

Shortening the Settlement Cycle for Securities to T + 2

SEC Approves Amendments to FINRA Rules to Conform to the Shortened Standard Settlement Cycle for Most Broker-Dealer Transactions From Three Business Days (T+3) to Two Business Days After the Trade Date (T+2)

Effective Date: September 5, 2017

Summary

On February 9, 2017, the Securities and Exchange Commission (SEC) approved amendments to FINRA rules¹ to conform to the SEC's amendment to Rule 15c6-1(a) under the Securities Exchange Act of 1934 (SEA) to shorten the standard settlement cycle for most broker-dealer transactions from three business days after the trade date (T+3) to two business days after the trade date (T+2) and the industry-led initiative to shorten the settlement cycle from T+3 to T+2.² The amendments revise settlement-related provisions in the following FINRA rules:

- ▶ Rule 2341 (Investment Company Securities);
- ▶ Rule 11140 (Transactions in Securities "Ex-Dividend," "Ex-Rights" or "Ex-Warrants");
- ▶ Rule 11150 (Transactions "Ex-Interest" in Bonds Which Are Dealt in "Flat");
- ▶ Rule 11210 (Sent by Each Party);
- ▶ Rule 11320 (Dates of Delivery);
- ▶ Rule 11620 (Computation of Interest);
- ▶ Rule 11810 (Buy-In Procedures and Requirements); and
- ▶ Rule 11860 (COD Orders).

The amendments to these rules become effective on September 5, 2017.

The rule text is available in Attachment A.

May 2017

Notice Type

- ▶ Rule Amendment

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

- ▶ FINRA Rule 2341
- ▶ FINRA Rule 11140
- ▶ FINRA Rule 11150
- ▶ FINRA Rule 11210
- ▶ FINRA Rule 11320
- ▶ FINRA Rule 11620
- ▶ FINRA Rule 11810
- ▶ FINRA Rule 11860
- ▶ Regulatory Notice 16-09
- ▶ Regulatory Notice 17-12
- ▶ SEA Rule 15c6-1(a)

Questions concerning this *Notice* should be directed to:

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Background & Discussion

Shortening the standard settlement cycle from T+3 to 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.³ To facilitate the industry efforts to shorten the standard settlement cycle, the SEC proposed amending SEA Rule 15c6-1(a) to shorten the standard settlement cycle to T+2 on the basis that a shorter settlement cycle will provide benefits across the financial system by, among other things, reducing credit, market and liquidity risk, and as a result reduce systemic risk for U.S. market participants.⁴

On March 22, 2017, the SEC adopted an amendment to SEA Rule 15c6-1(a) to establish a standard settlement time frame of T+2, which provides the regulatory certainty to promote a coordinated industry transition to T+2.⁵ As amended, SEA Rule 15c6-1(a) will prohibit broker-dealers from effecting or entering 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 second business day after the date of the contract, unless otherwise expressly agreed to by the parties at the time of the transaction.⁶

In support of the industry-led initiative and the SEC Proposing Release, FINRA proposed changes to its rules pertaining to securities settlement by, among other things, amending the definition of "regular way" settlement as occurring on T+2.⁷ On February 9, 2017, the SEC approved FINRA's amendments to the rules that establish or reference T+3 to conform to T+2.⁸

Scope of Rule Amendments

FINRA is adopting amendments to its rules pertaining to securities settlement by, among other things, shortening the time frames for delivery or settlement consistent with a T+2 settlement cycle. Specifically, FINRA is amending the following rules:

- ▶ Rule 2341 (Investment Company Securities);
- ▶ Rule 11140 (Transactions in Securities "Ex- Dividend," "Ex-Rights" or "Ex-Warrants");
- ▶ Rule 11150 (Transactions "Ex-Interest" in Bonds Which Are Dealt in "Flat");
- ▶ Rule 11210 (Sent by Each Party);
- ▶ Rule 11320 (Dates of Delivery);

- ▶ Rule 11620 (Computation of Interest);
- ▶ Rule 11810 (Buy-In Procedures and Requirements); and
- ▶ Rule 11860 (COD Orders).

Rule 2341 (Investment Company Securities)

Rule 2341(m) requires members, including underwriters, that engage in direct retail transactions for investment company shares to transmit payments received from customers for the purchase of investment company shares to the payee by the end of the third business day after receipt of a customer's order to purchase the shares, or by the end of one business day after receipt of a customer's payment for the shares, whichever is later. As amended, Rule 2341(m) adjusts the three-business day transmittal requirement to two business days while retaining the one-business day alternative.

Rule 11140 (Transactions in Securities "Ex-Dividend," "Ex-Rights" or "Ex-Warrants")

Rule 11140(b)(1) concerns the determination of normal ex-dividend and ex-warrants dates for certain types of dividends and distributions. As amended, Rule 11140(b)(1) provides that for cash dividends or distributions, or stock dividends, and the issuance or distribution of warrants, which are less than 25 percent 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 first business day preceding the record date if the record date falls on a business day, or the second business day preceding the record date if the record date falls on a day designated by FINRA's Uniform Practice Code Committee as a non-delivery date.

Rule 11150 ("Ex-Interest" in Bonds Which Are Dealt in "Flat")

Rule 11150(a) prescribes the manner for establishing normal ex-interest dates for all transactions, except "cash" transactions, in bonds or similar evidences of indebtedness which are traded "flat." As amended, Rule 11150(a) provides that such transactions are "ex-interest" on the first business day preceding the record date if the record date falls on a business day, on the second business day preceding the record date if the record date falls on a day other than a business day, and on the second business day preceding the date on which an interest payment is to be made if no record date has been fixed.

Rule 11210 (Sent by Each Party)

Rule 11210(c) and (d) set forth the "Don't Know" (DK) voluntary procedures for using "DK Notices" (FINRA Form No. 101) or other forms of notices, respectively. Depending upon the notice used, a confirming member may follow the "DK" procedures when it sends a comparison or confirmation of a trade (other than one that clears through the National Securities Clearing Corporation or other registered clearing agency), but does not receive a comparison or confirmation or a signed DK from the contra-member by the close of four

business days following the trade date of the transaction. As amended, paragraphs (c) and (d) of Rule 11210 provide that the DK procedures may be used by the confirming member if it does not receive a comparison or confirmation or signed DK from the contra-member by the close of one business day following the trade date of the transaction. In addition, paragraphs (c)(2)(A), (c)(3), and (d)(5) of Rule 11210, as amended, adjust the time in which a contra-member has to respond to a “DK Notice” (or similar notice) from four business days to two business days after the contra-member’s receipt of the notice.

Rule 11320 (Dates of Delivery)

Rule 11320 prescribes delivery dates for various types of transactions. As amended, Rule 11320(b) provides that for a “regular way” transaction, delivery shall be made at the office of the purchaser on, but not before, the second business day following the date of the transaction. In addition, Rule 11320(c), as amended, provides that 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 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 the purchaser, on a business day preceding the day of delivery, written notice of intention to deliver.

Rule 11620 (Computation of Interest)

Rule 11620 governs the computation of interest. As amended, Rule 11620(a) provides in part that, 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 second business day following the date of the transaction.

Rule 11810 (Buy-in Procedures and Requirements)

Rule 11810(j)(1)(A) sets forth the fail-to-deliver and liability notice procedures where a securities contract is for warrants, rights, convertible securities or other securities which have been called for redemption; are due to expire by their terms; are the subject of a tender or exchange offer; or are subject to other expiring events such as a record date for the underlying security and the last day on which the securities must be delivered or surrendered is the settlement date of the contract or later.

Under Rule 11810(j)(1)(A), the receiving member delivers a liability notice to the owing counterparty. The liability notice sets a cutoff date for the delivery of the securities by the counterparty and provides notice to the counterparty of the liability attendant to its failure to deliver the securities in time. If the owing counterparty, or delivering member, delivers the securities in response to the liability notice, it has met its delivery obligation. If the delivering member fails to deliver the securities on the expiration date, it will be liable for any damages that may accrue thereby. Rule 11810(j)(1)(A) further provides that when parties to a contract are both participants in a registered clearing agency that has an automated liability notification service, transmission of the liability notice

must be accomplished through such system. When the parties to a contract are not both participants in a registered clearing agency that has an automated liability notification service, such notice must be issued using written or comparable electronic media having immediate receipt capabilities no later than one business day prior to the latest time and the date of the offer or other event in order to obtain the protection provided by the Rule. As amended, Rule 11810(j)(1)(A) provides that in such cases, the receiving member must send the liability notice to the delivering member as soon as practicable but not later than two hours prior to the cutoff time set forth in the instructions on a specific offer or other event in order to obtain the protection provided by the rule.

Rule 11860 (COD Orders)

Rule 11860(a) directs members to follow various procedures before accepting collect on delivery (COD) or payment on delivery (POD) orders. As amended, Rule 11860(a)(4)(A) provides that the member shall have obtained an agreement from the customer that the customer will furnish instructions to the agent no later than the close of business on the first business day after the date of execution of the trade to which the confirmation relates in the case of a purchase by the customer where the agent is to receive the securities against payment, or COD.

Additional Guidance

In December 2016, FINRA published [Information Notice 12/14/16](#) that sets forth the 2017 Holiday Trade Date, Settlement Date and Margin Extension Schedule to provide firms the filing due dates for extension requests to be made in 2017. The filing dates specified within that Notice consider the effects of the T+2 settlement cycle. Most recently, in April 2017, to assist firms with operational and systems-related issues, FINRA published [Regulatory Notice 17-12](#) to provide information on how firms can apply for a Regulation T extension through the Regulatory Extension (REX) System after the transition to T+2, and a [technical notice](#) to provide information on the changes to the Over-the-Counter Reporting Facility (ORF) and Alternative Display Facility (ADF), and general testing information concerning trade reporting under T+2.

In March 2017, FINRA published an [Investor Highlight](#) to provide guidance to investors. The Investor Highlight describes how T+2 will impact investors and provides a link to the SEC's Investor Bulletin on this topic. It also notifies investors of the SEC's rule amendment and September 5, 2017, as the date on which the shortened settlement cycle will take effect.

Effective Date

The effective date of FINRA's amendments to the rules that establish or reference T+3 to conform to T+2 is September 5, 2017, which coincides with the industry's targeted transition date to T+2.⁹

1. See Securities Exchange Act Release No. 80004 (February 9, 2017), 82 FR 10835 (February 15, 2017) (Order Approving File No. SR-FINRA-2016-047) and Securities Exchange Act Release No. 80004A (March 6, 2017), 82 FR 13517 (March 13, 2017) (Correction to Order Approving File No. SR-FINRA-2016-047).
2. See Securities Exchange Act Release No. 80295 (March 22, 2017), 82 FR 15564 (March 29, 2017) (Securities Transaction Settlement Cycle; Final Rule) (File No. S7-22-16) (SEC Final Rule).
3. See [*Regulatory Notice 16-09*](#) (March 2016) (requesting comment on proposed amendments to FINRA rules in connection with the industry-led initiative to shorten the standard settlement cycle to T+2 and describing events pertaining to the initiative).
4. See Securities Exchange Act Release No. 78962 (September 28, 2016), 81 FR 69240 (October 5, 2016) (Amendment to Securities Transaction Settlement Cycle; Proposed Rule) (File No. S7-22-16) (SEC Proposing Release).
5. See *supra* note 2.
6. See *supra* note 2.
7. See Securities Exchange Act Release No. 79648 (December 21, 2016), 81 FR 95705 (December 28, 2016) (Notice of Filing of File No. SR-FINRA-2016-047).
8. See *supra* note 1.
9. See SEC Final Rule, 82 FR 15564, 15582 (stating that September 5, 2017, is an appropriate compliance date by which the transition to a T+2 standard settlement cycle should be completed, and that such compliance date provides sufficient time for broker-dealers, clearing agencies, self-regulatory organizations and other market participants, including retail investors, to plan for, implement, promulgate new rules, and test changes to systems, operations, policies and procedures).

Attachment A

New language is underlined; deletions are in brackets.

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Amendment to FINRA Rules

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2300. SPECIAL PRODUCTS

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2340. Investment Companies

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2341. 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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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) through (3) No Change.

(c) through (e) 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”

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11210. Sent by Each Party

(a) through (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) No Change.

(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 [sub]paragraph[s] (c)(2)(B) or (c)(2)(C) of this Rule.

(B) through (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) through (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 [four]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.

• • • **Supplementary Material:** -----

.01 No Change.

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11300. DELIVERY OF SECURITIES

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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

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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

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11810. Buy-In Procedures and Requirements

(a) through (i) No Change.

(j) Failure to Deliver and Liability Notice Procedures

(1)(A) If a contract is for warrants, rights, convertible securities or other securities which (i) have been called for redemption; (ii) are due to expire by their terms; (iii) are the subject of a tender or exchange offer; or (iv) are subject to other expiring events such as a record date for the underlying security and the last day on which the securities must be delivered or surrendered (the expiration date) is the settlement date of the contract or later, the receiving member may deliver a Liability Notice to the delivering member as an alternative to the close-out procedures set forth in paragraphs (b) through (h). When the parties to a contract are both participants in a registered clearing agency that has an automated service for notifying a failing party of the liability that will be attendant to a failure to deliver, the transmission of the liability notice must be accomplished through the use of said automated notification service. When the parties to a contract are not both participants in a registered clearing agency that has an automated service for notifying a failing party of the liability that will be attendant to a failure to deliver, such notice must be issued using written or comparable electronic media having immediate receipt capabilities [no later than one business day prior to the latest time and the date of the], and must be sent as soon

as practicable but not later than two hours prior to the cutoff time set forth in the instructions on a specific offer or other event in order to obtain the protection provided by this Rule.

(B) through (C) No Change.

(2) through (4) No Change.

(k) through (m) No Change.

• • • **Supplementary Material:** -----

.01 through .03 No Change.

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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) through (3) No Change.

(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.

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