

SEC proposes shortened settlement cycle

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A new SEC proposal would shorten the securities settlement cycle to one business day for most transactions.

This week, the SEC [proposed](#) to shorten the standard settlement cycle for securities transactions from two business days after the trade date (T+2) to one business day after the trade date (T+1), beginning March 31, 2024. The proposed changes are designed to reduce the credit, market and liquidity risks in securities transactions faced by market participants and U.S. investors. In connection with the proposed shortened settlement timeline, the proposal includes a requirement that, where a post-trade allocation, confirmation and affirmation process are necessary, broker-dealers and their customers would be required to agree to complete the process by the end of the trade date.

The proposal also notes that, while not proposed, the SEC is “actively assessing” a future movement to a same-day standard settlement cycle (T+0). To that end, the proposal also requests comment regarding potential pathways to T+0. The SEC noted that market participants have identified challenges to implementing T+0.

Comments on the proposal are due 30 days after publication in the Federal Register or April 11, 2022, whichever is later.

Shortened settlement cycle

Rule 15c6-2 currently requires that most broker-dealer transactions settle by T+2, and this requirement has been gradually shortened from T+5 over the last several decades. Transactions involving certain securities—such as government bonds, commercial paper, and some limited partnership interests—are exempt from the rule. For firm commitment offerings that are priced after 4:30 p.m. Eastern Time, the current rules permit the trade to be treated as made on the next trading day, and therefore settlement can occur on a T+3 cycle.

Pursuant to a so-called “override provision,” the rule provides some flexibility by permitting that parties to a trade may agree that the settlement date may be later than T+2, provided that the agreement is express and reached at the time of the transaction. (The SEC noted in the proposing release, however, that the override provision was intended to apply only to unusual transactions, such as option trades that typically settle 60 days after execution, although in practice this override provision is widely used in debt offerings.)

The proposal would shorten the standard settlement cycle to T+1 for most broker-dealer transactions. The SEC also proposes to eliminate the expressly longer settlement time for certain firm commitment offerings, subject to the continuing availability of the override provision. As a result, by default, firm commitment offerings priced after market close would be required to close the next day—shortening the normal settlement cycle for equity and equity-linked offerings (which typically price after market close) from three days to one day. In its proposing release, the SEC explained that the provision was originally intended to allow market participants time to print and deliver final prospectuses, and that in light of the adoption of “access equals delivery,” the SEC is unaware of other specific documentation that could not be completed by T+1. That said, the SEC indicated that the unchanged override provision would provide flexibility for offerings involving complex documentation that would cause T+1 settlement to be impractical.

Same-day allocations and affirmations

Investment managers that effect block trades for the accounts of several customers simultaneously need to provide post-trade underlying account allocation instructions to the broker or custodian before these transactions can settle. Similarly, certain transactions, primarily involving institutional trades, require post-trade exchange of confirmations and affirmations, in order for the parties to compare trade details and facilitate settlement with third-party custodians. These processes are often, but not always, completed on the trade date. In order to facilitate T+1 settlement, the proposal would require that broker-dealers and their institutional customers agree to allocate, confirm and affirm the trade details by the end of the trade date.

In connection with the proposed same-day affirmation rule, the proposal would also amend Rule 204-2 under the Investment Advisers Act of 1940 to require that investment advisers who are parties to a contract under Rule 15c6-2 maintain records of each confirmation received, and any allocation and each affirmation sent, with a date and time stamp for each allocation and affirmation that indicates when the allocation or affirmation was sent to the broker or dealer. Advisers would be required to keep originals of confirmations, and copies of allocations and affirmations, but may maintain records electronically if they satisfy certain conditions.

Impact on other rules

Reducing the standard settlement cycle to T+1 will have follow-on effects on various other rules or market practices that are themselves tied to the standard settlement cycle, closing or the settlement date, typically reducing those time frames by one day. These include:

- Requirements for closing out fail to deliver transactions within a certain number of days following the settlement date under Regulation SHO and Rule 15c3-3(m);
- Delivery of Rule 10b-10 confirmations, which must occur at or before completion of a transaction;
- Prospectus delivery deadlines, which in the case of “access equals delivery” will require filing the final prospectus on EDGAR before the time of settlement;
- The time period within which a broker-dealer must obtain cash payment or margin from a customer for a securities transaction under Regulation T; and
- Various self-regulatory organization and other rules that reference the time period under Rule 15c6-2 or “regular way” settlement.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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