Cahill

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SEC Proposes One-Day Settlement Cycle (T+1) and Requests Comment on Same-Day Settlement Cycle (T+0)

On February 9, 2022, the Securities and Exchange Commission (the "Commission") proposed to amend Rule 15c6-1 under the Securities Exchange Act of 1934 to shorten the standard settlement cycle for most broker-dealer transactions from two business days after the trade date ("T+2") to one business day after the trade date ("T+1") and to require that affirmations be completed on the same day as the trade date ("same-day affirmation").[1] The Commission is seeking comments from the public on proposed amendments regarding the T+1 settlement and same-day affirmation and also on whether it would be possible to achieve a same-day settlement cycle ("T+0"). The Commission is not, however, proposing T+0 settlement at this time. If adopted, the T+1 settlement period would take effect on March 31, 2024.

I. Background

In the 1920s, T+1 settlement was standard for securities transactions. Over the years, the settlement period lengthened to accommodate increases in the number of investors, the volume of trades and transactions, and the complexity of the transactions. The settlement cycle eventually grew to five business days or T+5.[2]

In the late 1980s, the Commission began working to shorten the settlement period to protect investors and reduce risk. The focus of the Commission's effort was the idea that "time equals risk," meaning "the length of time between the execution and settlement of a securities transaction correlates to the financial risk exposure inherent in the transaction, and … shortening this length of time can reduce the overall risk exposure."[3] This effort resulted in the settlement cycle being shortened to three business days, or T+3, in 1993. More recently, in 2017, the Commission reduced the standard settlement period to T+2 to increase market efficiency and reduce market, credit and liquidity risks.

Today, the Commission's concerns are compounded by technological advances. For example, the rise of "fintech" allows many more retail investors to trade securities, which, when coupled with certain other market effects

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[1] For the full text of the proposed rule, see Securities and Exchange Commission, Shortening the Securities Transaction Settlement Cycle, Release Nos. 34-94196, IA-5957 (February 9, 2022), available here [hereinafter the "Proposing Release"]. Unless otherwise specified, quoted statements in this memorandum are taken from the Proposing Release.

[2] https://www.sec.gov/news/statement/gensler-statement-rules-regarding-clearing-settling-020922

[3] See Report of the Bachmann Task Force on Clearance and Settlement Reform in U.S. Securities Markets, Submitted to The Chairman of the U.S. Securities and Exchange Commission (May 1992) ("Bachmann Report"), https://www.govinfo.gov/content/pkg/FR-1992-06-22/pdf/FR-1992-06-22.pdf, at 4.

such as widespread investor interest in “meme” stocks that gain traction on social media, can lead to incidents of extreme market volatility.[4] In a public statement, Commission Chair Gary Gensler stated:

> “… the significant volatility and trading volume in so-called meme stocks prompted larger-than-usual margin calls on retail brokerages. Several retail brokerages restricted customer access to trading in certain stocks. The market was extremely volatile, and many investors were told they couldn’t buy at a critical time. I share the frustration of investors who were locked out from making certain trades.”[5]

Consequently, the Commission is seeking to reduce periods in which investors face restricted access to markets by shortening the standard settlement cycle.[6]

II. Proposed Amendments

As described in the Proposing Release, the Commission’s proposal would:

1. Shorten the standard settlement cycle for most securities transactions from T+2 to T+1;
2. Repeal in its entirety the four business day settlement cycle (“T+4”) currently in effect for certain firm commitment offerings priced after 4:30 p.m.;
3. Require new contracts between broker-dealers and institutional customers to require the parties to complete allocations, confirmations, and affirmations on the same day as the trade date (same-day affirmation); and
4. Require central matching service providers to establish policies and procedures to facilitate straight-through processing.

The proposed repeal of the T+4 settlement cycle is intended to promote a uniform approach to the settlement of offerings. The Commission noted that technological advancements should eliminate any argument against a uniform approach for firm commitment offerings.

Finally, it is important to note that the Commission is not repealing or otherwise altering the “override provision” that allows parties to expressly agree to a settlement cycle longer than T+1.[7]

III. Next Steps

In addition to a general request of comments on “all aspects” of the proposed amendments, the Proposing Release includes over 140 groups of specific questions as to which the Commission is soliciting comment concerning the proposed amendments and the feasibility of T+0. Topics specified include:

- the potential impact of the proposed amendments on market participants engaging in cross-border activities or in trading across various classes of financial products;
- the “status and readiness” of existing technologies to support T+1;
- whether same-day affirmation introduces any new risks and whether it should have separate provisions for each of allocation, affirmation and confirmation; as well as

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[4] https://www.reuters.com/business/finance/how-sec-is-cracking-down-equity-market-after-gamestop-saga-2022-01-27/

[5] https://www.sec.gov/news/statement/gensler-statement-rules-regarding-clearing-settling-020922

[6] https://www.sec.gov/news/statement/crenshaw-settlement-cycle-20220209

[7] The Commission noted in the Proposing Release that it “has not identified instances indicating a risk of overuse of this provision.”

- myriad issues relating to internal record-keeping requirements and on-going compliance with other applicable regulations.

The public comment period will remain open until April 11, 2022.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Geoffrey E. Liebmann (partner) at 212.701.3313 or gliebmann@cahill.com or Michael Chaia (associate) at 212.701.3335 or mchaia@cahill.com, or email publications@cahill.com.