

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64605; File No. SR-DTC-2011-05)

June 6, 2011

Self-Regulatory Organizations; The Depository Trust Company; Order Granting Approval of a Proposed Rule Change to Amend Rules Relating to the Memo Segregation Function

I. Introduction

On April 15, 2011, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-DTC-2011-05 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on May 4, 2011.² The Commission received no comment letters. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

DTC’s Memo Segregation Service (“MSEG”) is an optional service which offers a mechanism for broker-dealer participants to protect fully-paid or excess margin securities by allowing the participant to shield from unintended delivery a designated quantity of securities that are in the participant’s DTC free account or that may be received during the daily processing cycle. Currently, a participant may set a “counter” for a specified minimum quantity of each security to be held in its account as a threshold to any intraday redelivery. When the counter for a security is greater than the inventory of the participant, MSEG will prevent the delivery of any quantity of the security out of the participant’s account unless: (1) the delivery is a permitted

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 64360 (April 28, 2011), 76 FR 25389 (May 4, 2011).

delivery (e.g., a free of value ACATS delivery or a “turnaround” as described below) or (2) the participant provides DTC with new instructions to reduce the MSEG counter.

The MSEG procedures currently support two optional “turnaround” MSEG indicators which enable participants to make deliveries for certain transaction types (including, but not limited to, stock loans and stock loan returns) from certain positions received intraday regardless of any MSEG-related deficit. Recently, DTC was advised by the Regulatory and Clearance Committee of the Securities Operations Section of SIFMA that several broker-dealer participants had expressed concern that their practices for turnaround of stock loans and stock loan returns (i.e., MSEG overrides) may be deemed by FINRA to be contrary to the Commission’s Rule 15c3-3 (“Customer Protection Rule”).³ DTC also communicated directly with participants affected through their use of this functionality, and they expressed similar concerns. In order to accommodate its participants in this regard, DTC is revising its procedures so that MSEG will no longer permit stock loan or stock loan return-related turnaround deliveries for a security when there is an MSEG deficit in the account.

In order to effect the rule change described above, DTC is amending its Settlement Service Guide (“Service Guide”), which is incorporated into DTC’s procedures, to make existing indicators that allow for the turnaround of stock loans and stock loan returns more restrictive. As a result, the procedures will no longer permit deliveries for stock loans, stock loan returns, The Options Clearing Corporation (“OCC”) stock loans, OCC stock loan returns, American

³ 17 CFR 204.15c3-3.

Depository Receipt (“ADR”) stock loans, and ADR stock loan returns to be completed from turnaround shares when an MSEG deficit exists.⁴

III. Discussion

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed 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.⁵ The Commission finds that DTC’s rule change, which should reduce the risk of unintended deliveries by broker-dealer participants of customer fully paid and excess margin securities in violation of the Customer Protection Rule, is consistent with this obligation under the Exchange Act because it should help DTC participants to better protect and have possession of customer fully-paid and excess margin securities that are held at DTC and in general, because it helps protect investors and the public interest.

Accordingly, for the reasons stated above the Commission believes that the proposed rule change is consistent with DTC’s obligation under Section 17A of the Exchange Act, as amended, and the rules and regulations thereunder.⁶

IV. Conclusion

⁴ The proposed change will also eliminate references in the Settlement Service Guide that MSEG-related functions are processed through the Participant Terminal System (PTS), as participants may currently use various platforms to communicate with DTC.

⁵ 15 U.S.C. 78q-1(b)(3)(F).

⁶ In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act, particularly with the requirements of Section 17A of the Act, and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-2011-05) be and hereby is approved.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.⁷

Cathy H. Ahn
Deputy Secretary

⁷ 17 CFR 200.30-3(a)(12).