

SEC Finalizes Move to T+1 with a 15-Month Window to Adapt

February 23, 2023

On February 15, 2023, the U.S. Securities and Exchange Commission (the “SEC”) issued a final rule (the “Final Rule”) 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 (“T+1”).¹ The Final Rule also shortens the standard settlement cycle for firm commitment underwritten offerings priced after 4:30 p.m. Eastern Time from four business days after the trade date (“T+4”) to T+2.

Significantly, the SEC has set the compliance date for the Final Rule at May 28, 2024, about two months later than the original proposed compliance date of March 31, 2024 but shy of the September 3, 2024 date many market participants were hoping for.

The key provisions of the Final Rule are further discussed below.

Shortening the Settlement Cycle. The Final Rule amends paragraph (a) of Rule 15c6-1 under the Securities and Exchange Act of 1934 (the “Exchange Act.”) to provide that the default for settlement of most securities transactions by broker-dealers is one business day. The Final Rule now prohibits a broker-dealer from effecting or entering into a contract for the purchase or sale of a covered security (absent select exemptions) that provides for payment of funds and delivery of securities later than T+1 unless otherwise expressly agreed by the parties at the time of the transaction.

Covered securities include all securities other than (i) exempted securities, (ii) government securities, (iii) municipal securities, (iv) commercial paper, (v) bankers acceptances, (vi) commercial bills, (vi) limited partnership interests that are not listed on an exchange and for which quotations are not disseminated through an automated quotation system of a registered securities association), (vii) security-based swaps and (ix) other contracts that the SEC may exempt by order.

¹ Shortening the Securities Transaction Settlement Cycle, Exchange Act Release No. 34-96930, (Feb. 15, 2023), available at <https://www.sec.gov/rules/final/2023/34-96930.pdf> (“Final Rules Release”).

For cash offerings of securities in the primary market that are priced after 4:30 p.m. and sold by an issuer to an underwriter under a firm commitment pursuant to a registered offering or to an initial purchaser by a broker-dealer participating in such offering, the default settlement is shortened to T+2 (instead of T+4).

As in the previous versions of the rule, the settlement dates established in the Final Rule are effectively a “default rule,” and extended settlement can be expressly agreed to by the parties at the time of the transaction in all cases (the so-called “override provision”). The override provision will continue to provide important flexibility for debt offerings with significant closing documentation that would make T+1 settlement difficult. In the case of a firm commitment underwritten offering, the relevant agreement can be made between the managing underwriter and the issuer.

Compliance Measures. Ostensibly to facilitate a smooth transition to T+1 on the compliance date, the SEC added a requirement for any broker-dealer engaging in an allocation, confirmation or affirmation process with another party or parties (“Third-Parties”) that is required in order to properly settle a covered transaction (the “Settlement Processes”) to either (i) enter into a written agreement with the relevant Third-Party or Parties to ensure proper completion of the Settlement Processes as soon as technologically practicable and no later than the end of the day on trade date or (ii) establish, maintain and enforce written policies and procedures reasonably designed to ensure such result. This represents a divergence from the originally proposed rule, which would have required written agreements and did not provide a policies and procedures alternative.²

While the ability to implement the T+1 timeline through policies and procedures rather than formal documentation in all cases is a good result for the industry, the SEC does include a number of prescriptions for the policies and procedures that must be adopted, including requiring that the policies and procedures:

- Identify and describe any technology systems, operations and processes that the broker or dealer uses to coordinate with Third Parties;
- Set target time frames on the trade date for completing the Settlement Processes;
- Describe procedures to ensure the prompt communication of trade information, investigate any discrepancies in trade information and adjust trade information;
- Describe how the broker or dealer plans to identify and address delays; and

² See Exchange Act Release No. 94196, Investment Advisers Act Release No. 5957 (Feb. 9, 2022), 87 FR 10436 (Feb. 24, 2022), available at <https://www.sec.gov/rules/proposed/2022/34-94196.pdf> (the original rule proposal).

- Measure, monitor and document the rates of the Settlement Processes on the timeline.

The Final Rule also requires investment advisers to keep a record of each confirmation received and any allocation and each affirmation sent or received.

Clearing Agency Straight-Through Processing. The Final Rule also requires a clearing agency that provides a central matching service to establish, implement, maintain and enforce written policies and procedures reasonably designed to facilitate straight-through processing of securities transactions at the clearing agency. Clearing agencies must provide a report every 12 months with (i) a summary of such policies and procedures, (ii) certain quantitative data on its straight-through processing and (iii) qualitative descriptions of its progress in facilitating straight-through processing and future steps it may take. The report must be filed electronically on EDGAR in an Interactive Data File.

Implications. Market participants must now begin preparing for T+1 settlement if they have not already done so. In particular, investment managers who must provide allocations for securities transactions, prime brokers, executing brokers and their respective customers and others who participate in intra-settlement allocations and affirmations will need to operationally prepare for the shortened cycle to the extent they are not already fully engaging in same-day processing. In addition, while the SEC opted not to amend other rules with deadlines tied to the settlement cycle (such as Reg. SHO Rule 204, Rule 10b-10 and SEC and FINRA margin rules), broker-dealers and market participants will need to prepare for shortened timelines under such rules.

Broker-dealers and market participants should note that the SEC continues to consider an eventual transition to same-day settlement (“T+0”). The SEC stated in the Final Rules Release that “the transition to a T+1 settlement cycle can be a useful step in identifying potential paths to T+0 settlement.”³



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³ Final Rules Release at 46.