similarly, gains have been achieved in defining the automation of corporate actions through the development of liability notification hub business requirements and the standardization of data for corporate action announcements. To promote the elimination of stock certificates, another subcommittee developed a "how to" guide for industry professionals and a "tool kit" to educate retail clients on the benefits of eliminating stock certificates.

Industry utilities have made considerable progress as well upgrading processing systems to prepare for STP. Approximately 99.9% of equity streetside (broker-to-broker) trades are compared by the marketplaces and submitted to National Securities Clearing Corporation ("NSCC") as "locked-in." While this number is lower for corporate and municipal fixed income trades (approximately 85%), new initiatives such as the Real Time Trade Matching ("RTTM") system and the Municipal Securities Rulemaking

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[5] *See* http://www.sia.com/stp/html/mission_statements.html for the mandate of the STP Steering Committee and subcommittees. Subcommittees include: Asset Manager/Buy-Side; The Bond Market Association/Fixed Income; Communications; Corporate Actions; Front Office; Institutional Oversight Committee ("IOC"), IOC/Business Practices & Matching Implementation, and IOC/Code of Practice; Payments Processing; Physical Securities; Securities Lending; Service Bureaus; STP Legal and Regulatory Subcommittee and Streetside Processing Subcommittee.

Board's 15-minute trade reporting rule will serve to further enhance streetside trade comparison rates. In addition, equity trade input has moved from end-of-day batch to intra-day from all market sources, with some submitting their data real-time. Equity trade reporting also has moved from end-of-day batch to intra-day output. NSCC's continuous net settlement ("CNS") system has been redesigned to support real-time processing and is scheduled to be implemented mid-2004. The Automatic Recall Management System ("ARMS") was developed for automating the manually intensive telephone and fax process for securities lending recalls facilitating securities lending STP.

In 2004, SIA has undertaken an overall project assessment and identified several areas of focus. Consisting of representatives from securities firms, exchanges, utilities, industry service providers, buy-side firms, and custodians, a new senior-level committee will prioritize the industry's development programs over the next five years. These include: same-day affirmation/matching for institutional trades; the automation of corporate actions announcements and liability notices; the dematerialization of physical certificates; continuing education on the use of Automated Clearing House for payments; and the adoption of industry standards. As we continue to work on these initiatives, especially institutional trade processing and the elimination of physical certificates, we welcome the Commission's participation. In fact, we believe that active involvement of the Commission will be necessary before we can be successful in achieving our goals. Our response to the Commission's specific request for comments is derived from work that has been ongoing over the last several years and is set out below.

III. Phased Approach to Trade Confirmation and Affirmation on T+0

One of the principal goals of the SIA's STP initiative is for all transactions to be confirmed and affirmed or matched on trade date ("T+0"). As you know, the Institutional Transaction Processing Committee ("ITPC") produced several White Papers evaluating the settlement process for institutional trades.[6] To address perceived deficiencies in the existing institutional transaction settlement process, the ITPC recommended an institutional transaction processing model in which trade data is matched by a matching utility. The matching utility would seamlessly match the data submitted by the broker-dealer and its institutional customer and would submit the matched transaction information to the depository in real-time.

The ITPC model was developed to facilitate settlement on T+1. Affirmation/matching on trade date is not as critical in a T+3 settlement environment. Rather, the Task Force believes the goal should be affirmation or matching as close to execution as possible, which presupposes automation of the allocation process. The industry is actively pursuing the new model for institutional transaction processing,

[6] *See* "Institutional Transaction Processing Model," May 2002, available at www.sia.com/stp/pdf/FinalITPCModelasofMay2002.pdf.

putting more emphasis on automation of allocations and less on central matching, which requires a reengineering of the processing model.

The goal of the Institutional Oversight Committee ("IOC"), which was formed to oversee implementation of STP for institutional transactions, is for all parties to a transaction to have the information required for settlement of a trade. This assumes that: 1) 100% of trades would be matched or affirmed on trade date (ultimately, the goal will be to replace the confirm/affirm process with matching); 2) all communications between participants would be asynchronous (non-sequential) and electronic, including notice of executions, allocations, match status/affirmations, and settlement instructions; 3) an industry standard electronic format for message communication would be adopted; and 4) manual processing should be exception-based.

International organizations also have recommended that confirmation and affirmation of institutional trades should occur as soon as possible after trade execution, preferably on T+0, but no later than T+1. For example, the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions issued 19 recommendations for securities settlement systems in 2001, including the above recommendation regarding confirmation and affirmation of institutional trades.[7] Likewise, the Group of Thirty issued a report describing best practices for clearing entities operating in developed markets with the goal of improving cross-border clearance and settlement.[8] The Report recommends that market participants collectively develop and use fully compatible and industry-accepted technical and market practice standards for the automated confirmation and agreement of institutional trade details on the day of the trade.[9] The Task Force strongly supports efforts to improve the global system of clearance and settlement to ensure that operational standards are the same for foreign and domestic market participants.[10]

The Task Force agrees with the Commission's preliminary assessment that industry-wide trade matching is the preferred method to improve the confirmation/affirmation process and to achieve STP. Matching speeds up the

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[7] *See* "Recommendations for Securities Settlement Systems," The Committee on Payment and Settlement Systems/International Organization of Securities Commissions Task Force (November 2001).

[8] *See* "Global Clearing and Settlement, A Plan of Action," The Group of Thirty (January 30, 2003).

[9] *Id.* at 31.

[10] *See, e.g.,* Letter to John G. Walsh, Executive Director, G-30, from Donald D. Kittell, Executive Vice President, SIA, and Ernest A. Pittarelli, Chairman, SIA Operations Committee, dated April 24, 2003, and Letter to Jean-Michel Godeffroy, Director General, Payment Systems, European Central Bank ("ECB"); Elias Kazarian, ESCB Secretariat, Securities Settlement Systems Policy, ECB; Eddy Wymeersch, Chairman, Banking and Finance Committee; and Wim Moeliker, CESR Secretariat, CESR, from John Cirrito, Chairman, Cross-Border Subcommittee, SIA Operations Committee, dated December 9, 2003.

affirmation process by eliminating steps and redundancies in the affirmation process. For example, upon receiving a notice of execution ("NOE"), the buy-side firm will allocate a block trade among individual accounts. When the broker-dealer receives allocation instructions (currently not required by regulation until the end of the trading day), the broker-dealer responds with a trade confirmation for each allocation. The confirmation is compared against the allocation instruction by the buy-side firm and a successful match results in an affirmation. Consequently, where information is exchanged sequentially as described above, timely action by all parties to the trade is critical to improving affirmation rates.

We agree with the Commission that imposing a requirement that all broker-dealers and their institutional customers use a matching service raises significant issues. Although we believe that matching is beneficial, the Task Force is mindful of the burden on small and medium-sized broker-dealers and investment managers. We believe an electronic confirmation/affirmation service could be an adequate alternative to a central matching service. We support mandating the time within which trades should be confirmed/affirmed or matched, but not the means by which affirmation or matching occurs.[11] In a shorter settlement cycle, though, we would need to reassess whether electronic confirmation/affirmation would suffice. The SIA's focal point is to achieve matched/affirmed trades on T+0 to the greatest extent possible.

As discussed below, the Task Force believes this is best achieved through an incremental approach. Although we are confident that this goal can be realized, we do not believe that it will happen without a mandate from the Commission. The challenge will be to incent all parties involved in trade processing—the buy-side, the sell-side, and their agents—to make a more determined effort to match or affirm trades on T+0. For example, today only 88.2% of trades are affirmed by noon of T+2.

The benefit of same-day affirmation/matching, *i.e.,* formally agreeing to trade details, is reduced risk, which is beneficial to all market participants. Low institutional affirmation rates expose firms to risk and increased costs. Until a trade is affirmed, it is uncertain that the counterparty agrees to the trade details, which could expose the firm to market risk. According to statistics provided by the Depository Trust Company ("DTC"), unaffirmed trades are much more likely to be reclaimed than affirmed trades.[12] Unaffirmed trades result in delivery orders ("DOs") and firms must devote time and resources to tracking down affirmations, taking time away from resolving those items

[11] Notably, no vendor has yet to publish specifications or a timeline for implementation of a U.S. matching model, which also makes it difficult to achieve this goal.

[12] According to DTC, 11% of institutional trades are never affirmed. Approximately 6.7% of unaffirmed trades are reclaimed, which involves the return of an original delivery any time after its receipt. On the other hand, the reclaim rate for affirmed or matched trades is much lower, *i.e.,* it is 37 times more likely that an unaffirmed trade will be reclaimed.

that are truly exceptions. The Task Force believes the industry should be moving toward a single process for settlement and that DOs should be used solely for exception processing and not as an alternate process for settlement. Additionally, same-day affirmation/matching improves controls around the allocation process.

Unfortunately, because the benefits of same-day affirmation/matching appear to accrue largely to the broker-dealer community, the buy-side community has been slow to adopt matching and same-day affirmation based on a cost/benefit analysis. In order to gain an understanding of the buy-side's views with regard to SIA's STP initiative, the Buy-Side STP Committee conducted a survey and found that buy-side firms use return on investment as a key component in prioritizing their investment dollars.[13] Those firms that have found an acceptable return on their investment are progressing on the IOC goals and those that do not see an adequate return have given the STP initiatives a much lower priority. The Task Force acknowledges that the costs are not shared equally among all market participants, but believes this is offset by the benefits in reduced systemic risk that accrue to the clearance and settlement system as a whole.

Specifically, investment managers would incur costs to upgrade their systems. In order to match or affirm trades same-day, investment managers would be required to submit allocations to broker-dealers earlier or pre-allocate trades. This presupposes electronic allocations, which would require smaller investment managers that currently allocate manually to adopt new technology that would generate an affirmation automatically by matching confirmations to allocations.

Same-day affirmation/matching would involve costs for broker-dealers as well. The ability to send NOEs and confirmations in a timely manner on trade date would require real-time systems and would require middle or back office systems to be integrated with front office systems, where trade execution information resides. Nevertheless, it would provide an opportunity to those willing to make the technology enhancements to provide additional services, *e.g.,* tools to electronically allocate trades, to their smaller and medium-sized customers.

The burdens of same-day affirmation/matching increase for non-U.S. trade participants. Due to time zone differences, the business day ends for investment managers in Asia and Europe before they receive execution details and, therefore, they typically do not submit allocation details to their U.S. counterpart until the next day. Again, the Task Force does not believe that this presents an insurmountable impediment to same-day affirmation/matching. We do, however, believe that these burdens should be given careful consideration by the Commission in determining the most feasible approach to having trades confirmed/affirmed on trade date and the timetable for implementation.

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[13] *See* Buy-Side Straight-Through Processing White Paper, SIA STP Buy-Side Committee (December 2003), available at www.sia.com/stp/pdf/SIA_STP_Buy-Side_White_Paper_Final_.pdf.

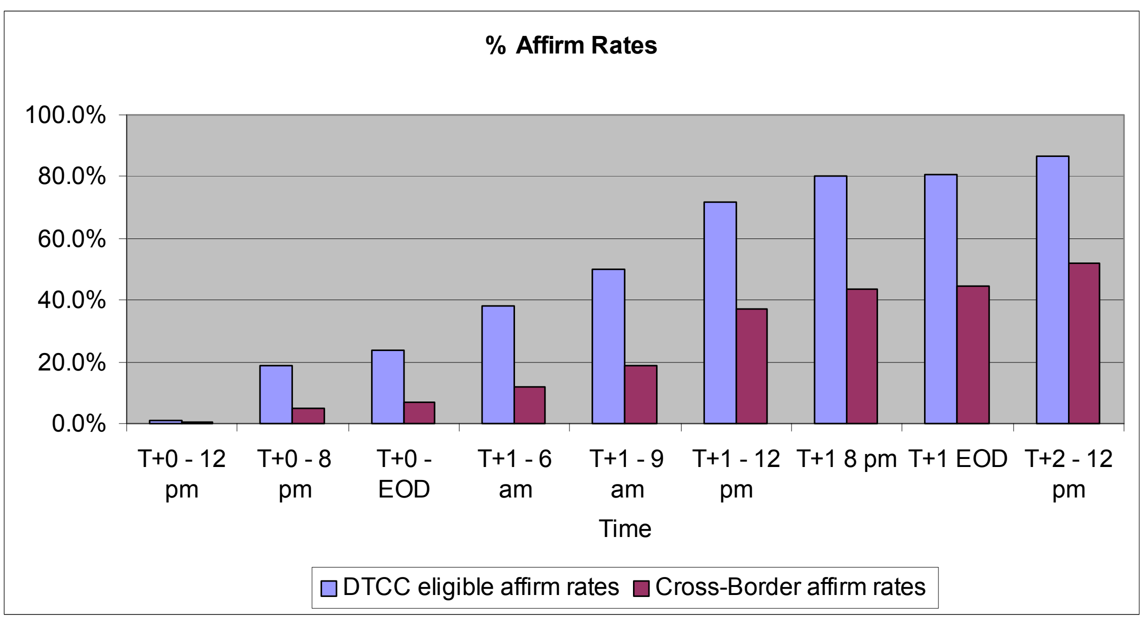
Previously, the IOC explored the feasibility of an SRO rule that would prohibit broker-dealers from extending delivery-versus-payment/receive-versus-payment ("DVP/RVP") privileges to any customer unless all trades with that customer are confirmed and affirmed on T+0, but determined that such a rule would place the onus of enforcement on broker-dealers who have limited control over the behavioral changes that would have to occur, particularly with respect to their buy-side customers. The Task Force does not believe that same-day affirmation/matching will happen without an SEC rule that obligates regulated entities to agree to trade details on trade date. We recognize, though, that a Commission rule would not reach investment managers with less than $25 million in assets, which are regulated at the state level, hedge funds, or investment advisers domiciled outside the U.S. Nevertheless, we believe that a Commission rule, phased in over a reasonable time period and accompanied by strong economic disincentives for those who fail to meet the specific milestones, could go a long way toward expediting the confirmation/affirmation process.[14] We believe the Commission should work closely with its counterparts at the state level to ensure a consistent regulatory approach that would reach all parties involved in the trade process.

[14] The Task Force is not suggesting that this could be accomplished in a single Commission rule. More likely, it would involve adopting rules under the Securities Exchange Act of 1934 and the Investment Adviser Act of 1940, and could require coordination by the Commission and bank regulators in this area. In addition, it would require stricter enforcement of existing rules. For example, SEC and SRO rules require that the order record include all account designations as well as the number of shares to be allocated per account. *See, e.g.,* Securities Exchange Act Rules 17a-3(a)(6) and 17a-3(a)(7) and NYSE Rule 410. However, an interpretation to NYSE Rule 410 allows member organizations to accept block orders and permits investment advisers to make allocations on such orders to customers and remain in compliance with Rule 410 provided that the organizations receive specific account designations or customer names by the end of the business day. The SEC's Division of Market Regulation has indicated that this exception applies to the requirements of Securities Exchange Act Rules 17a-3(a)(6) and 17a-3(a)(7) as well. In either instance, the investment adviser must be one who is registered under the Investment Advisers Act of 1940 or who, but for Section 203A, would be required to register under that Act.

Although there was consensus on the goal and the means to achieve it, the IOC did not consider an implementation timetable. Given current affirmation rates, the Task Force believes the Commission may want to consider a phased approach that is set based on current capabilities. For example, the Commission could adopt a rule requiring trades to be affirmed by 10:00 p.m. on trade date. The rule would be phased in by requiring trades to be affirmed by noon on T+1 within 24 months. When 95% of domestic trades are affirmed by noon on T+1 (or after 24 months), the requirement would be to affirm trades by 9:00 a.m. on T+1. When 95% of trades are affirmed by 9:00 a.m. (or after a certain period of time), the time within which trades would have to be affirmed would be moved up yet again.[15] If the Commission is concerned about the impact on non-U.S. customers trading in U.S. securities, we believe the staged implementation requiring earlier and earlier affirmation on T+1 addresses that concern. Nevertheless, due to time zone differences, cross-border affirmation rates may never reach those of rates within the U.S.

If the Commission determines to adopt a rule requiring confirmation/affirmation within certain prescribed timeframes, the Task Force believes that all DTC-eligible securities should be covered by the rule. The rule should apply to all securities that currently settle on T+3 or less. Structured derivatives should not be included in the rule.

[15] Omgeo, a joint venture between DTCC and Thomson Financial, provided data indicating that currently 71.9% of DTCC-eligible trades are affirmed by noon on T+1. At 9:00 a.m. on T+1, 50.1% of trades are affirmed. Cross-border trades have much lower affirmation rates, with only 37% affirmed by noon on T+1 and only 19% affirmed by 9:00 a.m. on T+1.



The Commission has specifically requested comment on what, if anything, the Commission should do to facilitate the standardization of reference data and use of standardized industry protocols by broker-dealers, asset managers, and custodians.[16] The Task Force believes it is critical for the industry to have and adhere to common standards. In fact, significant work is underway in the industry to standardize reference data and the use of standardized industry protocols.[17] The Commission should continue to require interoperability, which implies the use of standards, but should not otherwise act to mandate particular standards.

IV. Immobilization Today, Dematerialization Tomorrow

The STP Physical Securities Subcommittee ("Subcommittee") believes physical certificates should be eliminated. As the Commission notes, virtually all mutual fund securities, government securities, options, and municipal bonds in the U.S. are fully dematerialized. Achieving this objective will help reduce risks, costs, and processing delays and thereby will improve the industry's capacity to support prompt and accurate clearance and settlement of securities transactions for the benefit of all investors. Although the long-term goal of the Subcommittee is to eliminate physical certificates as a record of security ownership, a short-term goal is to encourage immobilization—removing certificates from circulation by depositing them and maintaining records of ownership electronically in book-entry. We are pleased that the Commission believes it is an appropriate time to consider further steps to remove securities certificates from the U.S. trading markets and our clearance and settlement system. As discussed below, we believe there is a strong case for eliminating securities certificates and certain regulatory initiatives can help to establish book-entry ownership as the standard.

The Subcommittee has been working concurrently on immobilization and dematerialization in the U.S. securities markets. Immobilization is an important step towards complete dematerialization. However, immobilization alone will not eliminate the manual paper process. Taking certificates out of circulation eliminates the opportunity for previously cancelled certificates to be fraudulently presented or

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[16] The Commission has mandated operational standards before. In 1998, the Commission issued an interpretation of the Exchange Act that stated that a clearing agency that only provided a matching service did not need to be subject to the full scope of clearing agency requirements. Securities Exchange Act Release No. 39829 (April 6, 1998). Instead, a matching service provider could apply for an exemption from registration. In 2001, the Commission granted such an exemption to the Global Joint Venture Matching Service, the DTCC-Thomson joint venture known as Omgeo. Securities Exchange Act Release No. 44188 (April 17, 2001). In granting the exemption, the Commission required that Omgeo, among other things, develop fair and reasonable linkages with other matching services to allow customers of other matching services to communicate trade and allocation data with customers of Omgeo (also known as interoperability).

[17] *See* STP Code of Practice Guidelines (September 26, 2003), available at http://www.sia.com/stp/pdf/STPCOPGuidelines.pdf.

inadvertently sold and presented for transfer, which minimizes risk for the issuer, broker-dealer, and the investor. Additionally, dematerialization will better serve the industry from a disaster recovery perspective. During the World Trade Center attacks, certificates held in vaults of a number of institutions at the site were destroyed and had to be replaced over many, many months at a cost of millions of dollars.

A. The Cost/Benefit Analysis For Elimination of Certificates Is Compelling

On March 23, 2004, the Physical Securities Subcommittee published "The Securities Industry Immobilization & Dematerialization Guide—The Phase Out of the Stock Certificate" (the "Guide").[18] The Guide provides a comprehensive look at the benefits of, and steps to be taken toward, the elimination of physical certificates. According to the Guide, in spite of progress that has been made, the risks, costs and delays inherent in processing physical certificates are significant and completely avoidable. Industry processors, financial intermediaries, and investors could save an estimated $250 million annually.[19] As investors become more accustomed to book-entry, the cost of processing physical certificates will be spread among a smaller universe of investors and total costs on a per investor basis can be expected to rise over time.

On the other hand, the costs to process book-entry only positions are negligible. Trades, asset movement, and dividend payments are all processed electronically by systems which already exist. Perhaps the largest cost involved in book-entry processing is the cost of mailing a statement, which already occurs for customers with positions in mutual funds, bonds, and other uncertificated securities. It is time to migrate away from certificates so that investors can realize the monetary and efficiency benefits of book-entry ownership.

The industry recognizes the benefits of book-entry ownership and has consistently encouraged investors to hold securities in streetname. Streetname ownership provides timely payment of all entitlements, including dividends and/or bond interest, consolidated reporting of all investor account holdings on a single quarterly statement, consolidated tax information, and insurance in the case of a broker-dealer insolvency through the Securities Investor Protection Corporation. In addition, liquidations are easier when securities are held in streetname at a broker-dealer. In fact, streetname ownership is

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[18] www.sia.com/stp/pdf/FinalSIAIDImplGuidewithComments032304.pdf.

[19] *Id.* Costs include safekeeping, postage and mail insurance, transfer/ship charges, microfilm and scanning, reporting and information services, medallion guarantees, lost certificate surety, staffing and overhead, corporate actions/reorganization processing, DTC deposits, messenger shipping costs, vault counts and security, and costs associated with restricted securities, firm transfers, physical receives and delivers, and house counts. The $250 million includes costs incurred by broker-dealers, custodian banks, DTC, transfer agents, issuers, and the Securities Information Center, the Commission's designee for the Lost and Stolen Securities Program.

widely accepted. The vast majority of securities are held in this form. Nevertheless, the risks and costs associated with processing the small percentage of certificates remaining in the marketplace are substantial.

In preparing the Guide, the Subcommittee identified benefits for the industry, issuers, and investors. Perhaps the most important benefit of book-entry ownership—whether streetname or through the Direct Registration System ("DRS")[20] operated by DTC—is that it is safer than holding physical certificates and the processes are more efficient, which promotes the industry's STP objectives. Investors who choose to hold physical certificates face additional risks, costs, and delays that investors with book-entry shares do not.

1. Investor Benefits

The advantages of book-entry ownership for investors are many. Investors can trade at any time and not risk "missing the market" because of delays associated with the handling of physical certificates. Sale proceeds are distributed more quickly and investors receive timely notification and immediate receipt of many corporate action entitlements. A clear accounting and audit trail of assets is provided on statements of holdings. Because no safeguarding of certificates is required, book-entry ownership eliminates the risk of catastrophic events.

Replacement fees for lost or stolen certificates are high (typically 2% to 3% of the market value of the security) and continually rising.[21] Book-entry ownership totally eliminates these costs. With the establishment of DRS, portability is not a concern. Investors can move shares easily between a transfer agent and broker-dealer. If the Commission were to mandate mailing of annual DRS statements, as suggested below, fewer assets would escheat as abandoned property because investors would be more inclined to provide address updates as they do today when securities are held in streetname at a broker-dealer and statements are mailed on a regular basis.

2. Benefits to Brokerage Firms and Financial Intermediaries

Brokerage firms and other financial intermediaries also benefit from book-entry ownership by eliminating the costs of processing physical certificates and further enabling STP for timely transaction settlement. Effective January 2004, the average cost to brokers for withdrawal by transfer ("WT") transactions through DTC is approximately

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[20] DRS allows an investor to establish either through the issuer's transfer agent or through the investor's broker-dealer a book-entry position on the books of the issuer, and to electronically transfer that position between the transfer agent and the broker-dealer.

[21] Based on information provided by Equiserve, the Subcommittee estimated that replacement fees cost investors nearly $50 million in 2002 and over $58 million in 2003.

$10 more for a physical certificate than for a DRS statement. Additionally, the costs of manual vault counts, messenger services, physical medallion guarantees, safekeeping, shipping and transport, insurance, and internal vault security would be eliminated.

Brokers also incur costs in connection with reject handling when investors present defective certificates that would be eliminated or reduced through the use of book-entry ownership systems. While lost securities are reported to the Securities Information Center ("SIC"), certificates related to escheated and cancelled shares are not currently required to be reported. Therefore, the likelihood of defective certificates is heightened. Brokers run the risk of releasing sale proceeds to a customer selling a security evidenced by a physical certificate, only to have the certificate rejected later by the transfer agent. Although efforts are underway to broaden the reporting categories to include cancelled and escheated certificates, brokers currently are subject to this risk.[22]

Eliminating physical certificates also offers benefits to transfer agents, which ultimately inure to issuers and shareholders. Based on information provided by the Securities Transfer Association ("STA"), the Subcommittee estimates transfer agent servicing costs of $45 million could be eliminated with dematerialization. Costs include certificate handling, security and storage, and reject handling.

3. Issuer Benefits

Corporate action processing for certificated accounts is many times more costly than processing book-entry accounts where no physical certificates need to be received and processed. While each transaction is unique in its processing requirements, the Subcommittee estimates the cost of processing a certificated account could easily be six times the cost of processing a book-entry account. For example, if processing fees are $2 for a book-entry account and $12 for a certificated account, the cost to an issuer with 100,000 certificated accounts would be $1 million more than if the accounts were book-entry. The time and expense associated with researching and processing un-exchanged certificates from previous corporate actions can be substantial.

The costs of printing, safeguarding and issuing certificates, and processing lost certificates are significant. In a dematerialized environment, costs for printing, storage, insurance, postage and envelopes are reduced immediately. Based on information provided by the STA, an issuer pays anywhere from $1.51 for a large issuer to $3.76 for a

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[22] As a result of this initiative, approximately 50% (by volume) of the transfer agent community now submits cancelled certificate details to the Lost and Stolen Securities Program database. Prior to the addition of these permissive categories to the database, the average "hit" rate was 3%. A hit occurs when a certificate received by a broker-dealer, when checked against the database, is flagged by the transfer agent as stopped, replaced, escheated, etc. Today, with the more robust database, the hit rate is 10%. Identifying problem certificates early in the transaction cycle avoids the risks and costs of rejection of a security at or after settlement.

small issuer per certificate for routine certificate distribution. The cost to distribute a DRS statement of holdings is estimated at $.44, so a large company can save an average of $1.07 and a small company can save as much as $3.32 on each DRS statement of holdings mailed in place of a certificate. For example, a large issuer that distributes 130,000 certificates per year can save nearly $139,000 and a smaller issuer that distributes 5,000 certificates can save approximately $17,000 per year.

Finally, costs attributable to lost certificate processing and related shareholder inquiries and correspondence are reduced. Taking certificates out of circulation also eliminates the possibility that previously cancelled certificates will be fraudulently or inadvertently presented as valid instruments, which is a risk for issuers, investors, and brokers alike. As the Commission recently noted in adopting new rules and rule amendments regarding processing requirements for cancelled certificates,[23] there have been a number of spectacular mishaps involving billions of dollars of cancelled certificates over the past decade.

B. Action Is Necessary to Achieve Dematerialization

For a variety of reasons, equity securities remain the only significant asset class to follow the antiquated process of issuing physical certificates. As discussed below, several states, including Delaware, require issuers incorporated within their states to make physical certificates available to investors. In addition, although other methods are available, production of the physical certificate has been the preferred method of perfecting a security interest under the Uniform Commercial Code when stock is pledged. Certain securities have restrictions on transfer and those restrictions typically have been recorded via a legend on the physical certificate.

With the introduction of DRS in 1996, the groundwork for dematerialization has been established. Working through a joint industry committee of representatives of the SIA and STA, the industry now offers investors a system that preserves the benefits of holding securities in the form of physical certificates as an alternative to streetname ownership. SIA strongly encourages streetname registration for the reasons discussed above, but we believe DRS, along with the Networking for Equities ("NFE") feature, provides the basis for complete immobilization and dematerialization.[24] Use of DRS, unfortunately, remains low and the structure needs further enhancements. The Task

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[23] Securities Exchange Act Release No. 48931 (December 16, 2003).

[24] Networking for Equities ("NFE") is an electronic securities system offered by DTC that enables the dematerialization of all types of physical security certificates, which cannot be held in DRS, to allow for the certificate to be held: 1) as a book-entry position; 2) on the books of the issuer or its transfer agent (as custodian); 3) at the investor account level (under the original registration on the certificate); and 4) with the option for the depositing broker-dealer to remain in control of the underlying asset. The objective of NFE is to support the dematerialization of all physical securities certificates currently held in safekeeping in the vaults of broker-dealers or custodians, not just equities.

Force believes full utilization will only occur with regulatory initiatives and support by the Commission, strong incentives for issuers to migrate to DRS, and renewed educational efforts by the industry.

In order to achieve full dematerialization, any new issue coming to market that is not "book-entry only"[25] should offer DRS, including the NFE feature. The DRS Profile System[26] should be expanded to make all categories of securities eligible. To increase participation in DRS, the Subcommittee has been working with the exchanges to change listing requirements to include DRS eligibility. SIA has requested that DTC explore the possibility of eliminating the option of requesting a certificate through the WT service for any issue that is DRS-eligible. DTC's system should default WTs for DRS-eligible issues to statement form.

In addition to the changes discussed above, SROs should amend their policies to close a loophole that allows investors to avoid fees for physical certificates. Under current practice, New York Stock Exchange ("NYSE")-listed companies are not allowed to charge investors a fee when they request a physical certificate; Nasdaq-listed companies follow the same practice. Brokers, however, are allowed to charge fees for transactions involving shares registered on the books of the issuer, including fees for the issuance of physical certificates. Until this long-standing practice is changed, investors can continue to request "free" certificates from the issuer or its transfer agent and will have no tangible motivation to participate in DRS. We believe investors who choose to hold certificates should bear the full cost associated with producing and processing those certificates.

There are concrete steps that the Commission can take that will promote participation in DRS. For securities positions held through DRS, the Commission should require transfer agents to provide the registered investor with a transactional statement at the time a transaction takes place. In addition, the Commission should require that transfer agents send statements to DRS-registered security holders at least once a year.

The Task Force notes that an additional impediment to full dematerialization is state laws that require physical certificates to be issued to investors who request them. Six of the 50 states, including Delaware where over 90% of companies are incorporated, require publicly held businesses incorporated in those states to give physical certificates to investors who request them. All other states do not require physical certificates to be

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[25] "Book-entry only" refers to a securities issuance represented by one paper certificate held at a depository with all records of initial beneficial ownership and of subsequent changes recorded in electronic media versus on paper certificates.

[26] The Profile System ("Profile") was implemented by DTC to electronically convey an investor's request to move from one form of securities ownership to another. Profile takes the place of the paper transaction advice for electronic movement of securities positions between street-name positions and direct registration book-entry positions.

issued. The Commission should strongly encourage its counterparts at the state level to work to change such state laws that inhibit dematerialization.

Finally, a renewed educational campaign is necessary to encourage more companies to issue their securities in a dematerialized format and to have financial intermediaries effectively communicate to investors the available alternatives for securities registration. As noted above, the SIA has published the Immobilization and Dematerialization Guide, which provides a comprehensive look at the benefits of, and steps to be taken toward, the elimination of physical certificates. Additionally, through internal and external education initiatives, the industry is educating financial advisors, sales representatives, customer service personnel, and operations staff about the available options for securities registration.

More needs to be done. We recognize that, despite these efforts, registered representatives still are not sufficiently educated about DRS. The Task Force recommends that SROs be required to include materials on DRS in licensing examinations for registered representatives. SROs also should require firms to cover securities registration options in the firm element of their continuing education programs. Transfer agents must do more to educate issuers and their own operations and service representatives as well. Investors must be educated as well. The Commission should exercise its regulatory authority to facilitate these efforts.

Complete dematerialization is our goal and the Commission's support in this area is crucial. Given the long-standing tradition of holding physical securities, it is unlikely that dematerialization will be achieved without the strong support and active involvement of the Commission. We urge the Commission to promote the elimination of certificates through vocal support of the initiatives discussed above, including working to effect necessary changes in state law, and by using its regulatory authority if necessary.

V. Shortening of the Settlement Cycle Should Not be Considered at This Point

As the above discussion demonstrates, the industry continues to improve its risk management procedures in order to maintain safe and reliable clearance and settlement through its commitment to STP. The Commission cites several factors that underlie its thinking that options relating to further shortening the settlement cycle should be considered including: the size and growth of the markets, tighter linkages among markets and participants, and possible wide-scale regional disruption. As a threshold matter, the Task Force believes that risk in the clearance and settlement system is well-mitigated by current risk management processes employed by DTC and NSCC. The STP projects under development, independent of the settlement cycle, will further reduce inherent risks in the system. While we agree that there are benefits to further shortening the settlement cycle, the benefits are not justified by the costs at this time.

Although considerable progress has been made, important building blocks for a shorter settlement cycle are not in place. Many of the thornier issues that presented difficulty in moving from T+5 to T+3, such as prospectus delivery requirements, alternative payment mechanisms, and continued use of physical certificates, remain unresolved. Moreover, there is a considerable amount of work to be done in the fixed income market just to get to the same level as the equity markets in terms of matching, affirmation rates, etc. Disaster recovery and business continuity planning would have to be more rigorous in a T+1 environment because we would have two less days to work out issues. Risk management procedures should not be driven by the settlement cycle. Work should continue on the STP goals identified by the Steering Committee, particularly improving the rate of matched/affirmed trades and elimination of physical certificates, and the Commission should reevaluate shortening the settlement cycle when those goals have been achieved. The Task Force's response to specific questions posed in the release is set out below.

A. Scope of Securities Covered by Rule 15c6-1

With respect to securities settlement cycles, the Commission requests comment on whether the securities covered by Rule 15c6-1 should be expanded. Preliminarily, the Task Force believes the scope of the Rule should remain the same.

In terms of syndicated offerings, syndicates priced after 4:30 p.m. generally settle on what can be viewed as a T+4 basis due to the requirements for prospectus delivery and the due diligence required between pricing and settlement. The current process consists of a pre-pricing phase, pricing date and three days of pre-settlement processing. Within this timeframe a multitude of tasks must be performed that a condensed settlement cycle would adversely affect, including the timely and accurate settlement of trades. Due to external dependencies, required manual intervention, systemic limitations, and regulatory requirements, changing the settlement cycle for such issues would require a substantial overhaul of the current process and therefore would concentrate the focus purely on settlement of trades rather than on the syndicate offering as a whole. Areas like Legal, transfer agents, the issuer itself, and central depositories all play a major part in bringing a new issue to market, long before a trade is ever processed. Requiring these participants to complete their multiple tasks more quickly is almost impossible.

In 1995, the Commission exempted foreign securities from Rule 15c6-1. Since that time, practices in foreign markets may have changed. Should there be consideration to lifting any of the exemptions, an analysis and assessment of foreign markets would need to be undertaken.

With respect to variable annuities, this product is bought and sold directly with the product manufacturer. Variable annuities are not fungible. Today, they settle on T+0 and the Task Force believes that should continue to be the appropriate settlement cycle.

B. Systems and Operational Challenges Affecting Newly Issued Securities

Although the Task Force firmly believes that further shortening of the settlement cycle would be ill-advised at this time, we set out below the particular challenges presented by newly issued securities in response to the Commission's specific request for comment on how a shortened settlement cycle would affect the processing of these securities. The processes that follow are the result of work performed by an SIA committee in connection with the T+1 initiative. Nevertheless, any consideration of shortening the settlement cycle raises the same issues that the industry confronted in moving settlement from T+5 to T+3, issues that have yet to be resolved. As discussed below, the challenges are significant, yet not insurmountable.

While the due diligence process may be streamlined to accommodate a shorter cycle for some deals (*e.g.,* equity initial public offerings ("IPOs") in which the forecasted proceeds accurately reflect the actual proceeds), it would not be possible to reduce the process on a consistent basis for all syndicate trades. The T+1 Syndicates and Electronic Storage Subcommittee ("Syndicates Subcommittee") in March 2002 determined that it would be possible, however, to remove one day from the process to shorten the syndicate settlement cycle to T+3 for virtually all U.S.-based and IPO syndicate deals. Therefore, in order to provide a consistent standard in the U.S. marketplace, the Syndicates Subcommittee recommended that the standard settlement cycle for IPOs and follow-on offerings be no shorter than T+3, with the flexibility of allowing longer settlement periods for foreign deals in which settlement cycles may be longer or for deals requiring added due diligence.

Generally, IPOs and follow-on offerings would have to be processed on a "when-issued" basis. Because the "when-issued" process would be prohibitively cumbersome to operations and because it is too manually intensive to streamline, the Syndicates Subcommittee recommended an alternative processing approach for both IPOs and follow-on offerings.

1. Proposed IPO Processing

Instead of a "when-issued" process, the Syndicates Subcommittee proposed that IPOs would settle on a predetermined "extended settlement" basis. The default settlement date would be T+3 but could vary based on due diligence requirements and settlement conventions. These recommendations would be applicable to both equity and fixed income products. The exchanges and the street would be advised of the new issue delivery date to allow for "other than standard processing." Additionally, systems logic would need to be developed to identify trades, which are exceptions to the standard processing settlement cycle. The extended settlement would only apply to trading on the first day of secondary trading following pricing ("S-2") as S-1 trades would coincide with the normal T+1 settlement cycle.

The proposed extended settlement process would enable the elimination of one day from the current settlement cycle (T+4 to T+3) and still allow for the required due diligence process. Additionally, since the settlement date is known, the when-issued symbol would not be needed. This would further eliminate the need for firms to cancel and rebill trades and the subsequent breaks that occur with the regular way and when-issued symbols and CUSIPS. Finally, open orders on the specialist's book would not need to be cancelled and only one confirmation would need to be sent.

The processing changes would necessitate that firms amend their internal systems to enable the extended settlement date and potentially receive a direct feed from the exchanges to automatically override their internal systems. NYSE, Nasdaq and DTCC's systems would require a change to allow for the syndicate settlement date to be included in the trading transaction files. Additionally, the exchanges would need to ensure that they could provide timely notification to the street and vendors of the extended settlement date. Systems could be modified to capture the first delivery date of a security. Logic could then be developed that would permit the correct settlement date to be applied to trades executed on different dates. This process would benefit equities and most fixed income products, including municipals.

2. Proposed Follow-On Offering Processing

Processing follow-on trades in the same extended settlement process as proposed for IPOs would be an additional challenge because of the on-going secondary trading of the existing outstanding shares. However, while purchasers of newly traded IPOs on S-2 (the first day of secondary market trading following pricing) would settle on an extended settlement basis, this would not be true for purchasers of follow-on offerings because they would purchase the already existing outstanding shares and would follow the regular settlement cycle. Because there are existing shares trading in the market, which will settle regular-way, a when-issued symbol would still be required to differentiate the follow-on offering shares trading in the secondary market from the outstanding shares of the company.

3. Decoupling Prospectus and Confirmation Delivery

The SIA believes that the SEC should decouple the confirmation process from the prospectus delivery requirement. The existing requirement for delivery of a final prospectus prior to or simultaneously with written confirmation of a sale is extremely burdensome in a T+3 environment and would be impossible in a shorter settlement cycle. Investors are adequately protected in making their investment decisions so long as all material information has been effectively made available to them (as compared to delivered to them) at or prior to the time of the confirmation, which supplements oral disclosures made at the time of the trade. As a result, the Commission should permit the final prospectus to be delivered separate from and within a reasonable period after the confirmation.[27] The prospectus should be made available to investors both electronically and in paper form (as long as availability does not equal duplicate delivery).

C. Impact on Prime Brokerage

When T+1 was under consideration, the Prime Brokerage Working Group of the SIA STP/T+1 Committee agreed with the principles of the ITPC model for institutional trade processing and identified issues unique to prime brokerage activity that would need to be addressed. Specifically, a prime broker may disaffirm a trade if there would not be sufficient funds in a customer's account to settle the affirmed trade, or a margin call would be required to settle the transaction. Currently, the disaffirmation may take place up to 3:00 p.m. on T+1 in a T+3 environment. The timing of trade disaffirmation would have to be reconsidered in light of trade guarantee and prime broker processing considerations if the settlement cycle were to be shortened.

D. Cost of Shortening the Settlement Cycle

It is difficult to evaluate the difference in cost between a conversion to T+1 and the implementation of STP initiatives within a T+3 environment.[28] The costs are relative to the size of a firm and the magnitude of the effort. Costs will vary depending on the nature of the firm, *e.g.,* clearing firm versus non-clearing firm, the state of a firm's systems, and whether the firm uses outside vendors, *i.e.,* where the cost of technology upgrades is mutualized among many users. For firms that have made significant investments in real-time technology, the costs would be less than the cost for firms that would have to re-engineer batch processing systems. When queried on the *percentage of effort* involved in STP versus T+1, firms indicated that the incremental cost of going from STP to T+1 is approximately 70/30. This may or may not be representative of actual dollars spent.

In 2000, as part of the T+1 effort, the SIA T+1 Business Case Committee estimated that the cost to shorten the settlement cycle would be $6-$8 billion, while the cost of STP would be $5.0 to $6.3 billion. The majority of the cost to transition to T+1 would be attributable to changes that firms would be required to make to internal systems to convert from batch to real-time processing. Once 100% confirmation/affirmation or

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[27] From a legal perspective, in order to permit a communication confirming the details of a transaction to precede final prospectus delivery, the SEC must develop an interpretation of Sections 2(10) and 5 of the Securities Act of 1933 that clarifies that such a communication is not a confirmation, and thus, not an illegal prospectus. Such an interpretation would ensure that the notice need not be accompanied or preceded by the sending or delivery of a final prospectus. *See* Letter to Robert L.D. Colby, Deputy Director, Division of Market Regulation, SEC, from Larry Morillo, Chair, SIA T+1 Legal and Regulatory Subcommittee, dated January 11, 2002.

[28] SIA does not believe T+2 is a viable stepping stone. It would not make sense to make the investment twice for the minimal risk reduction that T+2 would provide.

matching on trade date is achieved, the estimated cost to shorten the settlement cycle was estimated to be approximately $1.4 to $1.6 billion.

As discussed above, it is difficult to estimate and differentiate the costs of moving to T+1 versus STP. Since the estimates above were prepared, significant amounts of time and money have been spent on STP initiatives. Because many of the systems changes required for STP are the same as would be required for T+1, presumably these are costs that have already been incurred. However, firms have invested in STP to varying degrees and it is impossible to estimate with any degree of certainty what the remaining costs would be to shorten the settlement cycle. The Task Force believes that at the point in time when the industry, with the help of the Commission, reaches the STP goals that have been set, only then should we evaluate the cost of moving to T+1.

E. Alternatives to Shortening the Settlement Cycle That Would Increase Efficiency in the Clearance and Settlement System

It is clear that shortening the settlement beyond T+3 would provide benefits in terms of risk reduction, although analysis indicates that the costs may outweigh the benefits at this time.[29] Although the costs would be borne by all market participants, broker-dealers and large asset managers will have a bigger share of the cost burden. Smaller investment managers may have to invest in new technology and, therefore, costs may be disproportionate for asset managers because they will have all the costs but do not necessarily enjoy the benefits that accrue to other market participants. Although shortening the settlement cycle provides benefits, the bulk of the benefits derive from STP. The Committee believes the SEC should focus on helping market participants meet STP goals, as these represent workable alternatives to shortening the settlement cycle that will increase efficiency and mitigate risk in the clearance and settlement system.

Specifically, the STP goals that SIA is pursuing include:

- Striving for 100% electronic communications among participants;
- Locking-in customer-side trades on trade date;[30]

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[29] Credit risk would be mitigated in a T+1 settlement cycle because the number and value of unsettled trades in the system would be less than in the current T+3 environment. Additionally, mark-to-market or replacement risk, *i.e.,* the risk that one party to a trade may default leaving the counterparty at risk of replacing the trade at a different price, would be decreased as the settlement cycle is decreased by two days. The replacement cost of an unsettled trade does not vary in a linear way with the number of days between trade date and settlement date. For example, following a purely linear approach, the reduction would appear to be 67% (*i.e.,* two days' reduction). However, in a Value-at-Risk ("VAR") model, which is a square root of time approach, the reduction is approximately 42%. The Task Force believes the VAR approach is a more accurate reflection of the actual risk reduction encountered if the settlement cycle were shortened by two days.

[30] Beyond same-day affirmation/matching of institutional trades, various committees also have considered marking-to-market institutional trades on T+1 and T+2 in order to reduce risk. If, for example, there was a

- Immobilizing and then eliminating physical certificates;
- Reducing reliance on checks;
- Automating the corporate action liability and announcements processes; and
- Electronically communicating stock loan recalls.

F. Impact of Shortened Settlement Cycle on Cross-Border Trading

It is estimated that approximately 30% of the transactions settling at DTCC originate from non-U.S. locations. A shortened settlement cycle could impose significant hardships on foreign investors who typically fund U.S. securities purchases through a foreign exchange transaction. Because foreign exchange transactions settle in two days, currently foreign investors can concurrently effect the securities transaction and the foreign exchange trade knowing that the U.S. currency will be delivered in time for the securities transaction to be settled. In a T+1 settlement cycle, there would be a settlement mis-match and foreign investors would be placed at an economic and operational disadvantage relative to their U.S. peers.

In addition, issues arising from time zone differences would present a significant hurdle for foreign investors in a T+1 environment. As noted above, it is uncertain whether affirmation rates for cross-border transactions will ever achieve the levels for domestic transactions. Investment managers would have to dramatically change their staffing practices because execution details are typically received after the business day ends.

Further, the lack of standards and codes of practice for rules of engagement between counterparties must be addressed. Interoperability, *i.e.,* connectivity to other utilities, presents challenges that would impact cross-border trading in a shortened settlement cycle. More progress must be made by vendors who provide electronic dealing and matching systems to standardize and centralize settlement instructions.

VI. Conclusion

The Task Force appreciates this opportunity to share our views regarding the merits of same-day affirmation/matching, the obsolescence of physical certificates, and the desirability of further shortening the settlement cycle at this time. As discussed above, we believe the industry is making steady progress and, with the help of the Commission, can achieve the goals we have set for industry-wide STP. Shortening the settlement cycle at this time, although it could involve systems and procedural changes

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5% swing in the price of a stock, a locked-in institutional trade could be marked-to-the-market until settlement.

that may also facilitate STP, would divert time and attention from what we believe is the more important goal, which notably offers many of the same benefits of a shortened settlement cycle, *i.e.,* STP.

Staffs at both the SIA and The Bond Market Association ("TBMA") have collaborated on the issues presented in the SEC's Concept Release. For the most part, both organizations are in alignment with their overall recommendations. TBMA is proposing a block level trade match on trade date in addition to an allocation-level trade match/affirmation by T+1. SIA recognizes that there are differences between the fixed income and equity markets, and SIA respects the unique issues posed in the fixed income arena (specifically that trade size is larger and trades are typically not locked-in by an exchange). SIA supports the position that this additional block level match would be an appropriate means to reduce the unaffirmed trade risk of fixed income securities. Furthermore, it is SIA's understanding that while TBMA would prefer that market practices be the driver of conformance, TBMA is not opposed to a regulatory mandate should it be required. TBMA is offering its market practices as a foundation for rulemaking, which is consistent with the SIA's position.

We thank you for the opportunity to comment. If we can provide additional information, or if you would like to discuss our views further, please contact the undersigned or John Panchery, Managing Director, at 212.608.1500.

Sincerely,

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