

August 9, 2016

The Honorable Mary Jo White, Chair
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Shortening the Settlement Cycle (RIN 3235-AL86)

Dear Chair White:

The Committee on Capital Markets Regulation (the “**Committee**”) encourages the Securities and Exchange Commission (the “**SEC**”) to promptly issue a proposed rule that would amend Exchange Act Rule 15c6-1 by shortening the trade settlement cycle for equities, corporate and municipal bonds, unit investment trusts, and other financial instruments from three business days after a trade is executed (“**T+3**”) to two business days after a trade is executed (“**T+2**”).

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-four leaders drawn from the finance, business, law, accounting and academic communities. The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The settlement cycle is the period of time between execution of a contract to trade securities and the actual exchange of funds and securities. After the trade execution and prior to settlement, the purchaser and seller each have an obligation to deliver payment of funds and securities, respectively. And at settlement, the purchaser actually receives possession of the securities and the seller receives possession of the funds used by the purchaser to acquire the securities. The Committee believes that shortening the settlement cycle would result in a number of benefits, including lower counterparty risks and market risks for broker-dealers and their customers. Prompt SEC action would also provide an incentive to industry participants to prioritize the investments necessary to shift to a T+2 settlement cycle.

Procedural Background

The SEC has been considering shortening the settlement cycle since 2004.¹ Although the idea languished for some time, it has regained momentum in recent years as the financial crisis highlighted the risks of the clearing and settlement process as it became clear that it was possible that a counterparty to a large number of trades could potentially default on its obligations.²

¹ Concept Release: Securities Transactions Settlement, Exchange Act Release No. 49,405 (Mar. 11, 2004), available at <https://www.sec.gov/rules/concept/33-8398.htm> [hereinafter 2004 Concept Release].

² Omega, *The Road to Shorter Settlement Cycles: Creating a Trade Date Environment in the US and Across Global Markets 2* (2013).

The most recent analysis of the costs, benefits, and savings of a transition to T+2 is an October 2012 report by the Boston Consulting Group commissioned by the Depository Trust & Clearing Corporation. The report found that operational cost savings to broker-dealers, custodian banks, and asset managers would exceed the costs of the transition just three years after implementation.³ In June 2015, an industry steering committee consisting of senior-level representatives from securities industry associations and firms that represent various segments of the securities industry issued a white paper outlining a proposed timeline and industry requirements for migrating to a T+2 settlement cycle, including necessary regulatory changes.⁴

The Investment Company Institute (the “ICI”) and Securities Industry and Financial Markets Association (“SIFMA”) also sent a letter to Chair White in June 2015 seeking support for the change. The letter focused on Exchange Act Rule 15c6-1(a), which generally prohibits a broker or dealer from entering into a contract for the purchase or sale of security if the contract provides for payment of funds and delivery of securities later than the third business day after the date of the contract.⁵ The letter noted that though the rule technically permits a shorter settlement cycle than T+3, an amendment to the rule would ensure industry-wide adoption of a T+2 settlement cycle.⁶

The response from the SEC commissioners to the letter was highly positive. Commissioners Piwowar and Stein quickly issued a joint statement expressing their support for a T+2 settlement cycle⁷ and Commissioners Gallagher and Aguilar publicly noted their agreement shortly thereafter.⁸ Chair White stated her “strong” support for migrating to a T+2 settlement cycle in a letter to ICI and SIFMA in September 2015.⁹ Chair White’s letter noted that “regulatory certainty is [a] precondition to the success of any migration to T+2,” and that she was committed to considering regulatory changes on a timetable that would permit the industry to meet its goal of completing the migration to a T+2 settlement cycle by the third quarter of

³ The Boston Consulting Group, Cost Benefit Analysis of Shortening the Settlement Cycle 10 (2012), *available at* http://www.dtcc.com/~media/Files/Downloads/WhitePapers?CBA_BCG_Shortening_the_Settlement_Cycle_October2012.pdf.

⁴ PricewaterhouseCoopers, Shortening the Settlement Cycle: The Move to T+2 (2015), *available at* <http://www.ust2.com/pdfs/ssc.pdf>.

⁵ 17 CFR § 240.15c6-1(a).

⁶ Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, and Kenneth E. Bentsen, Jr., President and CEO, Securities Industry and Financial Markets Association, to Mary Jo White, Chair, U.S. Securities and Exchange Commission (June 18, 2015), *available at* <http://www.ust2.com/pdfs/SSCregfinal.pdf> [hereinafter ICI and SIFMA Letter].

⁷ Commissioner Michael S. Piwowar and Commissioner Kara M. Stein, Statement Regarding Proposals to Shorten the Trade Settlement Cycle (June 29, 2015), *available at* <https://www.sec.gov/news/statement/statement-on-proposals-to-shorten-the-trade-settlement-cycle.html>.

⁸ Commissioner Daniel M. Gallagher (@DanGallagherGrp), Tweet (July 1, 2015), *available at* <https://twitter.com/dangallaghergrp>; Commissioner Luis A. Aguilar, The Benefits of Shortening the Securities Settlement Cycle (July 16, 2015), *available at* <https://www.sec.gov/news/statement/benefits-of-shortening-the-securities-settlement-cycle.html>.

⁹ Letter from Mary Jo White, Chair, U.S. Securities and Exchange Commission, to Paul Schott Stevens, President and CEO, Investment Company Institute, and Kenneth E. Bentsen, Jr., President and CEO, Securities Industry and Financial Markets Association 1 (Sept. 16, 2015), *available at* <http://src.bna.com/i7>.

2017.¹⁰ Chair White’s letter stated that she was instructing the SEC staff to develop a proposal to amend Rule 15c6-1(a) to impose a T+2 settlement cycle.¹¹ The SEC targeted June 2016 for the publication of a proposed rule, according to the SEC’s Regulatory Flexibility Agenda.¹² To date, however, no proposed rule has been published and the SEC has not indicated when such a proposal may be forthcoming.

Benefits of a Shorter Settlement Cycle

The SEC previously noted in its 2004 conceptual release that “time equals risk” and therefore shorter settlement cycles decrease the risk of an adverse event occurring between the execution of a trade and its settlement.¹³ More specifically, a shorter settlement cycle lowers counterparty risk, which is the risk that a counterparty does not pay the amount due or provide securities at settlement.¹⁴ It also decreases the market risk that a non-defaulting party would face if forced to replace an unsettled contract because of changes in the price of a security during the settlement period.¹⁵ The Boston Consulting Group’s cost-benefit analysis estimates that a T+2 settlement cycle could reduce counterparty and market risk by about \$200 million annually.¹⁶ This estimate was made using brokers-dealers’ risk of default based on probabilities implied by their credit ratings.¹⁷

Importantly, reducing counterparty and market risks also reduces systemic risk where the inability of one market participant to meet its obligations could provoke a chain reaction whereby other institutions would fail to meet their obligations because of exposure to the defaulting counterparty.¹⁸ Indeed, in discussing a move to a shorter settlement cycle, the SEC’s Investment Advisory Committee has stated that “[w]ith perhaps only one or two exceptions . . . we cannot think of any other higher impact measure that is within reach, that does not potentially have other adverse consequences, and that can so substantially lessen what is otherwise significant systemic risk.”¹⁹

A migration to a T+2 settlement cycle would also improve capital optimization because reduced counterparty risk would result in lower margin requirements at clearinghouses. Boston Consulting Group estimates that a T+2 settlement cycle would provide annual benefits of \$25

¹⁰ *Id.* at 2.

¹¹ *Id.*

¹² Securities and Exchange Commission, *Shortening the Settlement Cycle*, Office of Information and Regulatory Affairs, <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201604&RIN=3235-AL86> (last visited July 13, 2016).

¹³ 2004 Concept Release, *supra* note 1.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Boston Consulting Group, *supra* note 3, at 35.

¹⁷ *Id.*

¹⁸ See Deloitte & Touche LLP, T+2 Industry Implementation Playbook 12 (2015), available at <http://www.ust2.com/pdfs/T2-Playbook-12-21-15.pdf>; 2004 Conceptual Release, *supra* note 1.

¹⁹ Investment Advisory Committee, Recommendation of the Investment Advisory Committee: Shortening the Trade Settlement Cycle in U.S. Financial Markets (Feb. 12, 2015), available at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/settlement-cycle-recommendation-final.pdf>.

million to broker-dealers from capital optimization.²⁰ In addition, switching to a T+2 settlement cycle would align the United States with other global markets. For example, the European Union, Hong Kong, South Korea, Australia, and New Zealand have implemented a T+2 settlement cycle.²¹ Finally, it is estimated that the switch could produce \$170 million annually in operational cost savings,²² such as through the reduction in manual processing by custodian banks and lower labor costs at broker-dealers from improved processes.²³

SEC Action is Needed

The Committee believes that the SEC needs to amend Exchange Act Rule 15c6-1(a) for the migration to T+2 to succeed. First, in order to ensure universal adoption, industry participants need to be incentivized to incur the costs of the transition. Second, SEC action could prompt other regulatory bodies to implement changes to their rules that apply to the settlement cycle. Third, a proposed rule to amend Exchange Act Rule 15c6-1(a) would be subject to notice and comment and so it would provide the public, market participants, and regulators an opportunity to identify and resolve any impediments to a successful transition to a T+2 settlement cycle.

Despite the benefits a change to T+2 would provide and the widespread support it has received, it still requires significant investments, estimated to be around \$550 million across all segments of the securities industry, including investments of up to \$4.5 million per large institutional broker-dealer, \$4 million per large retail broker-dealer, and \$4 million per large custodian bank.²⁴ These investments include revisions to broker-dealers' and custodian banks' core order processing systems, asset servicing functions, and documentation, as well as customer and staff education, and implementation testing.²⁵ A proposal by the SEC to shorten the settlement cycle would ensure that all industry participant promptly make the investments that a shorter settlement period would require.²⁶

SEC action may also prompt other regulatory bodies to implement amendments to their rules that would facilitate a transition to a T+2 settlement cycle. The ICI and SIFMA letter to Chair White identified Financial Industry Regulatory Authority, Municipal Securities Rulemaking Board (the "MSRB"), Office of the Comptroller of Currency, Federal Deposit Insurance Corporation, NASDAQ and NYSE rules that should be revised as part of the shift to a T+2 settlement cycle.²⁷ While the MSRB has finalized amendments to Rules G-12 and G-15 to define regular way settlement for municipal securities transactions as occurring on a two day

²⁰ Boston Consulting Group, *supra* note 3, at 10, 34.

²¹ PricewaterhouseCoopers, *supra* note 4, at 5; *Transition to T+2 Settlement for Cash Equities*, ASX, <http://www.asx.com.au/services/t2.htm> (last visited July 29, 2016); *Transition to T+2 Settlement Cycle for Cash Trades*, NZX, <https://www.nzx.com/regulation/T2-settlement> (last visited August 4, 2016).

²² Boston Consulting Group, *supra* note 3, at 10.

²³ *Id.* at 32.

²⁴ *Id.* at 9, 30-31.

²⁵ Deloitte & Touche LLP, *supra* note 18, at 21-78, 104; Aguilar, *supra* note 8, at 1.

²⁶ ICI and SIFMA letter, *supra* note 6, at 8.

²⁷ *Id.* at 5-8 and Annex A.

settlement cycle period, it has made the effectiveness of those amendments conditional on the SEC amending Exchange Act Rule 15c6-1(a).²⁸

Finally, by issuing a proposed rule subject to public notice and comment, the SEC would provide an opportunity for the public to communicate unidentified or unresolved impediments to a successful transition to a T+2 settlement cycle. For example, some believe that a T+2 settlement cycle could be problematic for retail investors who pay for their purchases of securities with physical checks because checks do not always clear within two business days of being deposited.²⁹ While the industry is aware of the issue and has proposed some possible solutions, such as requiring retail accounts to be funded with sufficient cash prior to executing a trade or for institutions to accept mobile payments,³⁰ there may be other complications that need to be resolved.

For the foregoing reasons the Committee believes that the SEC should act promptly to propose a rule that would require a T+2 settlement cycle by amending Exchange Act Rule 15c6-1(a). In the interim, the Committee believes that the SEC should provide an update on the expected timing of the release of the proposed rule and the current status of the SEC’s process.

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Thank you very much for your consideration of our views. Should you have any questions or concerns, please do not hesitate to contact the Committee’s Director, Prof. Hal S. Scott (hscott@law.harvard.edu), its Executive Director of Research, John Gulliver (jgulliver@capmksreg.org), or its Senior Research Fellow, Brent Speed (bspeed@capmksreg.org), at your convenience.

Respectfully submitted,



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²⁸ Municipal Securities Rulemaking Board, MSRB to Amend Rules to Define Two-Day Settlement Cycle (May 2016), available at <http://www.msrb.org/~media/Files/Regulatory-Notices/Announcements/2016-15.ashx>.

²⁹ Chris Kentours, *U.S. T+2 Settlement: The Long Journey Begins*, FinOps Report (Sept. 22, 2015), <http://finops.co/investments/us-t2-settlement-the-long-journey-officially-begins/>.

³⁰ *Id.*; Deloitte & Touche LLP, *supra* note 18, at 26-27.