

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79088; File No. SR-DTC-2016-009)

October 12, 2016

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Clarify Certain Rules Provisions Relating to Pledges

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4,<sup>2</sup> notice is hereby given that on October 3, 2016, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by DTC. DTC filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(4) thereunder.<sup>4</sup> The proposed rule change was effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change consists of modifications to the DTC Rules, By-laws and Organization Certificate (“Rules”)<sup>5</sup> in order to clarify certain provisions relating to DTC’s Pledge services, as described in greater detail below.<sup>6</sup>

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(4).

<sup>5</sup> Available at  
[http://www.dtcc.com/~media/Files/Downloads/legal/rules/dtc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/dtc_rules.pdf).

<sup>6</sup> Capitalized terms not defined herein are defined in the Rules, supra note 5.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The clearing agency has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Delivery or Pledge of Securities at DTC

DTC holds Eligible Securities on behalf of its Participants and reflects the transfer of interests in those securities by computerized book entry. There are two fundamental types of book-entry transfer under the Rules: Delivery and Pledge. A Delivery or a Pledge may be made (i) free of payment, where no funds are transferred through DTC, or (ii) versus payment through DTC net funds settlement in the ordinary course of business. The clarifying amendments in the proposed rule change relate to Pledges.

A Participant may instruct DTC to Deliver Securities from its Account to the Account of another Participant, in which case ownership of the Securities is transferred to the Receiver. Alternatively, a Participant (in this context, a Pledgor) that is granting a security interest in the Securities may instruct DTC to Pledge those Securities to the Pledgee Account of its counterparty (the Pledgee), in which case a security interest may

be transferred.<sup>7</sup> The Pledgor continues to own the Securities, subject to the Pledge, and the Pledgee may Release the Pledged Securities to the Pledgor. The Rules further provide that the Pledgee may exercise control of the Pledged Securities by instructing DTC to transfer the Pledged Securities to its Participant Account (if it is a Participant) or to the Account of another Participant, in either case, without the further consent of the Pledgor.<sup>8</sup>

As noted above, the characterization of any Pledge depends on agreements between the Pledgor and the Pledgee made outside of DTC. DTC does not inquire into the terms and conditions of those agreements but affords its Participants the means to Pledge the Securities by book-entry and, thereby, to perfect any properly created security interest with Control.<sup>9</sup>

The Rules around Pledges were originally drafted primarily for bank loan transactions, where the Pledgee at DTC was typically a bank, lending to the counterparty Participant/Pledgor against inventory of the Participant held at DTC. If the Pledgee was also a Participant, it might receive the Pledge Versus Payment and fund the loan through

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<sup>7</sup> The interest transferred is, however, only a security interest if the Pledgor and Pledgee have an agreement outside of DTC that constitutes a security agreement under applicable law and as to which the other requirements for attachment and enforceability of a security interest have been satisfied. See, e.g., N.Y. U.C.C. Law § 9-203.

<sup>8</sup> By giving such an instruction to the Corporation, the Pledgee represents that it is acting in accordance with applicable law and agreements. Rule 9(B), Section 1, supra note 5. Typically, a Pledgee would take this step only in the event of a default of its Pledgor under the outside agreements governing the Pledge.

<sup>9</sup> See, e.g., N.Y. U.C.C. Law § 8-106 and § 9-106.

DTC net funds settlement. This is rare, however, and most Pledges are made free of payment, against funding outside of DTC.

However, the Rules were not intended to be limited to this scenario; for instance, the definition of Pledgee prior to this proposed rule change allows for Pledgees that are not only banks.<sup>10</sup> DTC also offers Pledge services for transactions that are not bank loans, to Pledgees that are not banks. For example, Participants writing an option to buy or sell securities on an options exchange may pledge securities to the Options Clearing Corporation (“OCC”)<sup>11</sup> to collateralize that option. For this purpose, Participants may pledge the underlying securities to the Pledgee Account of OCC at DTC.<sup>12</sup>

In recognition of the various types of financing or collateral transactions for which a Pledge may be used, this proposed rule change would delete specific references to banks or loans, clarify that other types of financial institutions may be Pledgees, and make conforming changes to selected provisions relating to these matters.<sup>13</sup>

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<sup>10</sup> Pursuant to Rule 1 and Rule 2, Section 3, supra note 5, a Pledgee may be a bank, trust company or other person approved by DTC that enters into an agreement with DTC that is satisfactory to DTC.

<sup>11</sup> OCC is the sole clearing organization for all securities options exchanges, also servicing certain futures markets in the U.S., and is registered as a clearing agency with the Commission and as a derivatives clearing organization with the Commodity Futures Trading Commission. See The Options Clearing Corporation Disclosure Framework for Financial Market Infrastructures (January 31, 2016) available at <http://www.optionsclearing.com/components/docs/risk-management/pfmi-disclosures.pdf>, at 6.

<sup>12</sup> See DTC Settlement Service Guide (“Guide”) available at <http://www.dtcc.com/~media/Files/Downloads/legal/service-guides/Settlement.pdf>, at 9.

<sup>13</sup> Note that a Pledgee may but need not be a Participant, if it satisfies the further conditions of the Rules, supra note 10. A Pledgee that is not a Participant may not receive a Pledge Versus Payment. Rule 2, Section 3, supra note 5.

### Proposed Rule Changes

The proposed rule change would modify Rule 1 (Definitions) and Rule 2 (Participants and Pledges) to clarify that the Rules do not require (i) an entity to be a bank or to have engaged in a loan transaction with a Participant in order to qualify as a Pledgee, nor do the Rules require (ii) that Securities underlying a Pledge need to be pledged in connection with a loan. In addition, the definition of Pledgee would be updated to expressly include broker-dealers. Although the definition already allows types of entities other than banks to be Pledgees, the change should eliminate any ambiguity for this group of financial institutions that are already a permitted type of Participant pursuant to Rule 3 (Participants Qualifications).

In addition, pursuant to the proposed rule change, the Rules would be revised for other technical and clarifying changes to:

- (i) Clarify in Rule 1 that the terms Collateral and Collateral Monitor are used in the context of the obligations of Participants and that the underlying computations and recording of Collateral and Collateral Monitor relate to the applicable Business Day on which they occur;
- (ii) Clarify in Rule 1 that the term Collateral Value is used with respect to the Collateral of a Participant and that computations of Collateral Value relate to the applicable Business Day on which they occur;
- (iii) Clarify in Rule 1 that an instruction from a Participant or Pledgee to the Corporation with respect to a Release of a Security credited

to a Securities Account constitutes an Entitlement Order (in addition to a Delivery, Pledge or Withdrawal constituting Entitlement Orders as is already stated therein);

- (iv) Delete a reference in the Rule 1 definition of Free Delivery that a Free Delivery is made as provided in Rule 9(A) (Transactions in Securities and Money Payments) because Free Deliveries by their nature do not involve money payments through DTC's system;
- (v) Clarify in the Rule 1 definition of Free Pledge that a Free Pledge is made as provided in Rule 9(B) (in addition to Section 3 of Rule 2 and as specified in the Procedures) since Rule 9(B) applies to instructions to DTC to effect a Delivery, Pledge, Release or Withdrawal of Securities;
- (vi) Specify in the Rule 1 definition of Free Release the section number (i.e., Section 3) of Rule 2 (in addition to Rule 9(B) and the Procedures as already referenced therein) under which the definition of Free Release is provided for rather than stating a general reference to Rule 2 in this regard;
- (vii) Clarify the definition of Lender in Rule 1 consistent with the Rules generally to include that other lenders in addition to banks may extend credit to DTC for purposes authorized by the Rules;
- (viii) Clarify clause (2) of the definition of Pledge in Rule 1 to eliminate any ambiguity as to the scope of clause (2) by adding the words "including for purposes of Rule 4(A)" and the words "or providing

for” a security interest, so that there can be no doubt that clause (2) also applies to Rule 4(A) of the DTC Rules and that a “Pledge” on the books of DTC is not limited to the creation of a security interest but may also provide for a security interest consistent with applicable law;

- (ix) Clarify the text of the definition of Pledged Security in Rule 1 to (a) simply state that the term Pledged Security means a Deposited Security which is the subject of a Pledge, rather than stating that the term means a Deposited Security which is the subject of a Free Pledge or Pledge Versus Payment, and (b) delete descriptive language relating to Pledges that is redundant to the meaning of the term Pledge as set forth in Rule 1;
- (x) Add language to the definition of Limited Participant in Rule 1 in order to eliminate a potential ambiguity and state that the term Limited Participant does not include a Pledgee;<sup>14</sup>
- (xi) Clarify in Section 2 of Rule 2 that a Pledgee (in addition to a Participant) that utilizes the services of DTC for another Person does so as principal so far as the rights of DTC, and other Participants and Pledgees are concerned;
- (xii) Clarify text in Section 3 of Rule 2 that a Pledge relates to Deposited Securities rather than Securities in general; and

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<sup>14</sup> Although a Pledgee must sign an agreement with DTC and is bound by the Rules, a Pledgee need not be a Participant (although a Participant may also be a Pledgee), supra note 13.

- (xiii) Conform text in Rule 1 and Rule 2 for readability, grammar and usage.

### Implementation

The proposed rule change would become effective upon filing with the Commission.

### 2. Statutory Basis

Section 17A(b)(3)(F)<sup>15</sup> of the Act requires that the rules of the clearing agency be designed, inter alia, to promote the prompt and accurate clearance and settlement of securities transactions. DTC believes the proposed rule change is consistent with this provision because the proposed rule change consists of technical changes to the texts of the Rules as described above that would provide enhanced clarity with respect to the Participants that may use, and transactions that may be submitted through, DTC Pledge services. Therefore, by clarifying for Participants the types of transactions they may submit for processing through DTC Pledge services, the proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions.

### (B) Clearing Agency's Statement on Burden on Competition

DTC does not believe that the proposed rule change would have any impact or impose any burden on competition because it merely makes technical and clarifying changes to the Rules that do not impact the rights or obligations of Participants.

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<sup>15</sup> 15 U.S.C. 78q-1(b)(3)(F).

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

DTC has not received or solicited any written comments relating to this proposal.

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

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)<sup>16</sup> of the Act and paragraph (f) of Rule 19b-4<sup>17</sup> thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. 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](mailto:rule-comments@sec.gov). Please include File Number SR-DTC-2016-009 on the subject line.

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<sup>16</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>17</sup> 17 CFR 240.19b-4(f).

Paper Comments:

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

All submissions should refer to File Number SR-DTC-2016-009. 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 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 DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer

to File Number SR-DTC-2016-009 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>18</sup>

Robert W. Errett  
Deputy Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).