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SEC ADOPTS NEW FINAL RULES FOR CLEARANCE AND SETTLEMENT; PROPOSES CHANGES FOR INVESTMENT ADVISER RULES

To Our Clients and Friends:

On February 15, 2023, the Securities and Exchange Commission (the "SEC") adopted final rule changes intended to reduce risk in clearance and settlement for most broker-dealer securities transactions and proposed new rules designed to enhance safeguards for customer assets managed by investment advisers.

The new final rules amend Rule 15c6-1 under the Securities Exchange Act of 1934 (the "Exchange Act") to shorten the standard settlement cycle for broker-dealer transactions from two business days after the trade ("T+2") to one business day ("T+1"). The new rules also shorten the separate settlement cycle for firm commitment offerings, including initial public offerings, from T+4 to T+2, although most market participants already employ a T+2 settlement cycle for these offerings.

The rule amendments also adopt Rule 15c6-2, requiring a broker or dealer to establish, maintain and enforce written policies or enter into written agreements that ensure prompt completion of applicable allocation, confirmation or affirmation processes. To comply with the new rule, such agreements or policies must ensure that allocation, confirmation or affirmation processes be completed as soon as technologically practicable but in no case later than end of day on the trade date. Additionally, the new rules amend Rule 204-2 under the Investment Advisers Act of 1940 (the "Investment Advisers Act") to require investment advisers to keep records for transactions subject to Rule 15c6-2 above. Finally, the new final rules adopt Rule 17Ad-27 under the Exchange Act and amend Regulation S-T to require clearing agencies that provide a central matching service to facilitate straight-through processing and submit to the SEC via EDGAR an annual report regarding straight-through processing implementation. The compliance date for these rule changes is set for May 28, 2024.

These changes come in part as a response to the unprecedented volatility associated with the so-called "meme stock craze" of 2021. Commissioner Jaime Lizárraga supported the adoption of new rules, opining that it "helps mitigate some of the risks that drove stock price volatility and significant margin calls" during that event. SEC Chair Gary Gensler also supported the rule amendments, stating: "Cosmo might say this adoption will take our plumbing from bronze to copper. I say that, taken together, these amendments will make our market plumbing more resilient, timely, orderly, and efficient." Regarding the compliance date, he offered: "This implementation comes more than three years after key industry members first proposed shortening the settlement cycle, and a year and a quarter from now, providing sufficient time in my view for the transition." Other commissioners pushed back on the May 2024 implementation timeline. Commissioner Mark T. Uyeda did not support the final rules, saying that that in his view the SEC is "in an imprudent rush away from a sensible transition date[.]" Along with Commissioner Uyeda, Commissioner Hester M. Pierce also advocated for a compliance date in

September 2024. The changes also came with discussion that the SEC may eventually look to further reduce the settlement window. Via a statement, Commissioner Caroline A. Crenshaw said that moving to instantaneous trade processing ("T+0") "may be both desirable and feasible in the future."

The SEC's proposed changes to Rule 206(4)-2 under the Investment Advisers Act would rely on authority granted by section 411 of the Dodd-Frank Act to broaden the scope of, and protections for, assets protected by the rule. While the current rule protects client "funds and securities" under the care of an investment adviser, the proposed rule would encompass any client asset in the possession of the investment adviser and any client asset that the investment adviser has authority to obtain. This move would bring numerous kinds of physical assets and all crypto-assets into the scope of the rule's protection. Under the current rule, protected assets are covered when they are in the "custody" of an investment adviser, and the proposed changes would expand the definition of such custody to include situations where the adviser has discretion to trade those assets. While the current rule requires investment advisers to maintain client assets with a qualified custodian unless those assets are privately offered securities, the new rule would narrow that exception to situations where a qualified custodian is unavailable. Additionally, a qualified custodian would not include platforms used to trade assets like crypto, a move seemingly made to address the recent failures and struggles of major crypto-asset trading platforms. The proposed rule also requires that investment advisers title or register assets in the client's name and avoid asset commingling and prohibits investment advisers or related persons from taking certain interests in client assets under the adviser's custody without written consent. Finally, the proposed changes would further amend Rule 204-2 to enhance recordkeeping requirements related to covered client assets under the custody of an investment adviser. The proposed rule changes will be subject to a 60 day comment period after publication in the Federal Register.

Chair Gensler said in support of the rule that "investors working with advisers would receive the time-tested protections that they deserve for all of their assets, including crypto assets, consistent with what Congress envisioned." Commissioner Pierce, who was the only commissioner to vote against the proposal, raised a number of objections, concluding that "[w]hile our intent is good, the result may impose costs on investors that outweigh the benefits." Commissioner Uyeda added that the proposal "appears to mask a policy decision to block access to crypto as an asset class," which "deviates from the Commission's long-standing position of neutrality on the merits of investments," even though he voted in favor of the proposal as a means to gauge the public's reaction.

The following Gibson Dunn attorneys assisted in preparing this client update: Hillary Holmes, Harrison Tucker, Peter Wardle, and Kyle Clendenon.

Gibson Dunn lawyers are available to assist in addressing any questions you may have about these developments. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work, any of the following leaders of the firm's Capital Markets or Securities Regulation and Corporate Governance practice groups, or the following authors:

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