

MEMO# 4948

July 2, 1993

INSTITUTE COMMENT LETTER ON T+3 SETTLEMENT PROPOSAL

July 2, 1993 TO: BOARD OF GOVERNORS NO. 60-93 OPERATIONS COMMITTEE NO. 22-93
SEC RULES COMMITTEE NO. 59-93 TRANSFER AGENT ADVISORY COMMITTEE NO. 37-93
UNIT INVESTMENT TRUST COMMITTEE NO. 28-93 T+3 SETTLEMENT TASK FORCE RE:
INSTITUTE COMMENT LETTER ON T+3 SETTLEMENT PROPOSAL

The Institute has filed the attached comment letter with the Securities and Exchange Commission concerning the Commission's proposal to shorten the standard settlement period for most securities transactions involving a broker-dealer from five business days to three business days ("T+3"). The Commission's proposing release indicated that securities issued by investment companies would be covered by proposed Rule 15c6-1 under the Securities Exchange Act, and requested comment on difficulties that might result if the rule is applied to securities issued by mutual funds. The Institute's letter expresses support for the rule's general goal of reducing risks in the U.S. clearance and settlement system, but suggests that the Commission exclude securities issued by mutual funds (and unit investment trusts) from the rule for the present time in view of certain issues that arise. The letter notes that because mutual funds issue redeemable securities, the imposition of a T+3 settlement requirement could have unintended consequences. For example, problems could occur because certain fund portfolio securities, such as municipal securities, would be exempted from the shorter settlement requirement. If a T+3 requirement applies to fund shares, municipal bond funds could be obligated to pay redemption proceeds to shareholders within three business days, while the funds might not be able to receive cash upon disposing of portfolio securities for five business days. The letter also points out that the proposal may be inconsistent with the NASD's prompt payment rule, which generally requires brokers to transmit payments for mutual fund shares to the fund by the later of the fifth business day following receipt of the order and the business day that the broker actually receives money from the customer. If the proposed rule overrides the prompt payment rule, thus requiring brokers to transmit payment to a mutual fund within three business days regardless of whether they have received money from the customer, brokers could be forced to extend credit to customers that purchase shares through them. Such extensions of credit may violate Section 11(d)(1) of the Securities Exchange Act. In addition to identifying these issues, the letter asserts that transactions in securities issued by mutual funds present less clearing corporation and other systemic risk than transactions in other types of securities, so that application of the rule to these securities at this time is not necessary to achieve the goals of the proposal. The letter therefore recommends that the Commission move forward in implementing the proposed rule, but exclude securities issued by mutual funds (and by unit investment trusts, because they present many of the same issues) from its scope until the problems noted above can be resolved. Frances M. Stadler

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