

ALERTS

REMINDER: T+1 Settlement Cycle and Corresponding RIA Books and Records Rules Go Into Effect May 28

May 24, 2024

Effective Tuesday, May 28, 2024, the US will transition from a “T+2” settlement cycle to a “T+1” settlement cycle.[1] This change will impact all transactions in subject securities[2] effected through an SEC-registered broker-dealer absent an express agreement to the contrary.[3] The US Securities and Exchange Commission (“SEC”), in adopting the rule changes implementing the T+1 settlement cycle,[4] separately adopted an amendment to Rule 204-2 (“Books and Records Rule” or “Rule”) under the Investment Advisers Act of 1940, as amended, that also go into effect on May 28. For most registered investment advisers (“RIAs”) to private funds, the amended Books and Records Rule should not require significant changes to current operations.

The Books and Records Rule Amendment

The amendment to the Books and Records Rule requires that, in connection with any transaction subject to T+1 settlement,[5] an RIA must maintain records of each confirmation received and any allocation or affirmation sent or received. Such allocations and affirmations must include a timestamp indicating when the allocation and affirmation was sent or received.[6]

More specifically, the amendment to the Books and Records Rule revises paragraph (a)(7)(iii) of Rule 2024-2 to add the following bolded language:

The placing or execution of any order to purchase or sell any security; **and, for any transaction that is subject to the**

requirements of § 240.15c6-2(a) of this chapter, each confirmation received, and any allocation and each affirmation sent or received, with a date and time stamp for each allocation and affirmation that indicates when the allocation and affirmation was sent or received[.]

As is currently the case with records required to be maintained under the Rule, such records “be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in an appropriate office of the investment adviser.”[7]

RIAs must maintain required records in “a way that permits easy location, access, and retrieval of any particular record” and provide “legible, true, and complete” copies “promptly” if requested during an examination or in connection with an enforcement inquiry.[8]

Allocations, Confirmations and Affirmations

The Books and Records Rule amendment will likely have the greatest impact on transactions effected through an executing broker (that is, a broker-dealer other than the adviser’s prime broker or bank custodian, prime brokers and bank custodians collectively, “Clearing Agents”).[9] In such transactions, the executing broker transmits a “confirmation” to the Clearing Agent noting the terms of the transaction effected by the executing broker on behalf of their common customer.[10] Depending on the arrangement, either the RIA or its Clearing Agent then affirms the details of the confirmation provided by the executing broker; such instructions help facilitate the transfer of the position from the executing broker to the Clearing Agent. Where received or sent by an RIA, these confirmation and affirmation instructions must be retained in accordance with the Books and Records Rule.

Separately, in such transactions an adviser typically submits allocation instructions to its executing broker and/or Clearing Agent. These allocation instructions identify the Clearing Agent where a trade, or portion thereof, should be allocated and may separately identify the relevant underlying customer(s) accounts. Under the amended Books and Records Rule each such allocation transmitted by an adviser should be retained, whether submitted to the executing broker or the firm’s Clearing Agent.

Operational Impact

Confirmations

Under the amended Books and Records Rule, RIAs should be retaining a copy of any confirmation received. It is not uncommon, however, for an executing broker to send a confirmation to the Clearing Agent rather than the adviser itself.

Allocation Instructions

An RIA must maintain timestamped copies of allocation instructions sent to, or received from, its brokers and Clearing Agents.[11]

Affirmations

Where an RIA uses a “prime broker” as a fund’s custodian, the prime broker will typically affirm each trade submitted to it by an executing broker. We understand this process will continue unchanged in a T+1 environment and, as such, the adviser will typically neither send nor receive affirmations for trades cleared to their prime broker(s). However, in instances where an RIA does send or receive a copy of an affirmation, the amended Rule requires that the RIA retain it.

For advisers using agent banks as their Clearing Agents, certain bank custodians have requested that advisers obtain a TradeSuite ID[12] and otherwise subscribe to certain TradeSuite services. Requiring that each adviser have its own TradeSuite ID will help bank custodians segregate confirmations and other transaction records maintained by such bank custodian. Further, depending on the TradeSuite services to which the adviser subscribes, this will permit the adviser to self-affirm transactions cleared to the bank custodian (where desired).

In all instances, where an adviser is itself the party submitting the affirmation instructions, the adviser will need to maintain timestamped copies of each such affirmation and will need to maintain copies of affirmations otherwise received by the adviser. Notwithstanding the foregoing, neither the amended Books and Records Rule nor the related Exchange Act amendments require that an adviser self-affirm transactions, regardless of the type of Clearing Agent used.

Division of Examinations Risk Alert

The SEC's Division of Examinations published a Risk Alert in March announcing its intention to examine Registrants on their compliance with the new requirements, including evaluating, among other things, Registrants' "readiness" for the new recordkeeping requirements. [13]

Conclusion

To confirm preparedness for the Rule change, RIAs should:

- Ensure books and records policies have been updated to reflect the new requirement;
- Confirm the RIA is keeping a copy of all allocation instructions sent or received in a place and format where such instructions could be readily collected and produced in response to an SEC request; and
- Identify whether the RIA (1) receives trade confirmations from any Clearing Agent, broker or custodian or (2) affirms trades directly with a custodian and, if so, ensure such confirmations or affirmations, as applicable, could be readily collected and produced in response to an SEC request.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] That is, the scheduled settlement date for subject transactions will transition from two (2) business days after the relevant trade date ("T+2") to one (1) business day after the relevant trade date ("T+1").

[2] Generally, all securities other than exempted securities, government securities, municipal securities, commercial paper and security-based swaps. See rule 15c6-1 of the Securities Exchange Act of 1934, as amended ("Exchange Act") for a complete list of securities not subject to the T+1 settlement requirements.

[3] See rule 15c6-1(a) of the Exchange Act.

[4] See Exchange Act Release Nos. 34-96930 (Feb. 15, 2023), available at <https://www.sec.gov/files/rules/final/2023/34-96930.pdf> ("Adopting Release").

[5] That is, subject to T+1 settlement under Exchange Act rule 15c6-1(a).

[6] See 17 CFR § 275.204-2(a).

[7] See 17 CFR § 275.204-2(e)(1).

[8] See 17 CFR § 275.204-2(g).

[9] Although, for clarity, it will impact any transaction in which an RIA is sending or receiving allocation instructions.

[10] See Adopting Release at 84.

[11] The phrase “sent or received” is intended to apply to “any allocation” as well as each affirmation. See, e.g., Adopting Release at 107 (“As discussed above, in recognition of the role of third parties, the Commission is requiring advisers to keep records of allocations or affirmations sent or received, in the event that the adviser receives a copy of such records from a third party.”); see also *id.* at 297 (“These records include each confirmation received, and any allocation and each affirmation sent or received, with a date and time stamp for each allocation and affirmation that indicates when the allocation and affirmation were sent or received.”).

[12] TradeSuite is a product offered by the Depository Trust & Clearing Corporation (DTCC) that allows participants to, among other things, affirm institutional trades.

[13] See Shortening the Securities Transaction Settlement Cycle (March 27, 2024), available here. The appendix to the Risk Alert includes representative questions that the SEC staff may ask on examinations focused on T+1 compliance, noting that different questions will apply to different registrant types. Of note for RIAs are sample questions regarding changes to policies and procedures, operational risk management, any funding/liquidity concerns foreseen for trades that do not settle T+1 and outreach to vendors.

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