

ALERTS

SEC Seeks to Shorten the Standard Settlement Cycle to T+1

February 10, 2022

Yesterday, the U.S. Securities and Exchange Commission (“SEC” or the “Commission”) proposed new rules to shorten the standard securities-settlement cycle to one business day after the trade date (“T+1”).^[1] Specifically, if implemented, the new proposals would, *inter alia*:

- Reduce the standard settlement cycle for securities from the current two business days after trade date (“T+2”) window to T+1 by March 31, 2024;
- Eliminate the four business days after trade date settlement cycle (“T+4”) that currently applies to firm commitment offerings priced after 4:30 p.m.;
- Impose new requirements for broker-dealers and registered investment advisers to improve the rate of same-day affirmations; and
- Impose new requirements for central matching service providers (“CMSPs”) to facilitate straight-through processing.

Background and Current Regulatory Framework

The SEC views shortening the settlement cycle for securities transactions as a key tool to promote investor protection, reduce risk and increase operational efficiency of the securities markets. In 1993, the SEC adopted Rule 15c6-1^[2] under the Securities Exchange Act of 1934, as amended (“Exchange Act”) to shorten the then-existing five business day

settlement cycle to three business days (“T+3”) and then reduced it again in 2017 to the current T+2 cycle.[3] The SEC’s latest proposal would further amend Rule 15c6-1, adopt new Exchange Act Rule 15c6-2 and amend Rule 204-2 under the Investment Advisers Act of 1940, as amended (the “Advisers Act”), in order to institute a standard T+1 cycle, with an implementation deadline of March 31, 2024, and the goal of ultimately moving towards same day settlement (“T+0”).

Proposed SEC Rules/Amendments

Standard T+1 Settlement/Elimination of T+4 Settlement for Certain Firm Commitment Offerings

Currently, absent an express agreement of the parties to the transaction, Exchange Act Rule 15c6-1(a)[4] sets forth a standard T+2 settlement cycle for most types of securities transactions. Under the Proposing Release, Rule 15c6-1(a) would be amended to change standard settlement from T+2 to T+1. The Proposing Release otherwise leaves intact the existing enumerated exclusions, including the exempted securities listed therein and the ability for parties to a transaction to negotiate alternative settlement arrangements. In an effort to enable industry participants sufficient time to transition their processes and systems, the Proposing Release provides for a March 31, 2024, compliance date.

The Proposing Release will also eliminate Exchange Act Rule 15c6-1(c),[5] which currently establishes a separate T+4 settlement cycle for firm commitment offerings priced after 4:30 p.m.

Same-Day Allocation, Confirmation and Affirmation Process

The SEC also proposed new Exchange Act Rule 15c6-2, which would require broker-dealers engaging in allocation, confirmation and affirmation processes to enter into written agreements with their customers requiring such activities to be completed “as soon as technologically practicable and no later than the end of the [trade date].”[6] The Proposing Release does not define “technologically practicable” or otherwise provide specific guidance on the factors to be used in evaluating when allocation, confirmation and affirmation activities completed on trade date may be deemed untimely.

Investment Advisers Recordkeeping Changes

The Proposing Release also seeks to amend Advisers Act Rule 204-2 (the “Recordkeeping Rule”) to require registered investment advisers that are parties to contracts under Rule 15c6-2 to make and keep time stamped records of confirmations received and allocations and affirmations sent.

Central Matching Service Providers

Finally, the Proposing Release seeks to require CMSPs to “establish, implement, maintain and enforce policies and procedures that facilitate straight-through processing” (that is, the automation of the entire trade process).[7] Rule 17Ad-27 would also institute a reporting requirement whereby CMSPs would have to submit annual reports to the Commission describing their policies, procedures, efforts and plans to facilitate straight-through processing.

New Requirements for Broker-Dealers

If the Proposing Release is adopted in its current form:

- Broker-dealers would need to ensure that their agreements for the purchase or sale of securities provide for payment of funds or delivery by T+1.
- Where parties have agreed to engage in an allocation, confirmation or affirmation processes, broker-dealers would need to ensure that their written agreements require the completion of those processes as soon as “technologically practicable” and no later than the end of the day on the trade date.
- Broker-dealers would need to assess their current systems, operations, policies and procedures to ensure that they are aligned with the new T+1 settlement dates, as well as the new allocation, confirmation or affirmation processes.
- Broker-dealers would also need to assess their systems and operations with an eye towards implementing the necessary changes to accommodate any new operational requirements that will be instituted by CMSPs under new Rule 17Ad-27.

New Requirements for Registered Investment Advisers

- While existing Advisers Act Rule 204-2(a)(7)(iii) requires that registered investment advisers keep and maintain originals of all written communications relating to “[t]he placing or execution of any order to purchase or sell any security,”[8] the proposed change would expand this requirement to include retaining allocation, confirmation and affirmation information.
- Specifically, the proposed amendments to the Recordkeeping Rule would require registered investment advisers to record “each confirmation received, and any allocation and each affirmation sent [or] given to a broker-dealer 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.”[9]
- Additionally, if the proposed Exchange Act Rule 15c6-2 is adopted, registered investment advisers would be contractually obligated to complete their allocation, confirmation and affirmation processes as soon as “technologically practicable and no later than by the end of the trade date.”

Groundwork for Additional Settlement Cycle Shortening

Expectedly, the Proposing Release makes clear that the current move to a T+1 settlement cycle is an intermediate step as the SEC attempts to chart a path to T+0. Noting that it is already assessing the challenges and benefits of further decreasing the settlement cycle, the Commission seeks feedback from industry participants on potential frameworks and implementation for T+0, and any comments to inform future proposals therewith.

If you have any questions concerning this Alert, please contact *Julian Rainero, Derek N. Lacarrubba, William J. Barbera, Tarik Shah, J. Eric Prather* or your attorney at Schulte Roth & Zabel.

Further, we are gathering feedback from our clients about the impact of the SEC’s proposed rules as we prepare a comment letter. You can submit comments to CommentLetters@srz.com or discuss them directly with one of the authors or your attorney at Schulte Roth & Zabel.

[1] “Shortening the Securities Transaction Settlement Cycle”, Exchange Act Release No. 34-94196, Investment Advisers Act Release No. IA-5957 (Feb. 9, 2022) (“Proposing Release”).

[2] Exchange Act Release No. 33023 (Oct. 6, 1993), 58 FR 52891 (Oct. 13, 1993); *see also* 17 CFR § 240.15c6-1.

[3] Exchange Act Release No. 80295 (Mar. 22, 2017), 82 FR 15564, 15601 (Mar. 29, 2017).

[4] 17 CFR § 240.15c6-1(a).

[5] 17 CFR § 240.15c6-1(c).

[6] Proposing Release at 64.

[7] Proposing Release at 66-67.

[8] 17 CFR § 275.204-2(a)(7)(iii).

[9] Proposing Release at 235.

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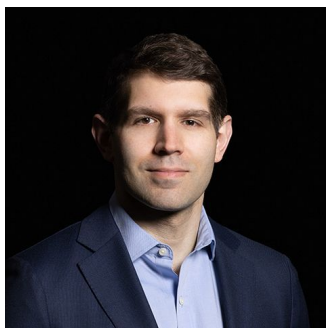
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