AST THOUGHT LEADERSHIP

5 Best Practices for a Successful T+2 Transition

The transition to a shortened time frame for securities transactions settlement – reducing to 2 days from 3 – is virtually upon us. September 5 of this year is the first effective date, with September 7 the first 2-day settlement date. You probably began a comprehensive project to ready your systems and people for the switch long ago. Here are ***5 Best Practices*** *to help you make sure nothing falls between the cracks.*

Best Practice 1: *Do a complete inventory and update of all internal and external documents*

Everything that refers to or specifies a three-day settlement period must be updated – from critical, legally binding contracts, SLAs and equity plan documents to shareholder communications and marketing materials. Consider, for example, tender offers and corporate actions notices. Typically the associated documentation and materials will specify the current 3-day guarantee period after the expiration of the tender. Now that will of course reduce to 2 days. All tender materials and notices of guaranteed deliveries will need to reflect that. And don't forget all "internal use only" materials like training and call center scripts. Also, please make sure that Equity Authorization Forms are updated to reflect all appropriate parties, especially for DWAC delivery requests. If you have not already, look into using the transfer agent's electronic authorization solution rather than relying on scanned PDFs. You may want to consider providing the DWAC authorization to your captive broker in an effort to reduce time delays with the information flow.

Best Practice 2: *Avoid penalties – ensure brokers' representation letters are complete and accurate*

Work closely with brokers to ensure they provide complete and accurate representation letters up-front. The shortened settlement period means one day less to review and return letters. You can't lose time for minor corrections like missing signatures or incomplete information. What makes this even more critical – beyond the mandated 2-day settlement – are the potential financial penalties in the form of interest charges the corporate issuer or the employee must pay due to any delay in settlement. The broker is still obligated to deliver shares to the purchaser on time. Absent possession of shares to deliver, the broker may take shares from inventory, or borrow them from another client or broker. The broker can charge margin interest – currently around 8 percent – until clean shares are delivered. Ideally, arrange for brokers to provide letters on the trade date, allowing time for counsel to review and issue an opinion, and for you to process and deliver shares. Or negotiate the fee with the broker, who sets it.

Best Practice 3: *Beware clearing restricted securities early*

Due to the risk of incurring margin interest until delivery occurs, brokers may request that issuers have restricted securities pre-cleared and delivered. Don't bypass consulting counsel before acting on such requests. Removing the affiliate restriction requires issuing an opinion. If there's no qualification to satisfy the removal of a restriction, counsel will be understandably reluctant to render such an Opinion. As a result of a visible case where the SEC found a transfer agent lacking sufficient controls with releasing legends off restricted stock, transfer agents have been tasked to become “gatekeepers” by the SEC to flag and prevent potential securities fraud and may have higher standards for Opinions.

Best Practice 4: *Tax to the max – and pay on time*

Avoid post-trade date corrections on tax rates and earnings – use the maximum tax rate and true up later. Any necessary adjustments can be done later, either via payroll or when the participant does their annual tax filing. Tax deposits with the IRS must occur the next business day after settlement if all employees’ cumulative tax withholding is $100,000 or more – even if you generally deposit on a monthly or semi-monthly schedule. That requirement remains in effect after T+2. With penalties for late deposits ranging from 2% to 15%, depending on how many days late the deposit is, err on the side of caution and pay – or overpay – on time.

Best Practice 5: *Prepare for double settlement day*

Mark Thursday, September 7, 2017 as “double settlement day” – it’s both the last day of T+3 settlement and the first day of T+2 settlement. Friday, September 1 is the last trade date with a 3-day settlement. Tuesday, September 5 is the first trade date with a 2-day settlement. This means trades on both dates will settle on September 7. It’s not only a critical period of time for processing and delivery. It also makes September 8 a “double deposit day” to pay taxes to the IRS, for trades made on both September 1 and September 5.

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