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SEC Finalizes Rule to Reduce Risks in Clearance and Settlement

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On February 15, 2023, the U.S. Securities and Exchange Commission (the "SEC") adopted rule changes to Exchange Act Rule 15c6-1, shortening the standard settlement cycle for most broker-dealer transactions in securities from two business days after the trade date (T+2) to one day (T+1). In addition to the shortened standard settlement cycle for most securities transactions, the SEC shortened the standard settlement cycle for firm commitment offerings priced after 4:30 p.m. from four business days after trade date (T+4) to two days (T+2). Despite the change, the SEC will still allow issuers and underwriters to propose and agree to alternative settlement dates. This can be done through an express agreement at the time of the transaction. Should parties enter into an express agreement adopting alternative settlement dates, it is standard practice to disclose the alternative settlement cycle to investors through the offering document and in a free writing prospectus or pricing term sheet.

Many of the exceptions to the settlement cycle rules remain. The amended Rule 15c6-1(a) will apply the T+1 requirement to contracts for the purchase or sale of a security, excluding exempted securities, government securities, municipal securities, commercial paper, bankers' acceptances, or commercial bills. Rule 15c6-1(b) will now exclude security-based swaps from the requirements of Rule 15c6-1(a). In addition, the rules will modify 17 CFR 275.204-2 ("Rule 204-2") under the Investment Advisers Act of 1940, which outlines recordkeeping requirements for registered investment advisers. The amendment to Rule 204-2 subjects registered investment advisers to a requirement of making and keeping records of allocations, confirmations, and affirmations for securities transactions subject to Rule 15c6-2(a).

The Impact

The SEC adopted the amendments with the intent of benefiting investors and reducing risks in securities transactions faced by market participants. This will be the first change to the length of the settlement cycle since 2017, when the SEC shortened the standard settlement cycle for most securities transactions from three business days after the trade date (T+3) to two days (T+2). As a result of shortening the settlement cycle, it is believed that operational and capital efficiency will increase. The changes come as a response to recent instances of market volatility due to the outbreak of the COVID-19 global pandemic in 2020 and heightened interest in certain stocks, known as "meme stocks," in 2021.

The SEC believes that reducing the settlement cycle will help mitigate potential vulnerabilities in the U.S. securities market and avoid trading disruptions. Before the rules were adopted, the SEC received over 300 comments from investors in support of the proposal. The adoption of the rule changes will also facilitate straight-through processing and cost savings throughout the system.

What's Next

The final rules will become effective 60 days after publication in the Federal Register, with the compliance date set for May 28, 2024. The compliance date was pushed from March 2024 to May 2024 following industry feedback. With speculation that the SEC could eventually move to a T+0 settlement cycle, the industry will need to continue to monitor the settlement cycle rules and their impact.

For More Information

If you would like further information concerning the matters discussed in this Client Alert, please contact a member of Corporate and Securities or the Investment Management Group or visit us online at chapman.com.