INVESTMENT COMPANY INSTITUTE

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SEC ISSUES CONCEPT RELEASE ON SECURITIES TRANSACTIONS SETTLEMENT

[17668] June 10, 2004 TO: SMALL FUNDS COMMITTEE No. 36-04 RE: SEC ISSUES CONCEPT RELEASE ON SECURITIES TRANSACTIONS SETTLEMENT The Securities and Exchange Commission ("SEC") has issued a concept release requesting comment on methods to improve the safety and operational efficiency of the U.S. clearance and settlement system and to help the U.S. securities markets achieve “straight- through processing” (“STP”).1 Specifically, the Concept Release requests comment on: (1) whether the SEC should adopt a new rule, or the self-regulatory organizations (“SROs”) should be required to amend their existing rules, to require the completion of the confirmation and affirmation process on trade date when a broker-dealer provides delivery-versus-payment (“DVP”) or receive-versus-payment (“RVP”) privileges to a customer; (2) the benefits and costs associated with implementing a settlement cycle for most broker-dealer transactions that is shorter than three days (“T+3”); and (3) reducing the use of physical securities. The most significant aspects of the Concept Release are summarized below. I. Trade Confirmation and Affirmation Currently, SRO confirmation rules require a broker-dealer to use the facilities of a registered clearing agency, an entity that has received an exemption from clearing agency registration, or a qualified vendor for the confirmation/affirmation of securities transactions when the broker-dealer provides DVP or RVP privileges to the customer. SRO confirmation rules also require the broker-dealer to have obtained an agreement from each customer with DVP/RVP privileges that the customer will affirm each trade promptly upon receipt of the confirmation. The SEC states that it believes that investment managers/investment advisers should be able to affirm their trades with their brokers on trade date. The Concept Release therefore requests comment on how best to have the confirmation/affirmation process completed on trade date for all institutional trades. Specifically, the Release states that SROs could amend their confirmation rules to prohibit broker-dealers from extending DVP/RVP privileges to any customer unless all trades with that customer are confirmed and affirmed on trade date or the 1 SEC Release Nos. 33-8398; 34-49405; IC-26384, (March 11, 2004), 69 FR 12922 (March 18, 2004) (“Concept Release”). The Concept Release is available on the SEC’s website at http://www.sec.gov/rules/concept/33- 8398.htm. 2 SEC could adopt a rule that would require broker-dealers to confirm and affirm trades on trade date.2 The Release states that the SEC is of the view that industry-wide trade matching is the best method to improve the confirmation/affirmation process and to achieve STP. It acknowledges however, that the imposition of a requirement that all broker-dealers and their institutional customers use a matching service raises some significant issues. For example, mandating the use of a matching service for the confirmation/affirmation process for institutional trades may stifle

innovation and competition and may impose an unnecessary burden on small and medium broker-dealers and asset managers. The Concept Release therefore requests comment on whether all participants in institutional trades should be required to use a matching service. The Concept Release also requests comment on a number of specific issues relating to trade date confirmation and affirmation including what would be the associated benefits, costs, burdens and risks and whether the benefits would accrue evenly to all market participants. Further, the Release requests comment on whether same-day confirmation and affirmation would affect cross-border trading, and if so how. Finally, the Release asks what, if anything, the SEC should do to facilitate the standardization of reference data and use of standardized industry protocols by broker-dealers, asset managers, and custodians. II. Securities Settlement Cycles The Concept Release notes that, while the implementation of a T+3 settlement cycle in the U.S. has been widely viewed as a success, the SEC believes that due to the growth of the securities markets since 1995 when Rule 15c6-13 (the rule mandating settlement on T+3) became effective, the participation of financial firms in multiple markets and the possibility of wide- scale regional disruption, it is now appropriate to consider facilitating a more efficient clearance and settlement system. The Concept Release therefore requests comment on the current operation of Rule 15c6-1 and the costs and benefits of implementing a settlement cycle shorter than T+3. The SEC states that while it believes that shortening the settlement cycle will reduce risk and increase efficiency, it must still determine whether the benefits of establishing a shorter settlement cycle justify its implementation costs. The Concept Release requests comment on a number of issues relating to the shortening of the securities settlement cycle including how it would affect efficiency and risk, whether investors will still have the same information, benefits and protections they have in the current T+3 environment and what securities should be exempted should the SEC undertake rulemaking to shorten the settlement cycle beyond T+3. In addition, the Release requests comment on whether achieving complete confirmation and affirmation rates on trade date is a 2 The Release requests comment on whether a new SEC rule should apply to all types of non-exempt securities and what the time frame should be for implementation. 3 Rule 15c6-1 provides that “a broker or dealer shall not effect or enter 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 third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction.” 3 prerequisite for shortening the settlement cycle, and if so, what are the additional costs for shortening the settlement cycle once complete trade date confirmation and affirmation has been achieved. Finally, the Release requests comment on the impact a shortened settlement cycle for U.S. equities and corporate securities would have on cross-border trading by non-U.S. entities of these instruments. III. Immobilization and Dematerialization of Securities Certificates The SEC states that while it endorses the concepts of immobilization or dematerialization of securities certificates, it recognizes that these concepts raise significant issues. Nevertheless, the SEC states that it believes it is time to explore ways to further reduce the use of securities certificates and, as a result, reduce the risk, inefficiency, and cost related to the use of certificates. The Concept Release therefore requests comment on a number of specific issues relating to immobilization or dematerialization, including whether securities should be completely immobilized or dematerialized in the U.S. The Release also requests comment on whether there are any operational, legal or regulatory impediments to immobilization or dematerialization. Finally, the Release requests comment if the existence of a viable, widely available direct registration system should be a prerequisite to complete immobilization or dematerialization. Diane Butler Ari Burstein Director – Transfer Agency & Associate Counsel International Operations