Capital Markets Alert

Skadden

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SEC Adopts T+2 Settlement Cycle for Securities Transactions

The amended rule does not change the settlement cycle for securities sold in most firm commitment underwritings and leaves open the ability of parties to affirmatively agree on a longer settlement cycle.

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

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On March 22, 2017, the Securities and Exchange Commission (SEC) adopted an amendment to Securities Exchange Act Rule 15c6-1(a) to shorten the standard settlement cycle for most broker-dealer securities transactions from three business days after the trade date (T+3) to two business days (T+2). Broker-dealers will be required to comply with the amended rule on September 5, 2017.

Key Takeaways

The amendment will reduce the degree to and time during which market participants are exposed to credit, market and liquidity risk arising from unsettled transactions. Additionally, it will align the U.S. with other T+2 settlement markets outside the U.S., reducing (i) the need for some market participants to hedge risks stemming from mismatched settlement cycles, and (ii) financing/borrowing costs for market participants who engage in cross-border transactions in both U.S. and non-U.S. markets.

The amendment does not change the permissive settlement cycle for securities sold in most cash-only, firm commitment underwritten offerings and leaves in place the ability of parties to affirmatively agree on a longer settlement cycle. However, notwithstanding retention of the firm commitment exception, underwriters may choose to comply with the new T+2 settlement cycle to avoid forcing subsequent secondary traders to extend their settlement cycle. If they elect to continue to settle on a T+3 or longer basis, underwriters should consider cautionary disclosure about the longer settlement cycle so that initial purchasers who wish to trade such securities prior to two business days before the closing of the initial trade can specify an alternative settlement cycle at the time of their secondary trade to prevent a failed settlement.

The amendment does not impact the conditional ability of the parties to a securities transaction to use the general "override provision" under Rule 15c6-1 to extend settlement dates by express agreement at the time of the transaction.

The amendment will require the completion and delivery of final prospectuses on an accelerated basis for certain offerings where the offering is not eligible for "access equals delivery." Section 5(b)(2) of the Securities Act makes it unlawful to deliver a security (*i.e.*, as part of settlement) unless accompanied or preceded by a compliant final prospectus. Securities Act Rule 172 provides for an "access equals delivery" model that permits, with certain exceptions, the prospectus delivery obligation to be satisfied by the filing of a final prospectus with the SEC, rather than physical delivery of the final prospectus to purchasers. Typically, a final prospectus must be filed by the second business day following the earlier of the pricing date or the date the prospectus is first used after effectiveness for public offerings or sales. In a T+2 settlement cycle, the final prospectus may need to be filed earlier to satisfy the requirements of Section 5(b)(2). For example, if settlement occurs in the morning of the second business day following the date of pricing, the final prospectus will need to be filed before that settlement occurs. For securities transactions that do not benefit from "access equals delivery" or otherwise require the delivery of a physical final prospectus, the move to a T+2 settlement cycle may leave little margin for any operational difficulties that could delay the delivery of a final prospectus despite a good faith effort by the broker-dealer. The SEC rejected calls to expand the use of Rule 172 or electronic delivery to address any prospectus delivery obligation problems; rather, the SEC encouraged industry participants to bring to its attention for future consideration any operational difficulties that might arise from these or similar facts.

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