

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82914; File No. SR-DTC-2017-022)

March 20, 2018

Self-Regulatory Organizations; The Depository Trust Company; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend the Loss Allocation Rules and Make Other Changes

I. Introduction

On December 18, 2017, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² proposed rule change SR-DTC-2017-022 to amend the loss allocation rules and make other changes (“Proposed Rule Change”).³ The Proposed Rule Change was published for comment in the Federal Register on January 8, 2018.⁴ The Commission did not receive any comments on the Proposed Rule Change. On February 8, 2018, pursuant to Section 19(b)(2)(A)(ii)(I) of the Act,⁵ the Commission designated a longer period within which to

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On December 18, 2017, DTC filed this proposal as an advance notice (SR-DTC-2017-804) with the Commission pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”) and Rule 19b-4(n)(1)(i) of the Act (“Advance Notice”). On January 24, 2018, the Commission extended the review period of the Advance Notice for an additional 60 days pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act. See 12 U.S.C. 5465(e)(1); 17 CFR 240.19b-4(n)(1)(i); 12 U.S.C. 5465(e)(1)(H); and Securities Exchange Act Release No. 82582 (January 24, 2018), 83 FR 4297 (January 30, 2018) (SR-DTC-2017-804).

⁴ Securities Exchange Act Release No. 82426 (January 2, 2018), 83 FR 913 (January 8, 2018) (SR-DTC-2017-022) (“Notice”).

⁵ 15 U.S.C. 78s(b)(2)(A)(ii)(I).

approve, disapprove, or institute proceedings to determine whether to approve or disapprove the Proposed Rule Change.⁶ This order institutes proceedings, pursuant to Section 19(b)(2)(B) of the Act,⁷ to determine whether to approve or disapprove the Proposed Rule Change.

II. Summary of the Proposed Rule Change⁸

As described in the Notice,⁹ DTC proposes to revise Rule 4 (Participants Fund and Participants Investment) to primarily change (i) the application of the Participants Fund in a Participant Default and for settlement,¹⁰ (ii) the loss allocation process,¹¹ (iii) the loss allocation governance for Non-Default Events,¹² and (iv) the retention time for

⁶ Securities Exchange Act Release No. 82670 (February 8, 2018), 83 FR 6626 (February 14, 2018) (SR-DTC-2017-022; SR-FICC-2017-022; SR-NSCC-2017-018).

⁷ 15 U.S.C. 78s(b)(2)(B).

⁸ The Commission notes that the Summary of the Proposed Rule Change section does not describe the Proposed Rule Change in its entirety. Other changes include, but are not limited to, the clarification of defined terms, various aspects of the settlement charges, and detailed procedures of the loss allocation. The complete Proposed Rule Change can be found in the Notice. See Notice, supra note 4. In addition, the text of the Proposed Rule Change is available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>.

⁹ The description of the Proposed Rule Change herein is based on the statements prepared by DTC in the Notice. See Notice, supra note 4. Each capitalized term not otherwise defined herein has its respective meaning either (i) as set forth in the Rules, By-Laws and Organization Certificate of DTC, available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>, or (ii) as set forth in the Notice.

¹⁰ See Notice, supra note 4, at 914-15.

¹¹ See id. at 915-18.

¹² See id. at 918.

the Actual Participants Fund Deposit of former participants.¹³ Furthermore, the Proposed Rule change would revise Rule 1 (Definitions; Governing Law) to add cross-references to terms that would be defined in proposed Rule 4.¹⁴

A. Application of the Participants Fund in a Participant Default and for Settlement

DTC proposes to revise Rule 4, Section 4 (Application of Participants Fund Deposits of Non-Defaulting Participants) to address the situation where the application of the Actual Participants Fund Deposit of a Participant that has failed to settle is insufficient to complete settlement among non-defaulting Participants on any Business Day.¹⁵ In such a situation, proposed Section 4 would state that the Participants Fund shall constitute a liquidity resource which may be applied by DTC in such amounts as DTC shall determine, in its sole discretion, to fund settlement among non-defaulting Participants.¹⁶

B. Loss Allocation Process

DTC proposes to revise Rule 4, Section 5 (Loss Allocation Waterfall) to address the loss allocation of losses and liabilities relating to or arising out of a Default Loss Event or a Declared Non-Default Loss Event.¹⁷ DTC proposes four key changes to its loss allocation process.

¹³ See id. at 918-19.

¹⁴ See id. at 919.

¹⁵ Id. at 915.

¹⁶ Id. at 919.

¹⁷ Id. at 920-21.

First, DTC proposes to replace the current discretionary application of an unspecified amount of retained earnings and undivided profits with a mandatory, defined Corporate Contribution.¹⁸ The proposed Corporate Contribution would be defined as an amount equal to 50 percent of DTC’s General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period.¹⁹ DTC’s General Business Risk Capital Requirement is, at a minimum, equal to the regulatory capital that DTC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.²⁰

Second, DTC proposes to introduce an Event Period to address the allocation of losses and liabilities (i) relating to or arising out of a Participant Default, where DTC has ceased to act for such Participant, and/or (ii) otherwise incident to the business of DTC, as determined in proposed Rule 4.²¹ DTC proposes to group together Default Loss Events and Declared Non-Default Loss Events occurring in a period of 10 Business Days for purposes of allocating losses to Participants.²²

Third, DTC proposes to introduce a loss allocation “round,” which would mean “a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Participants.”²³ DTC would

¹⁸ Id. at 916.

¹⁹ Id.

²⁰ Id.; 17 CFR 240.17Ad-22(e)(15).

²¹ Notice, supra note 4, at 916.

²² Id.

²³ Id. at 917.

notify Participants subject to a loss allocation of the amounts being allocated to them.²⁴

Participants would be required to pay the requisite amount no later than the second Business Day following the issuance of such notice.²⁵

Fourth, the Proposed Rule Change would continue to provide Participants the opportunity to limit their loss allocation exposure by offering a termination option, but the associated withdrawal process would be modified.²⁶ As proposed, if a Participant provides notice of its election to terminate its business with DTC as provided, in general, its maximum payment obligation with respect to any loss allocation round would be the amount of its Aggregate Requirement Deposit and Investment, as fixed on the first day of the Event Period, plus 100 percent of the amount thereof.²⁷ Participants would have five Business Days from the issuance of the first Loss Allocation Notice in any round to decide whether to terminate its participation with DTC, and thereby benefit from its Loss Allocation Cap.²⁸

C. Loss Allocation Governance for Non-Default Events

DTC proposes to clarify the governance around Non-Default Loss Event that would trigger loss allocation to Participants. Specifically, DTC proposes to require its Board of Directors to determine that there is a non-default loss that (i) may present a significant and substantial loss or liability, so as to materially impair the ability to DTC to

²⁴ Id.

²⁵ Id.

²⁶ Id. at 917-18.

²⁷ Id. at 917.

²⁸ Id. at 918.

provide clearance and settlement services in an orderly manner, and (ii) will potentially generate losses to be mutualized among the Participants in order to ensure that DTC may continue to offer clearance and settlement services in an orderly manner.²⁹

D. Retention Time for the Actual Participants Fund Deposit of a Former Participant

DTC proposes to reduce its retention time for the Actual Participants Fund Deposit of a Former Participant in certain situations from four years to two years.³⁰ Currently Rule 4 provides that, in general, after three months from when a Person has ceased to be Participant, DTC shall return to such Person the amount of the Actual Participants Fund Deposit of the former Participant of such payment provided that DTC receives such indemnities and guarantees as DTC deems satisfactory with respect to the matured and contingent obligations of the former Participant to DTC.³¹ Otherwise, within four years after a Person has ceased to be a Participant, DTC shall return to such Person the amount of the Actual Participants Fund Deposit of the former Participant.³² DTC proposes to reduce the four year retention period to two years, and preserve all other requirements relating to the return of the Actual Participants Fund Deposit.³³

III. Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the

²⁹ Id. at 918.

³⁰ Id. at 918-19.

³¹ Id. at 918.

³² Id.

³³ Id.

Act³⁴ to determine whether the Proposed Rule Change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the Proposed Rule Change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, the Commission seeks and encourages interested persons to comment on the Proposed Rule Change, and provide the Commission with arguments to support the Commission's analysis as to whether to approve or disapprove the Proposed Rule Change.

Pursuant to Section 19(b)(2)(B) of the Act,³⁵ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the Proposed Rule Change's consistency with Section 17A of the Act,³⁶ and the rules thereunder, including the following provisions:

- Section 17A(b)(3)(F) of the Act,³⁷ which requires, among other things, that the rules of a clearing agency, such as DTC, must be designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and to protect investors and the public interest;

³⁴ 15 U.S.C. 78s(b)(2)(B).

³⁵ Id.

³⁶ 15 U.S.C. 78q-1.

³⁷ 15 U.S.C. 78q-1(b)(3)(F).

- Rule 17Ad-22(e)(7)(i) under the Act,³⁸ which requires a covered clearing agency, such as DTC, to establish, implement, maintain and enforce written policies and procedures reasonably designed to, among other things, effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity by, at a minimum, maintaining sufficient liquid resources to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for the covered clearing agency in extreme but plausible market conditions;
- Rule 17Ad-22(e)(13) under the Act, which requires, in general, a covered clearing agency, such as DTC, to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations.
- Rule 17Ad-22(e)(23)(i) under the Act,³⁹ which requires a covered clearing agency, such as DTC, to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures.

³⁸ 17 CFR 240.17Ad-22(e)(1).

³⁹ 17 CFR 240.17Ad-22(e)(23)(i).

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the Proposed Rule Change. In particular, the Commission invites the written views of interested persons concerning whether the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act,⁴⁰ Rule 17Ad-22(e)(7)(i) under the Act,⁴¹ Rule 17Ad-22(e)(13) under the Act,⁴² Rule 17Ad-22(e)(23)(i) under the Act,⁴³ or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4(g) under the Act,⁴⁴ any request for an opportunity to make an oral presentation.⁴⁵

Interested persons are invited to submit written data, views, and arguments regarding whether the Proposed Rule Change should be approved or disapproved by

⁴⁰ 15 U.S.C. 78q-1(b)(3)(F).

⁴¹ 17 CFR 240.17Ad-22(e)(7)(i).

⁴² 17 CFR 240.17Ad-22(e)(13).

⁴³ 17 CFR 240.17Ad-22(e)(23)(i).

⁴⁴ 17 CFR 240.19b-4(g).

⁴⁵ Section 19(b)(2) of the Act grants to the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

[insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

The Commission asks that commenters address the sufficiency of DTC's statements in support of the Proposed Rule Change, which are set forth in the Notice,⁴⁶ in addition to any other comments they may wish to submit about the Proposed Rule Change.

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-DTC-2017-022 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-DTC-2017-022. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the Proposed Rule Change that are

⁴⁶ See Notice, supra note 4.

filed with the Commission, and all written communications relating to the Proposed Rule Change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of DTC and on The Depository Trust & Clearing Corporation's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-DTC-2017-022 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁷

Eduardo A. Aleman
Assistant Secretary

⁴⁷ 17 CFR 200.30-3(a)(57).