

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-90368; File No. SR-DTC-2020-801)

November 6, 2020

Self-Regulatory Organizations; The Depository Trust Company; Notice of No Objection To Advance Notice To Amend Rule 4

On September 9, 2020, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-DTC-2020-801 (“Advance Notice”) pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i)<sup>2</sup> under the Securities Exchange Act of 1934 (“Exchange Act”)<sup>3</sup> to amend Rule 4 of the Rules, By-Laws and Organization Certificate of DTC (the “Rules”). The Advance Notice was published for comment in the Federal Register on October 20, 2020,<sup>4</sup> and the Commission has not received comments regarding the changes proposed in the Advance Notice. This publication serves as notice of no objection to the Advance Notice.

I. THE ADVANCE NOTICE

A. Background

DTC is the central securities depository (“CSD”) for substantially all corporate

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> 15 U.S.C. 78a et seq.

<sup>4</sup> Securities Exchange Act Release No. 90169 (October 14, 2020), 85 Fed. Reg. 66666 (October 20, 2020) (SR-DTC-2020-801) (“Notice of Filing”).

and municipal debt and equity securities available for trading in the United States.<sup>5</sup> As a covered clearing agency that provides CSD services,<sup>6</sup> DTC provides a central location in which securities may be immobilized, and interests in those securities are reflected in accounts maintained for its Participants, which are financial institutions such as brokers or banks.<sup>7</sup> DTC does not provide central counterparty services and therefore does not

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<sup>5</sup> Each capitalized term not otherwise defined herein has its respective meaning as set forth in DTC’s rules, including, but not limited to, the Rules, By-Laws and Organization Certificate of DTC (the “Rules”) and the DTC Settlement Service Guide (the “Settlement Guide”), available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>. The Settlement Guide is a Procedure of DTC filed with the Commission that, among other things, operationalizes and supplements the DTC Rules that relate to settlement.

<sup>6</sup> A covered clearing agency is defined as a registered clearing agency that provides the services of a central counterparty (“CCP”) or CSD. See 17 CFR 240.17Ad-22(a)(5). CSD services means services of a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Exchange Act. See 17 CFR 240.17Ad-22(a)(3). Specifically, the definition of a clearing agency includes, in part, “any person, such as a securities depository that (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates.” 15 U.S.C. 78c(a)(23)(A).

<sup>7</sup> See, e.g., Securities Exchange Act Release No. 20221 (September 23, 1983), 48 Fed. Reg. 45167, 45168 (October 3, 1983) (File No. 600-1) (“A securities depository is a “custodial” clearing agency that operates a centralized system for the handling of securities certificates. Depositories accept deposits of securities from broker-dealers, banks, and other financial institutions; credit those securities to the depositing participants (sic) accounts; and, pursuant to participant’s (sic) instructions, effect book-entry movements of securities. The physical securities deposited with a depository are held in a fungible bulk; each participant or pledgee having an interest in securities of a given issue credited to its account has a pro rata interest in the physical securities of the issue held in custody by the securities depository in its nominee name. Depositories collect and pay dividends and interest to participants for securities held on deposit. Depositories also

become party to its Participants' transactions or guarantee settlement on behalf of its Participants.<sup>8</sup>

DTC provides settlement services for virtually all broker-to-broker equity and listed corporate and municipal debt securities transactions in the U.S., as well as institutional trades, money market instruments and other financial obligations. For end-of-day net funds settlement, the DTC settlement system records money debits and credits to Participant settlement accounts throughout a Business Day.<sup>9</sup> At the end of a Business Day, a Participant's settlement account will have a net debit (i.e., the sum of all money charges to a Participant's account exceeds the sum of all money credits), net credit (i.e., the sum of all money credits to a Participant's account exceeds the sum of all money charges), or zero balance. This final balance will determine whether the Participant has an obligation to pay or to be paid as part of the process of DTC completing settlement on that Business Day. A Participant that fails to pay its net debit balance and therefore defaults on its settlement obligations on a Business Day will not have paid for the

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provide facilities for payment by participants to other participants in connection with book-entry deliveries of securities. . . .”).

<sup>8</sup> A clearing agency that provides central counterparty services interposes itself between the counterparties to securities transactions, acting functionally as the buyer to every seller and the seller to every buyer. 17 CFR 240.17Ad-22(a)(2).

<sup>9</sup> Credits to a Participant settlement account arise from deliveries versus payment, receipt of payment orders, principal and interest distributions in respect of securities held, intraday settlement progress payments and any other items or transactions that give rise to a credit. Debits to a Participant settlement account are primarily due to receives versus payment, as well as other types of charges to the account permitted under the Rules. See Notice of Filing, supra note 4, 85 Fed. Reg. at 66667.

securities processed for delivery versus payment, and the securities will not be credited to its account.

DTC represents that there may be circumstances in which the amount of settlement payments received or available to DTC on a Business Day is not sufficient to pay all Participants with an end-of-day net credit balance on that Business Day (a “settlement gap”).<sup>10</sup> A settlement gap could occur on a Business Day as a result of a Participant Default, where a Participant fails to pay its settlement obligation (a “default gap”). A settlement gap could also occur on a Business Day as a result of causes other than a Participant Default (a “non-default gap”). Examples of a non-default gap could include a scenario in which the funds required to complete settlement are not available to DTC due to an operational or data issue arising at DTC or at a Participant or Settling Bank, a cyber incident, or other business disruption.<sup>11</sup> According to DTC, its failure to complete settlement on a given Business day could cause significant market-wide effects.<sup>12</sup>

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<sup>10</sup> See id.

<sup>11</sup> DTC is subject to a number of regulatory requirements related to its operational and cyber risks, including Rule 17Ad-22(e)(17) and Regulation Systems Compliance and Integrity. DTC’s overall approach to operational risk is summarized in its Disclosure Framework, available at <https://www.dtcc.com/legal/policy-and-compliance>. Among other things, DTC manages its operational risk pursuant to the Clearing Agency Operational Risk Management Framework, which the Commission approved in a separate rule filing. See Securities Exchange Act Release No. 81745 (September 28, 2017), 82 Fed. Reg. 46332 (October 4, 2017) (SR-DTC-2017-014).

<sup>12</sup> See Notice of Filing, supra note 4, 85 Fed. Reg. at 66667 (citing, e.g., Rule 9(B), supra note 5, which states: “Each Participant and the Corporation shall settle the balance of the Settlement Account of the Participant on a daily basis in accordance with these Rules and the Procedures. Except as provided in the Procedures, the Corporation shall not be obligated to make any settlement payments to any Participants until the Corporation has received all of the

B. The Participants Fund and Rule 4

The Participants Fund is prefunded and represents the aggregate of the deposits that each DTC Participant is required to make under DTC's Rules.<sup>13</sup> The Rules provide for a minimum deposit to the Participants Fund, and Participants with higher levels of activity that impose greater liquidity risk to the DTC settlement system have proportionally larger required deposits.<sup>14</sup> DTC has stated that the Participants Fund is a mutualized pre-funded liquidity and loss resource, and that DTC does not have an obligation to repay the Participants Fund and the application of the Participants Fund does not convert to a loss.<sup>15</sup> Once DTC applies the Participants Fund, the Participants are required, upon the demand of DTC, to replenish their shares of the Participants Fund to satisfy their minimum deposits.<sup>16</sup> DTC further represents that the principal purpose of the Participants Fund is to be one of the foundational liquidity resources available to DTC to fund a shortfall in order to complete settlement on a Business Day.<sup>17</sup>

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settlement payments that Settling Banks and Participants are required to make to the Corporation.”).

<sup>13</sup> See Rule 4 (Participants Fund and Participants Investment), supra note 5.

<sup>14</sup> See id.

<sup>15</sup> Securities Exchange Act Release No. 83950 (August 27, 2018), 83 Fed. Reg. 44393 (August 30, 2018) (SR-DTC-2017-804).

<sup>16</sup> See Section 4 of Rule 4 (Participants Fund and Participants Investment), supra note 5.

<sup>17</sup> See Notice of Filing, supra note 4, 85 Fed. Reg. at 66668 (citing DTC's Settlement Guide which provides that the Participants Fund creates liquidity and collateral resources to support the business of DTC and to cover losses and liabilities incident to that business).

Currently, Section 4 of Rule 4 provides that, if there is a Defaulting Participant and the amount charged to the Actual Participants Fund Deposit of the Defaulting Participant pursuant to Section 3 of Rule 4<sup>18</sup> is not sufficient to complete settlement, DTC may apply the Actual Participants Fund Deposits of Participants other than the Defaulting Participant (each, a “non-defaulting Participant”), and apply such other liquidity resources as may be available to DTC, including, but not limited to, the End-of-Day Credit Facility.<sup>19</sup> DTC recognizes that currently, certain provisions of Rule 4 might be construed to narrow the scope of use of the Participants Fund (and any other liquidity resources) for settlement to a default gap only.<sup>20</sup> In order to ensure that DTC may use the Participants Fund and other liquidity resources to fund a settlement gap regardless of its cause, DTC has proposed revising Rule 4, as discussed below.

C. Description of Proposed Changes

DTC states that Section 4 of Rule 4 does not address the use of the Participants Fund to complete settlement when there is a non-default gap and could be construed as limiting the pro rata application of the Participants Fund to fund a settlement gap to

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<sup>18</sup> Section 3 of Rule 4 provides that if a Participant is obligated to DTC pursuant to the Rules and the Procedures and fails to satisfy any such obligation, DTC shall, to the extent necessary to eliminate such obligation, apply some or all of the Actual Participants Fund Deposit of such Participant to such obligation to satisfy the Participant Default. See Section 3 of Rule 4, supra note 5.

<sup>19</sup> Section 2 of Rule 4 provides that “End-of-Day Credit Facility” is any credit facility maintained by DTC for the purpose of funding the end-of-day settlement of transactions processed through the facilities of DTC. See Section 2 of Rule 4, supra note 5. Also see Securities Exchange Act Release No. 80605 (May 5, 2017), 82 Fed. Reg. 21850 (May 10, 2017) (SR-DTC-2017-802; NSCC-2017-802) (renewing the committed revolving credit facility of DTC and National Securities Clearing Corporation).

<sup>20</sup> See Notice of Filing, supra note 4, 85 Fed. Reg. at 66668.

default scenarios.<sup>21</sup> DTC further represents that, on each Business Day, settlement occurs during a tight timeframe, in conjunction with the Federal Reserve's National Settlement Service and Fedwire.<sup>22</sup> If there is a delay with the receipt or disbursement of funds for settlement, DTC would need to address those problems quickly in order to complete settlement on that Business Day.<sup>23</sup>

In the Advance Notice, DTC describes the proposed changes to address this situation and expressly ensure that the Participants Fund could be used to complete settlement in the event of a non-default gap. First, DTC proposes to amend Section 4 of Rule 4 to state that (i) the Participants Fund, (ii) the existing retained earnings or undivided profits of DTC, and (iii) any other liquidity resources as may be available (including, but not limited to, the End-of-Day Credit Facility), would be available to DTC as liquidity resources to fund settlement on a Business Day, regardless of whether the settlement gap is a default gap or a non-default gap. The proposal would state that DTC may apply its available resources to fund settlement, in such order and in such amounts as it determines, in its sole discretion. Second, DTC proposes to provide that a determination to apply the Participants Fund shall be made by either the Chief Executive Officer, Chief Risk Officer, Chief Financial Officer, a member of any management committee, Treasurer or any Managing Director as may be designated by the Chief Risk Officer from time to time. The proposal also states that the Board of Directors (or an

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<sup>21</sup> See Notice of Filing, supra note 4, 85 Fed. Reg. at 66669.

<sup>22</sup> See id.; see also, Settlement Guide at 19-20, supra note 5.

<sup>23</sup> See Notice of Filing, supra note 4, 85 Fed. Reg. at 66669.

authorized Committee thereof) shall be promptly informed of the determination.<sup>24</sup> Third, DTC proposes to make certain clarifying and conforming changes, including to clarify that a Participant's pro rata share of an application of the Participants Fund would be the same whether there is a default gap or a non-default gap, and to make minor changes for conformity and readability.

## II. DISCUSSION AND RECOMMENDATION

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Clearing Supervision Act is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities ("SIFMUs") and strengthening the liquidity of SIFMUs.<sup>25</sup>

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe regulations containing risk management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency.<sup>26</sup> Section 805(b) of the Clearing Supervision Act provides the following objectives and principles for the Commission's risk management standards prescribed under Section 805(a):<sup>27</sup>

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<sup>24</sup> The requirement that DTC would also promptly notify the Commission in the event that the Participants Fund were used to complete settlement would remain unchanged.

<sup>25</sup> See 12 U.S.C. 5461(b).

<sup>26</sup> 12 U.S.C. 5464(a)(2).

<sup>27</sup> 12 U.S.C. 5464(b).



- to promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

Section 805(c) provides, in addition, that the Commission’s risk management standards may address such areas as risk management and default policies and procedures, among others areas.<sup>28</sup>

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (the “Clearing Agency Rules”).<sup>29</sup> The Clearing Agency Rules require, among other things, each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for its operations and risk management practices on an ongoing basis.<sup>30</sup> As such, it is appropriate for the Commission to review advance notices against the Clearing Agency Rules and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act. As discussed below, the Commission believes the proposal in the Advance Notice is consistent with the objectives and

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<sup>28</sup> 12 U.S.C. 5464(c).

<sup>29</sup> 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 Fed. Reg. 66220 (November 2, 2012) (S7-08-11). See also Securities Exchange Act Release No. 78961 (September 28, 2016), 81 Fed. Reg. 70786 (October 13, 2016) (S7-03-14) (Standards for Covered Clearing Agencies). DTC is a “covered clearing agency,” as defined in Rule 17Ad-22(a)(5). See supra note 6.

<sup>30</sup> Id.

principles described in Section 805(b) of the Clearing Supervision Act,<sup>31</sup> and in the Clearing Agency Rules, in particular Rule 17Ad-22(e)(1), (e)(2)(i) and (v), and (e)(7).<sup>32</sup>

A. Consistency with Section 805(b) of the Clearing Supervision Act

The Commission believes that the Advance Notice is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act,<sup>33</sup> because the changes proposed in the Advance Notice are consistent with promoting robust risk management, promoting safety and soundness, reducing systemic risks, and supporting the broader financial system.

First, the Commission believes that the proposal is consistent with promoting robust risk management. DTC proposes to amend Section 4 of Rule 4 to provide expressly for the pro rata application of the Participants Fund, retained earnings, and any other liquidity resources, including DTC's credit facility, to any settlement gap, including a non-default gap. As noted above, settlement occurs during a tight timeframe on each Business Day. If there is a delay with the receipt or disbursement of funds for settlement, it would need to be addressed quickly in order to complete settlement on that Business Day. The proposal would clarify which resources DTC can access and use in the most time-efficient and effective manner to ensure settlement.<sup>34</sup> Moreover, the proposal would

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<sup>31</sup> 12 U.S.C. 5464(b).

<sup>32</sup> 17 CFR 240.17Ad-22(e)(1) and (e)(2)(i).

<sup>33</sup> 12 U.S.C. 5464(b).

<sup>34</sup> The Commission further believes that use of the Participants Fund may be the most efficient method of completing settlement at the end of a Business Day on a tight timeframe, as it generally consists of cash which, pursuant to DTC's Investment Policy, must be held in demand deposit, savings or checking bank accounts that provide same day access to funds. See Exchange Act Release No. 88513 (March 30, 2020), 85 Fed. Reg. 19047, 19048 (April 3, 2020). The

specify the particular DTC personnel whose approval could authorize the use of the Participants Fund to finance a settlement gap. The Commission believes that the proposal is designed to allow DTC to take timely and effective action to fund a settlement gap, regardless of whether it is a default or non-default gap, and therefore complete settlement, by identifying and applying appropriate liquidity resources, which is consistent with the promotion of robust risk management.

Second, the Commission believes that the proposal is consistent with the promotion of safety and soundness of DTC and, by extension, the broader financial system. As stated above, the proposal would expressly provide that DTC may use the Participants Fund and other specified resources as a liquidity resources in the event of a settlement gap. With this proposal, DTC would expressly state how it would manage the potential liquidity risk that may arise from both the default of a Participant as well as a non-default event, including operational issues at DTC, a Participant, or a Settling Bank. With the proposal, DTC would be better positioned to timely complete settlement if a default or non-default gap arises. Accordingly, the Commission believes that the proposal is consistent with the promotion of safety and soundness.

Finally, the Commission believes that the proposal is consistent with reducing systemic risks and supporting the stability of the broader financial system. With clear authority to use the Participants Fund and other resources to address both a default and non-default settlement gap, DTC should be better positioned to access sufficient liquidity, and thus be better able to manage its liquidity risks in the event of a settlement gap. DTC

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Commission observes that, as a general matter, it likely could take more time to access retained earnings or draw down on the credit facility.

is a SIFMU and serves as the only central securities depository in the United States, settling virtually all broker-to-broker equity and listed corporate and municipal debt securities transactions in the United States, as well as institutional trades, money market instruments and other financial obligations. This access to liquidity during a stress event would help mitigate any risk to settlement finality due to DTC having insufficient funds to meet payment obligations to its Participants. As such, access to this liquidity would help to strengthen the liquidity of DTC and mitigate potential risks to settlement finality, thereby reducing systemic risks and supporting the stability of the broader financial system.

For the reasons stated above, the Commission believes the changes proposed in the Advance Notice are consistent with Section 805(b) of the Clearing Supervision Act.<sup>35</sup>

B. Consistency with Rule 17Ad-22(e)(1)

Rule 17Ad-22(e)(1) under the Act requires that DTC establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.<sup>36</sup>

As discussed above, current Section 4 of Rule 4 does not address the use of the Participants Fund or other liquidity resources to complete settlement when there is a non-default gap, and DTC is concerned that it could be construed as limiting the pro rata application of the Participants Fund to fund a settlement gap to default scenarios. The proposal would amend Rule 4 to expressly state that the Participants Fund, DTC's

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<sup>35</sup> 12 U.S.C. 5464(b).

<sup>36</sup> 17 CFR 240.17Ad-22(e)(1).

retained earnings, and other liquidity resources may be used by DTC to fund a settlement gap to complete settlement on a Business Day, whether the settlement gap is the result of a Participant Default or otherwise. In addition, the proposal makes clarifying and conforming changes and provides governance regarding the application of the Participants Fund.

The Commission believes that the above changes are designed to ensure greater certainty in the Rules regarding what resources would be available to DTC to complete settlement in the event of a settlement gap. The proposal would provide a clear, transparent and enforceable legal basis for DTC to apply the Participants Fund, retained earnings, or other liquidity resources to any settlement gap. It would also clarify that a Participant's pro rata share of an application of the Participants Fund would be the same whether there is a default gap or a non-default gap, and expressly state that DTC may apply its available resources to fund settlement, in such order and in such amounts as it determines, in its sole discretion.

Therefore, the Commission believes the proposal is designed to help ensure that DTC's Rules remain well-founded, transparent, and legally enforceable in all relevant jurisdictions, consistent with Rule 17Ad-22(e)(1) under the Act.<sup>37</sup>

C. Consistency with Rule 17Ad-22(e)(2)(i) and (v)

Rule 17Ad-22(e)(2) under the Act requires, in part, that DTC establish, implement, maintain and enforce written policies and procedures reasonably designed to

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Id.

provide for governance arrangements that (i) are clear and transparent, and (v) specify clear and direct lines of responsibility.<sup>38</sup>

As discussed above, the proposal would provide that a determination to apply the Participants Fund shall be made by either the Chief Executive Officer, Chief Risk Officer, Chief Financial Officer, a member of any management committee, Treasurer or any Managing Director as may be designated by the Chief Risk Officer from time to time. The proposal would also provide that the Board of Directors (or an authorized Committee thereof) shall be promptly informed of the determination. With this proposal, the Rules would expressly define who would be responsible for making the determination to apply the Participants Fund to a settlement gap and would require that the Board of Directors (or its authorized Committee) would be informed of such determination promptly.

Therefore, the Commission believes the proposal is designed to provide for governance arrangements regarding the use of the Participants Fund to complete settlement that are clear and transparent and specify clear and direct lines of responsibility, consistent with Rule 17Ad-22(e)(2)(i) and (v) under the Act.<sup>39</sup>

D. Consistency with Rule 17Ad-22(e)(7)(i)

Rule 17Ad-22(e)(7)(i) under the Act requires, in part, that a covered clearing agency, like DTC, establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency, including measuring,

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<sup>38</sup> 17 CFR 240.17Ad-22(e)(2)(i) and (v).

<sup>39</sup> Id.

monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity, by maintaining sufficient liquid resources to effect same-day settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios.<sup>40</sup>

As described above, the proposal would clarify that the Participants Fund and other resources may be applied by DTC to fund settlement in the event of a default or non-default gap. The proposed change is designed to help ensure that DTC is able to manage its settlement and funding flows on a timely basis and effect same day settlement of payment obligations in certain foreseeable stress scenarios.

Therefore, the Commission believes that the proposal is reasonably designed to help DTC effectively manage liquidity risk in a timely manner to complete settlement, and accordingly is consistent with Rule 17Ad-22(e)(7)(i).<sup>41</sup>

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<sup>40</sup> 17 CFR 240.17Ad-22(e)(7)(i).

<sup>41</sup> Id.

III. CONCLUSION

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act, that the Commission DOES NOT OBJECT to Advance Notice (SR-DTC-2020-801) and that DTC is AUTHORIZED to implement the proposed change as of the date of this notice or the date of an order by the Commission approving proposed rule change SR-DTC-2020-011, whichever is later.

By the Commission.

J. Matthew DeLesDernier,  
Assistant Secretary.