

OCC Bulletin 2017-22| June 9, 2017

## Securities Operations: Shortening the Settlement Cycle

### Summary

The Office of the Comptroller of the Currency (OCC) is issuing this bulletin to highlight actions that national banks and federal savings associations (collectively, banks) should take to prepare for the change in the regular securities settlement cycle for most U.S. securities transactions. The change becomes effective on September 5, 2017.

### To

Chief Executive Officers and Compliance Officers of National Banks and Federal Savings Associations, Federal Branches and Agencies, Department and Division Heads, All Examining Personnel, and Other Interested Parties

### Note for Community Banks

This guidance applies to all OCC-supervised banks.

### Highlights

- Effective September 5, 2017, the regular industry settlement cycle for many U.S. securities including equities, corporate and municipal bonds, and unit investment trusts—and financial instruments composed of these products—will be shortened from the third business day after the trade date (T+3) to the second business day after the trade date (T+2).
- Amendments to U.S. Securities and Exchange Commission (SEC) and Municipal Securities Rulemaking Board (MSRB) rules reflect this change.
- Banks should prepare to meet the applicable time frames for the T+2 settlement cycle for trades related to banks' securities activities. These activities include banks' investment and trading portfolios and securities settlement and servicing provided to banks' custody and fiduciary accounts.
- Banks that offer retail nondeposit investment products through a broker-dealer should assess the broker-dealer's preparedness for the new settlement time frames.

## Background

On March 22, 2017, the SEC adopted an amendment to the Securities Transaction Settlement Cycle Rule shortening the regular settlement cycle from T+3 to T+2 for many U.S. securities including equities, corporate bonds, and unit investment trusts—and financial instruments composed of these products—when these securities are traded on the secondary market. The SEC's compliance date is September 5, 2017.<sup>1</sup> In addition, on March 28, 2017, the MSRB made similar changes to the settlement cycle for municipal securities.<sup>2</sup> Other securities self-regulatory organizations have finalized, or plan to finalize, rules necessary to implement the new settlement cycle and related processes.<sup>3</sup> These rule changes, made in conjunction with a multi-year securities industry initiative to shorten the settlement cycle, are intended to reduce counterparty risk, lower margin requirements for clearing agency members, reduce procyclical margin and liquidity demands during periods of market volatility, and better align the U.S. settlement requirements with other markets across the globe. Industry participants have been developing and testing the necessary changes to processes and systems to implement this industry-wide change. The private sector developed a comprehensive guide for industry-wide planning, implementation and testing, titled "T+2 Industry Implementation Playbook,"<sup>4</sup> which was published in December 2015. These changes to the securities trading clearance and settlement process and, indirectly, to income processing, corporate action processing, securities lending, and other related processes<sup>5</sup> significantly affect a broad range of market participants and services including

- banks.
- financial market utilities that provide central counterparty services and central securities depository services.
- matching and electronic trade confirmation services.
- broker-dealers.
- municipal securities dealers.
- custodians.
- transfer agents.
- institutional and retail investors.
- asset managers.
- securities lending agents.

- systems and service providers that support these activities.

## **Guidance for Banks**

The OCC expects that as of the T+2 compliance date, in accordance with industry standards and applicable securities and self-regulatory organizations' rules for securities clearance and settlement, banks will not effect or enter into a contract for the purchase or sale of an affected security that provides for payment of funds or delivery of securities later than the second business day after the date of the contract, unless otherwise expressly agreed to by the parties at the time of the transaction.<sup>6</sup> The OCC expects banks to be prepared to meet T+2 standards as of September 5, 2017.

Bank management and the board of directors should employ effective change management processes and provide effective oversight to ensure banks are prepared for this industry-wide change. Preparation includes identifying all lines of business, products, and activities that involve securities settlement and servicing. Bank management should monitor the progress of industry participants as preparation and testing are coordinated and completed. This monitoring includes regulatory changes that affect securities settlement and servicing, system and process changes at financial market utilities, custodians' system and process changes, and third-party system or service provider changes.

Based on the nature and scope of banks' securities processing activities, bank management should determine what system and process changes or outreach may be needed for a smooth transition to T+2. Bank management should establish and follow an appropriate project plan for implementation. Issues management should consider when developing the project plan include

- changes to investment accounting, trust accounting, or other securities processing systems.
- changes to operational procedures for securities clearance and settlement, income processing, corporate action processing, and securities lending.
- changes to client agreements and disclosures that reflect settlement time frames.
- client communication.
- oversight of third parties' T+2 implementation processes.

- changes to service-level agreements with third parties providing trade clearance and settlement, income processing, or other services affected by T+2 implementation.
- training for front, middle, and back office employees.
- enhanced focus on risk management practices, risk metrics, and surveillance systems to effectively identify and address potential increases in failed trades or processing exceptions.
- staffing and contingency planning for the days leading up to and immediately following implementation.

For broad risk management guidance for implementing product changes, national banks should refer to OCC Bulletin 2004-20, "Risk Management of New, Expanded, or Modified Bank Products and Services," and federal savings associations should refer to "New Activities and Services," section 760 of the *Office of Thrift Supervision Examination Handbook*.

For many banks, the majority of the changes needed to implement T+2 will be completed by third parties—industry utilities, custodians, systems and service providers, broker-dealers through which banks trade for themselves or on behalf of their fiduciary and custody accounts, and broker-dealers providing retail brokerage services to bank customers. For guidance on assessing and managing risks associated with third-party relationships, banks should refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," October 30, 2013.

Banks are also encouraged to refer to the comprehensive industry website, T+2 Settlement, at [ust2.com](http://ust2.com) for further guidance on how to prepare for this change.<sup>7</sup>

### **Further Information**

Please contact Joel Miller, Director, or Patricia Dalton, Technical Expert, Asset Management Group, Market Risk, at (202) 649-6360.

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<sup>1</sup> Refer to SEC Rule 15c6-1(a) under the Securities Exchange Act of 1934. Also refer to 82 FR 15564, "Securities Transaction Settlement Cycle," March 29, 2017.

<sup>2</sup> Refer to MSRB Regulatory Notice 2017-07, "MSRB Announces Date of Transition to a Two-Day Settlement Cycle for Municipal Securities Transactions."

<sup>3</sup> For example, refer to FINRA Regulatory Notice 17-19, "Shortening the Securities Settlement Cycle for Securities to T+2" (May 2017); and SEC, Self-Regulatory Organization, Release No. 34-80020 (February 10, 2017) (granting approval to a rule change for the New York Stock Exchange).

<sup>4</sup> The T+2 Settlement website, [ust2.com](http://ust2.com), is sponsored by an Industry Steering Committee and Industry Working Group comprising senior-level representatives from industry associations and firms that represent various segments of the industry and includes a link to the T+2 Playbook.

<sup>5</sup> Refer to footnote 4. The T+2 Playbook includes a detailed list of products (asset types) that could be affected by T+2 implementation.

<sup>6</sup> OCC regulations 12 CFR 12.9(a), "Settlement of Securities Transactions" (national banks), and 12 CFR 151.130(a)(1), "When Must I Settle a Securities Transaction?" (federal savings associations), currently require banks to settle certain securities transactions by T+3, although the regulations do not prohibit banks from settling transactions earlier than T+3. The OCC intends to further align its rules with the movement to T+2 settlement.

<sup>7</sup> Refer to footnote 4.