

SECURITIES AND EXCHANGE COMMISSION
(Release No 34-77744; File No. SR-MSRB-2016-04)

April 29, 2016

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Granting Approval of a Proposed Rule Change Consisting of Proposed Amendments to Rules G-12 and G-15 to Define Regular-Way Settlement for Municipal Securities Transactions as Occurring on a Two-Day Settlement Cycle and Technical Conforming Amendments

I. Introduction

On March 1, 2016, the Municipal Securities Rulemaking Board (the “MSRB” or “Board”) filed with the Securities and Exchange Commission (the “SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change consisting of proposed amendments to the MSRB Rules G-12 and G-15 to define regular-way settlement for municipal securities transactions as occurring on a two-day settlement cycle and technical conforming amendments (the “proposed rule change”).

The proposed rule change was published for comment in the Federal Register on March 18, 2016.³ The Commission received four comment letters on the proposed rule change.⁴ This order approves the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR § 240.19b-4.

³ Securities Exchange Act Release No. 77364 (Mar. 14, 2016), 81 FR 14906 (Mar. 18, 2016) (the “Notice of Filing”).

⁴ See Letters from Martin A. Burns, Chief Industry Operations Officer, Investment Company Institute (“ICI”), dated April 4, 2016 (“ICI Letter”); Michael Nicholas, Chief Executive Office, Bond Dealers of America (“BDA”), dated April 8, 2016 (“BDA Letter”); Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry Financial Markets Association (“SIFMA”), dated April 8, 2016 (“SIFMA Letter”); David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute (“FSI”), dated April 8, 2016 (“FSI Letter” and, together with the BDA Letter, the ICI Letter, and the SIFMA Letter, the “Comment Letters”).

II. Description of the Proposed Rule Change

The MSRB's proposed rule change consists of proposed amendments to Rule G-12, on uniform practice, and Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, to define regular-way settlement for municipal securities transactions as occurring on a two-day settlement cycle ("T+2") and technical conforming amendments.⁵ According to the MSRB, following the financial crisis in 2008, regulators implemented additional rules and regulations designed to reduce risk in the markets, achieve greater transparency and improve efficiency in the financial industry.⁶ Consistent with those goals, the MSRB stated that the securities industry launched a voluntary initiative to shorten the settlement cycle for securities transactions to reduce counterparty risk, decrease clearing capital requirements, reduce liquidity demands, and harmonize the settlement cycle globally.⁷

The MSRB has identified two MSRB rules – G-12(b)(ii)(B)-(D) and Rule G-15(b)(ii)(B)-(C) – essential to facilitate the move to T+2.⁸ As stated by the MSRB, these rules currently define regular-way settlement as occurring on a three day settlement cycle ("T+3").⁹ The MSRB, therefore, proposes to amend Rules G-12(b)(ii)(B)-(D) and G-15(b)(ii)(B)-(C) to define regular-way settlement as occurring on T+2, and to make certain technical conforming amendments to MSRB Rules G-12(b)(i)(B), G-15(b)(i)(B), and G-15(g)(ii)(B).¹⁰

⁵ See supra note 3.

⁶ Id.

⁷ Id.

⁸ Id.

⁹ Id.

¹⁰ Id.

According to the MSRB, the migration to T+2 will provide significant benefits to the financial industry broadly.¹¹ The MSRB stated that the benefits to the industry include the mitigation of counterparty risk, a decrease in margin requirements for National Securities Clearing Corporation’s (“NSCC”) clearing members, a reduction in pro-cyclical margin and liquidity demands especially during periods of market volatility, and an increase in global settlement harmonization by aligning the U.S. markets with other major markets, such as the European Union.¹² The MSRB also asserted that by shortening the time between trade and execution and settlement by one business day (from T+3 to T+2), the risk of counterparty default and the capital required to mitigate this risk would be reduced.¹³ In the MSRB’s view, the likely costs of the proposed rule change, including the changes in processes and technology as well as behavioral modifications by the industry and investors, are justified by the likely benefits associated with transitioning to T+2.¹⁴

Proposed Amendments to MSRB Rules G-12(b)(ii)(B)-(D) and G-15(b)(ii)(B)-(C)

According to the MSRB, Rule G-12 establishes uniform industry practices for processing, clearance and settlement of transactions in municipal securities between a broker, dealer or municipal securities dealer and any other broker, dealer or municipal securities dealer.¹⁵ Specifically, the MSRB noted that Rule G-12(b)(ii) defines “regular way” settlement as

¹¹ Id.

¹² Id.

¹³ Id.

¹⁴ Id.

¹⁵ Id.

occurring on a T+3 basis.¹⁶ As proposed by the MSRB, the proposed rule change would amend Rule G-12(b)(ii)(B)-(D) to define “regular way” settlement as occurring on a T+2 basis.¹⁷

According to the MSRB, Rule G-15 requires municipal securities brokers and municipal securities dealers to provide customers with written confirmations of transactions, containing specified information; and prescribes certain uniform practice procedures for dealers that transact municipal securities business with customers.¹⁸ Specifically, the MSRB noted that Rule G-15(b)(ii) defines “regular way” settlement as occurring on a T+3 basis.¹⁹ As proposed by the MSRB, the proposed rule change would amend Rule G-15(b)(ii)(B)-(C) to define “regular way” settlement as occurring on a T+2 basis.²⁰

Technical Conforming Amendments

The MSRB has proposed technical conforming amendments to Rules G-12(b)(i)(B), G-15(b)(i)(B) and G-15(g)(ii)(B).²¹ As proposed by the MSRB, Rules G-12(b)(i)(B) and G-15(b)(i)(B) would both be revised by replacing the reference to “National Association of Securities Dealers, Inc.” with the “Financial Industry Regulatory Authority.”²² Similarly, the MSRB proposes to amend Rule G-15(g)(ii)(B) to replace the reference to “NASD Conduct Rule

¹⁶ Id.

¹⁷ Id.

¹⁸ Id.

¹⁹ Id.

²⁰ Id.

²¹ Id.

²² Id.

2260(g),” which is retired, and replace it with the current relevant rule cite “FINRA Rule 2251(g).”²³

Compliance Date

The MSRB has stated that the compliance date of the proposed rule change will be announced by the MSRB in a notice published on the MSRB website, which date would correspond with the industry’s transition to a T+2 regular-way settlement, which would include amendments by the SEC to Exchange Act Rule 15c6-1(a).²⁴

III. Summary of Comments Received

As noted previously, the Commission received four comment letters on the proposed rule change.²⁵ The commenters generally support the proposed rule change. The SIFMA Letter, ICI Letter, FSI Letter, and BDA Letter, each, expressed general support for the proposed rule change.²⁶ In its comment letter, however, BDA expressed concern with respect to the impact the proposed rule change will have on certain retail investors who purchase securities by written check.²⁷ BDA made a substantially similar comment in its response to the MSRB’s Request for Comment on Changes to MSRB Rules to Facilitate Shortening the Securities Settlement Cycle, published on November 10, 2015 (the “Request for Comment”), which the MSRB addressed in the Notice of Filing.²⁸ The MSRB stated in the Notice of Filing that it believes that the vast majority of firms have access to technology that would enable their clients to deliver funds in

²³ Id.

²⁴ Id.

²⁵ See supra note 4.

²⁶ See SIFMA Letter; BDA Letter; ICI Letter; and FSI Letter

²⁷ See BDA Letter.

²⁸ See supra note 3.

order to settle their municipal securities trades on a T+2 basis, and firms should encourage their customers to leverage electronic funds payment to streamline processing.

The BDA Letter and the SIFMA Letter each addressed the impact of the proposed rule change on MSRB Rule G-32.²⁹ BDA expressed its desire that the MSRB leave Rule G-32 unchanged,³⁰ while SIFMA expressed its belief that the proposed rule change provided “an opportune time to revise customer disclosure requirements of brokers, dealers, and municipal securities dealers” under Rule G-32 but stated that such considerations should not impede progress of the proposed rule change.³¹ Both BDA and SIFMA made substantially similar comments in their responses to the Request for Comment, which the MSRB noted in the Notice of Filing and stated that it may consider suggested clarifications in the future.³²

The FSI Letter also expressed general support and agreement with the proposed rule change, and noted interest in seeing the MSRB coordinate with other regulators and market participants to educate investors and other market participants about the effects of shortening the settlement cycle to T+2.³³ The MSRB stated that it expects to coordinate implementation of a T+2 regular-way settlement cycle for municipal securities transactions with other regulators.³⁴

IV. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change as well as the comments received. The Commission finds that the proposed rule change is consistent with the

²⁹ See BDA Letter; See SIFMA Letter.

³⁰ See BDA Letter.

³¹ See SIFMA Letter.

³² See supra note 3.

³³ See FSI Letter.

³⁴ See supra note 3.

requirements of the Act and the rules and regulations thereunder applicable to the MSRB.

In particular, the Commission finds that the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act,³⁵ which requires, among other things, that the rules of the MSRB be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest. The Commission believes that the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act because the proposed rule change is reasonably designed to remove impediments to, and perfect the mechanism of, a free and open market in municipal securities by shortening the time between trade execution and settlement by one business day. According to the MSRB, the benefits of the proposed rule change will enhance the overall efficiency of the securities markets, promote financial stability, and better align U.S. securities markets with global markets.

In approving the proposed rule change, the Commission has also considered the proposed rule change's impact on efficiency, competition, and capital formation.³⁶ The Commission does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

For the reasons noted above, the Commission believes that the proposed rule change is consistent with the Act.

³⁵ 15 U.S.C. 78o-4(b)(2)(C).

³⁶ 15 U.S.C. 78c(f).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁷ that the proposed rule change (SR-MSRB-2016-04) be, and hereby is, approved.

For the Commission, pursuant to delegated authority.³⁸

Robert W. Errett
Deputy Secretary

³⁷ 15 U.S.C. 78s(b)(2).

³⁸ 17 CFR 200.30-3(a)(12).