four comment letters, two in support, 8 one in opposition, 9 and one suggesting that additional regulatory changes may be necessary to implement T+3 settlement. 10 Supporters cited benefits such as reduction in market risk and liquidity risk. Thomson Trading Services ("Thomson") suggested an amendment to MSRB rules that require use of a registered clearing agency's facilities for automated confirmations and acknowledgments. R.N. Dillingham opposed the proposed rule change and asserted an inability on the part of retail investors to meet settlement obligations.

Prior to filing with the Commission, the MSRB received six letters commenting on T+3 settlement for municipal securities. ¹¹ All six commenters are small retail broker dealers which are concerned with their ability to comply with the proposal, the proposal's increased economic costs, and its effect on their relationship with individual investors.

III. Discussion

As discussed below, the Commission believes that the MSRB's proposed rule change is consistent with Sections 15B and 17A of the Act. 12 By adopting a T+3 settlement time frame for municipal securities, the settlement cycle for municipal securities will be consistent with the settlement cycle for most corporate and investment company securities. Separate settlement cycles would impose unnecessary cost and operational difficulties on industry participants. 13 As more fully described in the T+3 adopting release, the Commission believes that faster trade settlement can reduce the potential for gridlock and foster investor confidence in securities markets during periods of high volume and price volatility by reducing systemic risk and liquidity risk

Steve Harris, Executive Vice President, Golden Harris Capital Group, Inc., to David Clapp, Chairman, MSRB (April 11, 1994); Ronald E. Ott, President, Davidson Securities, Inc., to Judy Somerville, MSRB (May 10, 1994); Roger Springate, Jr., Springate & Company, to MSRB (May 11, 1994); Frederick Stoever, President, Stoever Glass & Co., to Chris Taylor, Executive Director, MSRB (undated); and Gene J. d'Ercole, Executive Vice President, Wulff, Hansen & Co., to David Clapp, Chairman, MSRB (June 9, 1994).

in the municipal bond market. ¹⁴ As the Investment Company Institute noted in its comment letter, the proposed rule change also addresses the problems associated with a mutual fund's obligation to redeem shares daily at the fund's net asset value upon request by its shareholders. ¹⁵

Thus, the Commission believes that the proposed rule is consistent with Section 15B. Section 15B, among other things, requires that the MSRB's rules be designed to foster cooperation and coordination with persons engaged in clearing, settling, and processing information with respect to, and facilitating transactions in, municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest. 16 By reducing risk in the municipal securities market, the proposed rule change protects investors and the public interest. By eliminating the burden of separate settlement cycles, the proposal fosters cooperation and coordination with persons engaged in the clearing, settling, and facilitating transactions in municipal securities consistent with Section 15B.

In Section 17A, Congress set forth in its findings that linking all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will reduce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors.¹⁷ While municipal securities generally are defined as exempt securities under the Act, ¹⁸ municipal securities are specifically included for purposes of Section 17A of the Act. ¹⁹ By shortening the settlement time frame for municipal

securities so that it is the same as the settlement time frame for corporate securities, the proposal should forward the goal of developing uniform standards and procedures as set forth in Section 17A.

Commenters opposed to the proposed rule change raised concerns previously considered in connection with the adoption of Rule 15c6–1. Four commenters expressed concern that their customers would not or could not pay for their securities purchases by T+3, thus forcing the broker-dealer to finance the customer's purchases for two days. Several commenters raised similar concerns during the adoption process for Rule 15c6–1. In the adopting release, the Commission stated that:

The Commission is sensitive to the costs necessary for transition to a shorter settlement time frame but on balance believes that the benefits to the financial system outweigh those costs. Moreover, the Commission believes Rule 15c6–1 creates an incentive for broker-dealers, particularly retail firms, to encourage timely customer payments, and improve management of cash flows * * *. [T]he Commission expects broker-dealers will have adequate notice to educate customers about the need for prompt payment and will have adequate time and incentive to implement changes to reduce the need for financing.²¹

The Commission continues to believe that the benefits in risk reduction outweigh the costs involved.

Several commenters were concerned about the ability of retail customers to meet T+3 settlement obligations, particularly given their heavy reliance on the mail to receive confirms, make payments, and deliver physical stock certificates.²² The Commission believes that matters such as these can be handled by broker-dealers educating their customers on the need to send payment immediately after execution of trades and through employment of methods to speed delivery of confirmations and stock certificates. In most instances, checks mailed on trade date should reach the broker-dealer by T+3.

One commenter stated that its relationship with individual investors will be affected adversely because customers will believe that their broker is experiencing financial difficulties or that the broker believes that the

 $^{^8}$ Letters from American Bankers Association and Investment Company Institute, supra note 3.

Investment Company Institute, *supra* note 3. ⁹ Letter from R.N. Dillingham, *supra* note 3.

¹⁰Letter from Thomson Trading Services, Inc., supra note 3.

¹¹ Supra note 7.

^{12 15} U.S.C. 780-4 and 78q-1 (1988).

¹³ In its comment letter, the American Bankers Association supported the rule because, among other reasons, settling municipal, securities on a T+5 basis while settling most other securities on a T+3 basis which require operating multiple settlement systems, which will be extremely burdensome and costly.

¹⁴ By reducing the settlement time frame for municipal securities transactions from five business days to three business days, there will be fewer unsettled municipal securities trades subject to credit and market risk at any given time, and there would be less time between trade execution and settlement for the value of those trades to deteriorate. Such risk reduction was one of the major reasons the Commission adopted Rule 15c6–1

¹⁵ T+3 settlement for mutual funds could create problems in satisfying redemption requests, particularly for funds such as municipal bond mutual funds whose portfolios are invested largely in securities that are not subject to T+3. The Investment Company Institute states "if a municipal bond mutual fund has to sell portfolio securities to meet redemptions, it might be unable to satisfy its obligations if redemption proceeds has to be paid to redeeming shareholders within three days while the fund could not be assured of receiving the proceeds from selling its portfolio securities until two days later."

^{16 15} U.S.C 78o-4(B)(2)(C) (1988).

^{17 15} U.S.C 78q-1(a)(1)(D) (1988).

¹⁸ 15 U.S.C 78c(a)(12)(A)(ii) (1988).

¹⁹ 15 U.S.C 78c(a)(12)(B)(ii) (1988).

²⁰ Letters from Golden Harris Capital Group, Inc., Davidson Securities, Inc., Stoever Glass & Co., and Wulff, Hansen & Co., *supra* note 7.

²¹ Supra note 4.

²² Letters from Golden Harris Capital Group, Inc., Springate & Company, Conners & Co., Inc., R.N. Dillingham, and Wulff, Hansen & Co., *supra* notes 3 and 7.