



Primary Market Transactions under the T+2 Shortened Settlement Cycle

Background:

On March 22, 2017, the Securities and Exchange Commission (“SEC”) adopted an amendment to Rule 15c6-1(a) to shorten by one business day the standard settlement cycle for most broker-dealer securities transactions. Currently, the standard settlement cycle for these transactions is three business days, known as T+3. The amended rule shortens the settlement cycle to two business days, T+2. As a result, broker-dealers will be required to comply with the amended rule beginning on September 5, 2017 (so, trades subject to the standard settlement cycle made on Friday, September 1, 2017 and on Tuesday, September 5, 2017 will both settle on Thursday, September 7, 2017).

As stated in the SEC’s rule, the T+2 requirement would not apply to certain categories of securities. In the case of firm commitment underwritten offerings, Rule 15c6-1(d) states:

“For purposes of paragraphs (a) and (c) of this section, the parties to a contract shall be deemed to have expressly agreed to an alternate date for payment of funds and delivery of securities at the time of the transaction for a contract for the sale for cash of securities pursuant to a firm commitment offering if the managing underwriter and the issuer have agreed to such date for all securities sold pursuant to such offering and the parties to the contract have not expressly agreed to another date for payment of funds and delivery of securities at the time of the transaction.”

In its March 22, 2017 adopting release, the SEC noted:

“The commenter expressed concern over a statement made by the Commission in a footnote of the T+2 Proposing Release regarding the override provision in Rule 15c6-1(a). Specifically, in the T+2 Proposing Release, the Commission noted that at the time Rule 15c6-1(a) was adopted, the Commission stated its belief that the usage of the over provision of Rule 15c6-1(a) was intended to apply only to unusual transactions, such as seller’s option trades that typically settle as many as sixty days after execution as specified by the parties to the trade at execution. In the T+2 Proposing Release, the Commission stated its preliminary belief that the use of this provision should continue to be applied in limited cases to ensure that the settlement cycle set by Rule 15c6-1(a) remains a standard settlement cycle.”

In response, the SEC clarified that:

“The Commission notes that its statement, as expressed in the footnote in the T+2 Proposing Release, is only with respect to the override provision in Rule 15c6-1(a) and does not relate to the application of Rule 15c6-1(d) in the specific context of firm commitment offerings.”

As a result, SIFMA, in consultation with its Capital Markets Committee, has outlined the following considerations for underwriters, issuers, selling securityholders and their respective counsel in the context of primary market transactions under the T+2 shortened settlement cycle.

Equities:

In general, for primary market transactions in equity securities (including initial public offerings), SIFMA expects that market participants will move with the shortened settlement cycle under Rule 15c6-1(a). Furthermore, it is recommended that in the early stages of a transaction, the following deal participants and service providers should hold discussions about each participant’s readiness to adhere to the shortened settlement cycle:

- Company counsel (and selling shareholders’ counsel, if any)
- Underwriters’ counsel
- All accounting firms delivering a comfort letter to the underwriters
- Transfer agent or other service providers
- Financial Printer

We highlight the below transaction types for additional attention regarding timing issues to meet T+2 shortened settlement cycle deadlines. The items listed for consideration in the subsections may apply generally to all equity transactions but warrant particular attention for these individual products.

1. **Overnight Blocks / Bought Deals:**

SIFMA expects that substantially all follow-on equity offerings will move with the shortened settlement cycle in order to align with the settlement cycle of the same CUSIP already trading in the secondary market in accordance with SEC Rule 15c6-1(a). As a result, (particularly in the case of overnight block trades and bought deals of shares being sold by affiliates) the selling shareholders, underwriters, issuers and their respective counsel should give additional consideration to timing issues to ensure sufficient preparations are made to provide for the delivery of those securities and related documentation under the shortened settlement cycle, with particular attention paid to:

- Share de-legending opinions and process
- Share transfer / medallion guarantee process
- Local counsel opinions
- Overseas selling shareholders (and time zone issues)
- Finalization of final prospectus and delivery of final comfort letter
- Filing of final prospectus versus time of settlement

2. Business Development Companies:

SIFMA expects primary market transactions in equity securities for Business Development Companies to move with the shortened settlement cycle. However, Business Development Companies are excluded from the “access equals delivery” provision of SEC Rule 172. Therefore, underwriters, issuers, and their respective counsel should give additional consideration to timing issues to ensure sufficient preparations are made to provide for finalization and delivery of the final prospectus under the shortened settlement cycle. This is especially important for transactions executed on a short timeline (such as overnight follow-on offerings or bought deals). These additional considerations include:

- Timeline for Financial Printer and relevant mail services
- Consideration of different parties involved and the timeline for the preparation, delivery and filing of final prospectus (especially for debt deals or registered converts)

3. Closed-End Funds:

Although primary market transactions in equity securities for Closed-End Funds could opt for extending settlement under Rule 15c6-1(c), SIFMA expects these transactions to move with the shortened settlement cycle. However, Closed-End Funds are excluded from the “access equals delivery” provision of SEC Rule 172. Therefore, underwriters, issuers, and their respective counsel should give additional consideration to timing issues to ensure sufficient preparations are made to provide for finalization and delivery of the final prospectus under the shortened settlement cycle. This is especially important for transactions executed on a short timeline (such as overnight follow-on offerings or bought deals). These additional considerations include:

- Timeline for Financial Printer and relevant mail services
- Consideration of different parties involved and the timeline for the preparation, delivery and filing of final prospectus

Unlike other equity IPOs that may price after market close and designate the next business day as the initial trade date, Closed-End Fund IPOs generally price after market close but use the pricing date as the initial trade date. By moving the trade date to the following business day, any impact of the shortened settlement cycle could be mitigated, subject to the general considerations mentioned above.

Fixed Income Securities:

In general, for primary market transactions in fixed income securities, SIFMA expects that market participants will move with the shortened settlement cycle under Rule 15c6-1(a) or opt for extended settlement under Rule 15c6-1(d) consistent with current market practice, which permits parties to agree to an extended settlement date for firm commitment underwritten offerings.