

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67599; File No. SR-DTC-2012-03)

August 6, 2012

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Implement a Change in the Practices of The Depository Trust Company as They Relate to Post-payable Adjustments

I. Introduction

On April 25, 2012, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-DTC-2012-03 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ The proposed rule change was published for comment in the Federal Register on May 5, 2012.² The Commission received three comment letters on the proposal.³ On June 11, 2012, DTC requested an extension to the deadline for action on the proposed rule change by the Commission and August 6, 2012 was designated as the new date by which the Commission would be required to take action. On July 26, 2012, DTC filed Amendment No. 1 to the proposed rule change (“Amendment No. 1”). The Commission is publishing this notice and order to solicit comments on the proposed rule change, as modified by Amendment No. 1, and to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 34-66894 (May 1, 2012), 77 FR 26796 (May 5, 2012).

³ Letter from Dan W. Schneider, Counsel and Secretariat to The Association of Global Custodians, to Elizabeth M. Murray (sic), Secretary, Commission (May 29, 2012); letter from Cristeena G. Nasser, Senior Counsel, Center for Securities, Trust & Investments, American Bankers Association, to Elizabeth M. Murphy, Secretary, Commission (May 31, 2011); and letter from Stephen M. Renna, Chief Executive Officer, CRE Financial Council, to Elizabeth M. Murray (sic), Secretary, Commission (June 29, 2012).

II. Description of the Proposal

Historically, DTC has accommodated issuers and/or their agents (“Paying Agents”) by facilitating the collection and, in many cases, the reallocation of certain misapplied, misdirected, or miscalculated principal and income payments (“P&I”).⁴ Under today’s practices, these types of post-payable adjustments can occur up to one year after the initial payment is made. As more fully discussed below, DTC has proposed a change in practice, which will allocate assignment of accountability appropriately and mitigate risk associated with the reallocation of such P&I.

Background:

Several years ago, DTC formed a cross-industry working group to study the severity of P&I processing problems and to analyze possible solutions. The working group at that time focused mainly on the timeliness of rate information submitted to DTC by Paying Agents and recommended several changes to DTC’s Operational Arrangements. Those changes were approved by the Commission and implemented in 2008 (“2008 Changes”).⁵ Implementation of the 2008 Changes resulted in a 75% decrease in late submission of rate information and a significant increase in the allocation of P&I on payment date. More recently, the working group has suggested that, among other things, DTC create a time limit for processing post-payable adjustments received from Paying Agents.

Under current practice, DTC will process post-payable adjustments received from Paying Agents for up to one year after the initial payment is made. After DTC processes the debits and credits for the misapplied P&I, DTC participants must process trade adjustments against any

⁴ P&I include Principal Pass-Thru payments, Full Calls, Partial Calls, Maturities, Pre-Refundings and all interest and dividend payments.

⁵ Securities Exchange Act Release Numbers 34-57542 (March 20, 2008) 73 FR 16403 (March 27, 2008) (File No. SR-DTC-07-11).

customer who traded the security since the error occurred. Participants must also process adjustments to their customers' accounts for the misapplied principal and associated interest. DTC has been requested a number of times by the Association of Global Custodians ("AGC") to focus more closely on the risks associated with income adjustments and to look for ways to reduce that risk.⁶

The Proposed Changes:

In an effort to mitigate the risks associated with post-payable adjustments, DTC created the Post Payable Adjustment Task Force ("Task Force"). The Task Force is made up of Paying Agents and representative members of the AGC, the American Bankers Association, and the Corporate Actions division of the Securities Industry and Financial Markets Association. The Task Force has reviewed the current payments environment and proposed changes that will both reduce the volume of post-payable adjustments and the risks inherent in processing these adjustments in the future. The open participation by all segments of the industry has started to bring greater transparency to both challenges and pain points, which affect the entire industry. DTC recognizes that solutions will require some time to implement and for that reason is proposing the following staggered implementation plan, which has been approved by the Task Force:

1. Effective January 1, 2013:

⁶ In fact, AGC's recommendation was to adopt a new practice in which DTC would state that: (i) misapplied, misdirected, or miscalculated principal payments must be reversed within two business days after the initial payment; and (ii) misapplied, misdirected, or miscalculated interest payments and cash dividend payments must be reversed within seven business days after payment. However, at this time, DTC is establishing an interim policy, which will put it closer to such an end state.

- a. DTC will require that all new issues submitted to DTC for issue eligibility include details on the servicer and calculating agent.
 - b. DTC will require that all post-payable adjustment requests include the root cause adjustment code and information identifying issuance date, instrument, issuer, servicer, and calculating agent. DTC will not process any post-payable adjustments missing these key details.
2. Effective July 1, 2013, DTC will begin tracking and making publicly available reports on issuer performance as it relates to post-payable adjustments in the form of a report card.
 3. Effective January 1, 2014, DTC will no longer process post-payable adjustment requests through the settlement system beyond 180 calendar days after the initial payment date.
 4. Effective July 1, 2014, DTC will no longer process post-payable adjustment requests through the settlement system beyond 120 calendar days after the initial payment date.
 5. Effective January 1, 2015, DTC will no longer process post-payable adjustment requests through the settlement system beyond 90 calendar days after the initial payment date.⁷

Additionally, DTC has agreed to work with the industry to investigate the development and potential operation of an industry proposed adjustment claims repository (“Adjustment Claims Repository”). The Adjustment Claims Repository would address the collection and

⁷ These changes have been reviewed in detail with the Task Force and the Task Force has agreed to the proposed changes.

redistribution of misapplied and/or misdirected P&I between issuers and/or Paying Agents and the participants holding the affected securities beyond DTC's proposed post-payable adjustment cut-off periods. The proposed implementation dates set forth in this order for the timeframes within which DTC will process post-payable adjustments may be reevaluated if this process requires significant investment by DTC and the industry. DTC will revise those effective dates in a new proposed rule change filing, if so determined.

DTC will continue to service all court-directed adjustments (with appropriate supporting documentation), regardless of age. DTC will also continue to service other categories of adjustments, which are mutually agreed upon by Task Force members as "uncontrollable" post-payable adjustments, regardless of age.

Issuers and/or Paying Agents wishing to modify certain P&I beyond the time period that DTC will process the adjustments may do so by obtaining a "P&I Allocation Register" and making adjustments and payment arrangements directly with the affected DTC participants.

III. Comment Letters

The Commission received three comment letters opposing the proposed rule change.⁸ In response to the three comment letters, DTC worked with the AGC, the American Bankers Association, and the Commercial Real Estate Finance Council to draft Amendment 1 to the proposed rule change filing. The comment letters mention that the timeframe proposed for shortening the window for DTC to process post-payable adjustments is overly aggressive. DTC has worked with the Task Force to stagger the timeframe for implementation of changes in the processing of post-payable adjustments through the end of 2014. The comment letters also

⁸ Letters from Dan W. Schneider, Cristeena G. Nasser, and Stephen M. Renna, supra note 3.

suggested that DTC create an industry working group to review the various causes of adjustments and noted that the vast majority of adjustments are the result of actions outside the control of Paying Agents. In response, DTC created the Task Force, which has reviewed and will continue to review the reasons for post-payable adjustments to determine the root causes of such adjustments. Once the root causes of the adjustments are finally determined, the Task Force will meet to create workable solutions to reduce the number of adjustments, including working with the industry to look to restructure and simplify the legal documentation and post payable adjustments process and including an opinion of “materiality” as defined under Regulation AB. The comment letter from Dan W. Schneider also requested that an industry working group design a plan for DTC to administer an Adjustment Claims Repository. DTC has agreed to work with the industry to investigate the development and potential operation of the proposed Adjustment Claims Repository. The Adjustment Claims Repository would address the collection and redistribution of misapplied and/or misdirected income and principal payments between issuers and/or Paying Agents and the participants holding the affected securities beyond DTC’s proposed post-payable adjustment cut-off periods.

DTC will notify the Commission of any additional comments received by DTC.

IV. Discussion

After careful review of the proposed rule change, as modified by Amendment No. 1, and consideration of the comment letters and DTC’s response, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable, in particular Section 17A.⁹ Section 17A(b)(3)(F) of the Act¹⁰ requires,

⁹ 15 U.S.C. 78q-1.

¹⁰ 15 U.S.C. 78q-1(b)(3)(F).

among other things, that the rules of a clearing agency be designed to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions. The Commission finds that limiting the ambiguity surrounding payment finality will remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act¹¹ and the rules and regulations thereunder. IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹² that the proposed rule change (File No. SR-DTC-2012-03) be, and hereby is, approved.¹³

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Kevin M. O'Neill
Deputy Secretary

¹¹ 15 U.S.C. 78q-1.

¹² 15 U.S.C. 78s(b)(2).

¹³ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

¹⁴ 17 CFR 200.30-3(a)(12).