

## Shortening the Settlement Cycle for Securities to T + 2

### FINRA Requests Comment on Proposed Amendments to FINRA Rules to Support the Industry Initiative to Shorten the Settlement Cycle for Securities in the U.S. Secondary Market From T+3 to T+2

Comment Period Expires: April 4, 2016

#### Summary

Shortening the settlement cycle from trade date plus three business days (T+3) to trade date plus two business days (T+2) for U.S. secondary market transactions in equities, corporate and municipal bonds, unit investment trusts, and financial instruments composed of these products is an industry-led initiative. To support this industry-led initiative, FINRA seeks comment on proposed amendments to FINRA rules relating to the settlement cycle. FINRA proposes to adopt necessary rule changes in a manner and timeline that is consistent with the Securities and Exchange Commission (SEC) and other self-regulatory organizations (SROs) in an effort to provide the regulatory certainty necessary for an efficient transition.

The proposed rule text of the impacted rules is in Attachment A.

Questions concerning this *Notice* should be directed to:

- ▶ Kosha Dalal, Associate Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6903; or
- ▶ Sarah Kwak, Counsel, OGC, at (202) 728-8471.

#### March 2016

##### Notice Type

- ▶ Request for Comment

##### Suggested Routing

- ▶ Compliance
- ▶ Government Securities
- ▶ Institutional
- ▶ Legal
- ▶ Municipal
- ▶ Mutual Fund
- ▶ Operations
- ▶ Senior Management
- ▶ Systems
- ▶ Trading

##### Key Topics

- ▶ Special Products
- ▶ Uniform Practice Code

##### Referenced Rules & Notices

- ▶ NASD Rule 2830
- ▶ FINRA Rule 11120
- ▶ FINRA Rule 11140
- ▶ FINRA Rule 11150
- ▶ FINRA Rule 11210
- ▶ FINRA Rule 11320
- ▶ FINRA Rule 11620
- ▶ FINRA Rule 11860
- ▶ SEA Rule 15c6-1

## Action Requested

FINRA encourages all interested parties to comment. Comments must be received by April 4, 2016.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to [pubcom@finra.org](mailto:pubcom@finra.org); or
- ▶ Mailing comments in hard copy to:  
Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment.

**Important Notes:** All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.<sup>1</sup>

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).<sup>2</sup>

## Background & Discussion

In 1995, the standard U.S. trade settlement cycle for equities, municipal and corporate bonds, and unit investment trusts, and financial instruments composed of these products<sup>3</sup> was shortened from five business days after the trade date to T+3.<sup>4</sup> Since then, the SEC and the financial services industry have continued exploring the idea of shortening the settlement cycle even further.<sup>5</sup>

In April 2014, The Depository Trust & Clearing Corporation (DTCC) published its formal recommendation to shorten the standard U.S. trade settlement cycle to T+2 and announced that it would partner with market participants and industry organizations to devise the necessary approach and timelines to achieve T+2.<sup>6</sup> In February 2015, the SEC's Investor Advisory Committee strongly endorsed DTCC's recommendation.<sup>7</sup> Market participants believe a shorter settlement cycle will yield important benefits to the industry by promoting financial stability and significantly mitigating risks to the financial system.

In collaboration with the financial services industry, DTCC formed an Industry Steering Committee (ISC) and an Industry Working Group and sub-working groups to facilitate the move to T+2.<sup>8</sup> In June 2015, the ISC published a white paper titled “Shortening the Settlement Cycle: The Move to T+2,” which outlined the activities and proposed timeframes that would be required to move to T+2 in the U.S.<sup>9</sup> The proposed timeframes included regulators and SROs finalizing their rule amendments by the second quarter of 2016, and developing and testing market infrastructure in 2017 with final implementation of T+2 by the third quarter of 2017.

Concurrently, in June 2015, the Securities Industry and Financial Markets Association (SIFMA) and the Investment Company Institute (ICI) jointly submitted a letter to SEC Chair Mary Jo White, expressing support of the efforts by the financial services industry to shorten the settlement cycle and identifying several SEC and SRO rule changes that they believed would require amendment for an effective transition to T+2.<sup>10</sup> The ICI/SIFMA letter categorized the rule changes as follows: (1) rules that specifically establish or reference a T+3 settlement cycle (*e.g.*, SEA Rule 15c6-1)<sup>11</sup>; (2) rules that do not specifically reference T+3 as the standard settlement cycle, but establish timeframes based on the settlement date of a trade and require one or more parties to act prior to settlement taking place; and (3) rules that establish timeframes based on settlement date, but require action after settlement occurs (*e.g.*, Regulation T, Regulation SHO, SEA Rule 15c3-3(m)).

In September 2015, SEC Chair White responded to the ICI/SIFMA letter expressing her strong support for industry efforts to shorten the trade settlement cycle to T+2 and urging the industry to continue to pursue the necessary steps towards achieving T+2 by the third quarter of 2017. SEC Chair White also indicated that she instructed SEC staff to develop a proposal to amend SEA Rule 15c6-1(a) to require settlement no later than T+2.<sup>12</sup>

## Proposed Amendments

SEA Rule 15c6-1 currently establishes “regular way” settlement as occurring no later than T+3 for all securities, except for government securities and municipal securities, commercial paper, bankers’ acceptances, or commercial bills.<sup>13</sup> In anticipation of the SEC’s changes to SEA Rule 15c6-1 to facilitate settlement no later than T+2 and to ensure that FINRA acts in concert and conformity with the impending rule changes by other SROs,<sup>14</sup> FINRA is proposing definitional changes to its rules pertaining to securities settlement by, among other things, amending the definition of “regular way” settlement as occurring on T+2. The proposed technical changes would implement the anticipated rule changes of the SEC and the other SROs. Accordingly, FINRA believes that the proposed rule changes will not impose any burdens on the industry in addition to those necessary to implement the industry-wide initiative.

FINRA has preliminarily identified the following rules that establish or reference a T+3 settlement cycle that would need to be amended to reflect a T+2 settlement cycle:

- ▶ NASD Rule 2830 (Investment Company Securities);
- ▶ FINRA Rule 11140 (Transactions in Securities “Ex-Dividend,” “Ex-Rights” or “Ex-Warrants”);
- ▶ FINRA Rule 11150 (Transactions in “Ex-Interest” in Bonds Which are Dealt in “Flat”);
- ▶ FINRA Rule 11210 (Sent by Each Party);
- ▶ FINRA Rule 11320 (Date of Delivery);
- ▶ FINRA Rule 11620 (Computation of Interest); and
- ▶ FINRA Rule 11860 (COD Orders)

The attachment to this *Notice* sets forth a list of the rules and the affected rule text that would be amended to comport with the industry-led initiative to move to T+2. As part of the ongoing initiative, FINRA will continue to review its rules to verify that impacted rules for securities settlement are identified and considered for amendment as appropriate.

## Economic Impact Assessment

The industry-led effort to shorten settlement cycle to T+2 was based, in part, on an in-depth cost-benefit study commissioned by DTCC.<sup>15</sup> The study identified several anticipated benefits. It concluded that a shorter settlement cycle would benefit market participants by mitigating operational and systemic risks by, among other things:<sup>16</sup>

- ▶ aligning U.S. markets with other major global markets such as the European Union and markets in the Asia Pacific region (*e.g.*, Hong Kong and South Korea) that have already moved to T+2 and other global markets that are examining a move to T+2 (*e.g.*, Canada and Japan);
- ▶ lessening member firm capital and margin requirements at the clearing agency by reducing risk exposure;
- ▶ reducing the additional margin and liquidity needs that can happen during times of economic volatility; and
- ▶ decreasing counterparty risk by moving trades more quickly to settlement, enabling capital to be freed up faster for reinvestment and reducing credit and counterparty exposure.

As part of the ongoing initiative to move to T+2, FINRA is assessing the changes that will be required to those FINRA systems and applications that base calculations on T+3. In addition, moving to a shortened settlement cycle would impose costs across various other segments of the industry. These costs would include technological and infrastructure investments, as well as costs associated with implementing various operational changes required to achieve a shorter settlement cycle.

Some of these costs and benefits of the shortened settlement cycle may, directly or indirectly, impact the investing public. For example, public investors would likely benefit from reduced counter-party risk and reduced delays in settlement. Alternatively, costs associated with meeting the shortened settlement cycle may be passed on, in part or in whole, to investors. FINRA specifically seeks comment on any direct or indirect impacts that may accrue to investors.

FINRA notes that the potential economic impacts to the industry and investors discussed here are associated with the industry-wide move to T+2 and the SEC's anticipated amendments to SEA Rule 15c6-1(a), and FINRA believes that its proposed technical rule changes would not impose any additional burdens on the market participants.

## Request for Comment

In addition to generally requesting comments, FINRA specifically requests comment on the questions below.

1. Would the proposed rule amendments have an effect on conduct that is required for compliance with any other FINRA rule?
2. Are there any other FINRA rules that should be amended to support the move to T+2?
3. Are there any economic impacts, including costs and benefits, to the industry that are associated specifically with FINRA's proposed rule changes and are they in addition to those arising from the industry-wide move to T+2 and the SEC's anticipated amendments to SEA Rule 15c6-1? If so,
  - a. What are these economic impacts and what are their primary sources?
  - b. To what extent would these economic impacts differ by business attributes, such as size of the firm or differences in business models?
  - c. What would be the magnitude of these impacts, including costs and benefits?

FINRA requests data and quantified comments where possible.

4. What economic impacts, including costs and benefits, would accrue to investors as a result of FINRA's proposed rule changes? What would be the magnitude and primary sources of these costs and benefits to investors? What factors or attributes would contribute to the costs borne by different segments of the public?

## Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
2. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
3. Examples of such financial instruments include mutual funds, exchange-traded funds, exchange-traded products, American depository receipts, options (exercise and assignment), rights, and warrants.
4. Effective in 1995, SEA Rule 15c6-1(a) provides, in relevant part, that “a broker or dealer shall not effect or enter into a contract for the purchase or sale of a security (other than an exempted security, government security, municipal security, commercial paper, bankers’ acceptances, or commercial bills) that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction.” Although not covered by SEA Rule 15c6-1, in 1995, the SEC approved the Municipal Securities Rulemaking Board’s rule change requiring transactions in municipal securities to settle by T+3. See Securities Exchange Act Release No. 35427 (Feb. 28, 1995), 60 FR 12798 (Mar. 8, 1995) (File No. SR-MSRB-94-10).
5. See e.g., Securities Industry Association (SIA), “[SIA T+1 Business Case Final Report](#)” (Jul. 2000); [Concept Release: Securities Transactions Settlement](#), Securities Exchange Act Release No. 49405 (Mar. 11, 2004); and Depository Trust & Clearing Corporation, “[Proposal to Launch a New Cost-Benefit Analysis on Shortening the Settlement Cycle](#)” (Dec. 2011).
6. See Depository Trust & Clearing Corporation, “[DTCC Recommends Shortening the U.S. Trade Settlement Cycle](#)” (Apr. 2014).
7. See “[Recommendation of the Investor Advisory Committee: Shortening the Trade Settlement Cycle in U.S. Financial Markets](#)” (Feb. 12, 2015).
8. The ISC includes, among other participants, DTCC, the Securities Industry and Financial Markets Association and the Investment Company Institute.
9. See “[Shortening the Settlement Cycle: The Move to T+2](#)” (Jun. 18, 2015) (White Paper).
10. See [letter from ICI and SIFMA to Mary Jo White, Chair, SEC](#) (Jun. 18, 2015) (ICI/SIFMA letter) at 5–8.
11. See *supra* note 4.
12. See [letter from Mary Jo White, Chair, SEC, to Kenneth E. Bentsen, Jr., President and CEO, SIFMA, and Paul Schott Stevens, President and CEO, ICI](#) (Sep. 16, 2015) at 2.
13. See also FINRA Rule 11320(b) which provides, in relevant part, that “[i]n connection with a transaction ‘regular way,’ delivery shall be made at the office of the purchaser on, but not before, the third business day following the date of the transaction.”

14. On November 10, 2015, the MSRB issued MSRB Regulatory Notice 2015-22 seeking comment on draft amendments to MSRB Rule G-12 (Uniform Practice) and MSRB G-15 (Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers) to facilitate shortening the settlement cycle for transactions in municipal securities. The comment period expired on December 10, 2015.
15. *See supra* note 6. *See also* The Boston Consulting Group, "[Cost benefit analysis of shortening the settlement cycle](#)," (Oct. 2012) (examining and evaluating the necessary investments and resulting benefits associated with a shortened settlement cycle).
16. *Id.*

## ATTACHMENT A

Below is the text of the proposed rule changes.<sup>1</sup> Proposed new language is underlined; proposed deletions are in brackets.

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### 2000. BUSINESS CONDUCT

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### 2800. SPECIAL PRODUCTS

#### 2830. Investment Company Securities

(a) through (l) No Change.

##### **(m) Prompt Payment for Investment Company Shares**

(1) Members (including underwriters) that engage in direct retail transactions for investment company shares shall transmit payments received from customers for such shares, which such members have sold to customers, to payees (*i.e.*, underwriters, investment companies or their designated agents) by (A) the end of the [third]second business day following a receipt of a customer's order to purchase such shares or by (B) the end of one business day following receipt of a customer's payment for such shares, whichever is the later date.

(2) No Change.

(n) No Change.

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### 11000. UNIFORM PRACTICE CODE

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#### 11100. SCOPE OF UNIFORM PRACTICE CODE

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1. In anticipation of the SEC's changes to SEA Rule 15c6-1 to facilitate settlement no later than T+2, and to act in concert and conformity therewith, FINRA may change the rule text of its impacted rules to reference SEA Rule 15c6-1.

**11140. Transactions in Securities “Ex-Dividend,” “Ex-Rights” or “Ex-Warrants”**

(a) No Change.

**(b) Normal Ex-Dividend, Ex-Warrants Dates**

(1) In respect to cash dividends or distributions, or stock dividends, and the issuance or distribution of warrants, which are less than 25% of the value of the subject security, if the definitive information is received sufficiently in advance of the record date, the date designated as the “ex-dividend date” shall be the [second]first business day preceding the record date if the record date falls on a business day, or the [third]second business day preceding the record date if the record date falls on a day designated by the Committee as a non-delivery date.

(2) and (3) No Change.

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**11150. Transactions “Ex-Interest” in Bonds Which Are Dealt in “Flat”****(a) Normal Ex-Interest Dates**

All transactions, except “cash” transactions, in bonds or similar evidences of indebtedness which are traded “flat” shall be “ex-interest” as prescribed by the following provisions:

(1) On the [second]first business day preceding the record date if the record date falls on a business day.

(2) On the [third]second business day preceding the record date if the record date falls on a day other than a business day.

(3) On the [third]second business day preceding the date on which an interest payment is to be made if no record date has been fixed.

(b) No Change.

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**11200. COMPARISONS OR CONFIRMATIONS AND “DON’T KNOW NOTICES”****11210. Sent by Each Party****(a) Comparisons or Confirmations**

(1) Each party to a transaction, other than a cash transaction, shall send a Uniform Comparison or Confirmation of same on [or before the first business day following the date of]the day of the [transaction]trade.

(2) through (4) No Change.

(b) No Change.

**(c) “DK” Procedures Using “Don’t Know Notices” (FINRA Form No. 101)**

When a party to a transaction sends a comparison or confirmation of a trade, but does not receive a comparison or confirmation or a signed DK, from the contra-member by the close of [four]one business day[s] following the trade date of the transaction, the following procedure may be utilized.

(1) The confirming member shall send by certified mail, return receipt requested, or messenger, a “Don’t Know Notice” on the form prescribed by FINRA to the contra-member in accordance with the directions contained thereon. If the notice is sent by certified mail the returned, signed receipt therefor must be retained by the confirming member and attached to the fourth copy of the “Don’t Know Notice.” If delivered by messenger, the fourth copy must immediately be dated and manually receipted by, and imprinted with the firm stamp of, the contra-member pursuant to the provisions of paragraph (c)(4) of this Rule, returned to the messenger and thereafter be retained by the confirming member.

(2)(A) After receipt of the “Don’t Know Notice” as specified in paragraph (c) (1) of this Rule, the contra-member shall have [four]two business days after the notice is received to either confirm or DK the transaction in accordance with the provisions of subparagraphs (B) or (C) of this Rule.

(B) and (C) No Change.

(3) If the confirming member does not receive a response from the contra-member by the close of [four]two business days after receipt by the confirming member of the fourth copy of the “Don’t Know Notice” if delivered by messenger, or the post office receipt if delivered by mail, as specified in paragraph (c)(1) of this Rule, such shall constitute a DK and the confirming member shall have no further liability for the trade.

(4) and (5) No Change.

**(d) “DK” Procedure Using Other Forms of Notice**

When a party to a transaction sends comparison or confirmation of a trade, but does not receive a comparison or confirmation or a signed DK, from the contra-member by the close of one business day[s] following the date of the transaction, the following procedure may be utilized in place of that provided in the preceding paragraph (c) of this Rule.

(1) through (4) No Change.

(5) If the confirming member does not receive a response in the form of a notice from the contra-member by the close of [four]two business days after receipt of the confirming member’s notice, such shall constitute a DK and the confirming member shall have no further liability.

(6) through (8) No Change.

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**11300. DELIVERY OF SECURITIES**

**11320. Dates of Delivery**

(a) No Change.

**(b) “Regular Way”**

In connection with a transaction “regular way,” delivery shall be made at the office of the purchaser on, but not before, the [third]second business day following the date of the transaction.

**(c) “Seller’s Option”**

In connection with a transaction “seller’s option,” delivery shall be made at the office of the purchaser on the date on which the option expires; except that delivery may be made by the seller on any business day after the [third]second business day following the date of the transaction and prior to the expiration of the option, provided the seller delivers at the office of purchaser, on a business day preceding the day of delivery, written notice of intention to deliver.

(d) through (h) No Change.

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**11600. DELIVERY OF BONDS AND OTHER EVIDENCES OF INDEBTEDNESS****11620. Computation of Interest****(a) Interest [T]to [B]be Added to the Dollar Price**

In the settlement of contracts in interest-paying securities other than for “cash,” there shall be added to the dollar price interest at the rate specified in the security, which shall be computed up to but not including the [third]second business day following the date of the transaction. In transactions for “cash,” interest shall be added to the dollar price at the rate specified in the security up to but not including the date of transaction.

(b) through (f) No Change.

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**11800. CLOSE-OUT PROCEDURES****11860. COD Orders**

(a) No member shall accept an order from a customer, including foreign customers and/or broker-dealers trading with or through the member, for eligible transactions of such customers that settle in the United States, pursuant to an arrangement whereby payment for securities purchased or delivery of securities sold is to be made to or by an agent of the customer unless all of the following procedures are followed:

(1) and (2) No Change.

(3) The member shall deliver to the customer a confirmation, or all relevant data customarily contained in a confirmation with respect to the execution of the order, in whole or in part, not later than the close of business on the [next business day after] date of any such execution of the transaction.

(4) The member shall have obtained an agreement from the customer that the customer will furnish its agent instructions with respect to the receipt or delivery of the securities involved in the transaction promptly upon receipt by the customer of each confirmation, or the relevant data as to each execution, relating to such order (even though such execution represents the purchase or sale of only a part of the order), and that in any event the customer will assure that such instructions are delivered to its agent no later than:

(A) in the case of a purchase by the customer where the agent is to receive the securities against payment (COD), the close of business on the [second]first business day after the date of execution of the trade as to which the particular confirmation relates; or

(B) No Change.

(5) No Change.

(b) No Change.