

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82434; File No. SR-DTC-2017-024)

January 3, 2018

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing of Proposed Rule Change to Amend Procedures in the DTC Settlement Service Guide Relating to the Intra-Month Collection of Required Participants Fund Deposits

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 22, 2017, 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 the clearing agency. 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 of DTC is annexed hereto as Exhibit 5.³ The proposed rule change would amend the Procedures, set forth in the Settlement Guide, relating to the amount a Participant is required to Deposit to the Participants Fund to satisfy a deficiency in its Required Participants Fund Deposit (“Deficiency”),⁴ as a result of an

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Each capitalized term not otherwise defined herein has its respective meaning as set forth in the Rules, By-Laws and Organization Certificate of The Depository Trust Company (“Rules”), available at <http://www.dtcc.com/legal/rules-and-procedures.aspx> and the DTC Settlement Service Guide (“Settlement Guide”), available at <http://www.dtcc.com/~media/Files/Downloads/legal/service-guides/Settlement.pdf>.

⁴ The Required Participants Fund Deposit of a Participant is the amount the Participant is required to Deposit to the Participants Fund pursuant to Section 1 of

increase in its Required Participants Fund Deposit calculated on an intra-month basis, i.e., on a Business Day⁵ other than the last Business Day of a month, as described below. Specifically, the proposed rule change would codify in the Settlement Guide the practice currently followed by DTC, to determine the “Reference Amount” (as defined below) used by DTC, in conjunction with the existing methodology that determines whether a Participant must Deposit an additional amount to the Participants Fund to satisfy a Deficiency that occurs intra-month.⁶ In addition, the proposed rule change would codify a practice used by DTC relating to calculating a threshold amount, for any intra-month increase in the Required Participants Fund Deposit for a Participant that has been placed on the Watch List⁷ (“Watch List Threshold”), to determine whether the Participant must

Rule 4. Rule 4, Section 1, supra note 3. The Participants Fund, described more fully below, is provided for in Rule 4. Rule 4, supra note 3. Deposit, in this context, pursuant to Section 1 of Rule 1, means causing the appropriate amount in cash to be paid to DTC for credit to the Participants Fund pursuant to Section 1 of Rule 4. Rule 1, Section 1, supra note 3. The Settlement Guide, which is proposed to be amended hereby, sets forth Procedures for the calculation and payment of the Required Participants Fund Deposit. See Settlement Guide, supra note 3 at 47-50. Procedures, in this context, pursuant to Section 1 of Rule 1, means “the Procedures, service guides, and regulations of DTC adopted pursuant to Rule 27, as amended from time to time.” Rule 1, Section 1, supra note 3. The Settlement Guide constitutes Procedures of DTC, as defined in the Rules. See Settlement Guide, supra note 3 at 1.

⁵ The term “Business Day” means any day on which DTC is open for business. Rule 1, Section 1, supra note 3.

⁶ See Settlement Guide, supra note 3 at 50-51 (describing this methodology).

⁷ The term “Watch List” means, at any time and from time to time, the list of Participants whose credit ratings derived from the Credit Risk Rating Matrix are 5, 6 or 7, as well as Participants that, based on the Corporation’s consideration of relevant factors, including those set forth in Section 10 of Rule 2, are deemed by the Corporation to pose a heightened risk to the Corporation and its Participants. Rule 1, Section 1, supra note 3. Rule 1 states: “The term “Credit Risk Rating Matrix” means a matrix of credit ratings of Participants specified in Section 10(a)

Deposit an additional amount to the Participants Fund to satisfy a Deficiency that occurs intra-month. The proposed rule change would provide that the Watch List Threshold would be lower than the Standard Threshold (as defined below).⁸ The proposed rule change would also include technical and clarifying changes to the text of the Settlement Guide (a) for enhanced readability, (b) to make grammatical corrections, and (c) to add new section headings, as discussed below.

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

of Rule 2. The matrix is developed by the Corporation to evaluate the credit risk such Participants pose to the Corporation and its Participants and is based on factors determined to be relevant by the Corporation from time to time, which factors are designed to collectively reflect the financial and operational condition of a Participant. These factors include (i) quantitative factors, such as capital, assets, earnings, and liquidity, and (ii) qualitative factors, such as management quality, market position/environment, and capital and liquidity risk management.”
Id.

⁸ Pursuant to the Settlement Guide, if there is a significant increase to the Participant's Required Participants Fund Deposit as calculated on an intra-month Business Day, such that the increase meets a certain threshold amount (“Standard Threshold”), the Participant is required to Deposit the difference between its Actual Participants Fund Deposit and its Required Participants Fund Deposit. See Settlement Guide, supra note 3 at 50-51.

1. Purpose

The proposed rule change would amend the Procedures set forth in the Settlement Guide relating to the amount a Participant is required to Deposit⁹ to the Participants Fund to satisfy a Deficiency, due to an increase to its Required Participants Fund Deposit, as calculated on an intra-month basis, as described below.¹⁰ Specifically, the proposed rule change would codify the practices currently followed by DTC with respect to (i) determining the Reference Amount for a Participant (as described below) and (ii) the application of the Watch List Threshold, as described below. The proposed rule change would also include technical and clarifying changes to the text of the Settlement Guide (a) for enhanced readability, (b) to make grammatical corrections, and (c) to add new section headings, as discussed below.

Background

DTC maintains a cash Participants Fund in an aggregate amount based on maintaining liquidity resources sufficient to complete net settlement among non-defaulting Participants if a Participant, or Affiliated Family of Participants, with the largest net settlement obligation failed to settle.¹¹ The Settlement Guide describes the

⁹ Deposit, in this context, pursuant to Section 1 of Rule 1, means causing the appropriate amount in cash to be paid to DTC for credit to the Participants Fund pursuant to Section 1 of Rule 4. Rule 1, Section 1, supra note 3.

¹⁰ See Id.

¹¹ The DTC net settlement system and the Rules are structured so that the net settlement obligation of a Participant (its Net Debit Balance) is limited by its Net Debit Cap. See Settlement Guide, supra note 3 at 65. The maximum Net Debit Cap of any Participant is \$1.8 BN and the maximum Net Debit Cap for an Affiliated Family of Participants is \$2.85 BN. See Settlement Guide, supra note 3 at 65-66. These limits are determined based on liquidity resources available to

methodology for the calculation and procedures for payment of Required Participants Fund Deposits.¹² The aggregate Required Participants Fund Deposits must equal \$1.15 billion (BN); however, Participants may make Voluntary Participants Fund Deposits to support their activity.¹³ The minimum Required Participants Fund Deposit for each Participant is \$7,500.¹⁴ The Required Participants Fund Deposit for each Participant is calculated based on a 60 business-day rolling average (“60-day Rolling Average”) of the Participant’s highest intra-day Net Debit Balance peaks, to allocate ratably the first \$450 million (“MM”) of the aggregate Participants Fund.¹⁵ An additional algorithm proportionally allocates an additional \$700 MM among Participants whose Affiliated Family’s Net Debit Caps exceed \$2.15 BN.¹⁶ If a Participant defaults, its Actual Participants Fund Deposit (the Required Participants Fund Deposit plus its Voluntary Participants Fund Deposit) may be applied to satisfy any liability or loss due to its default, including liquidity to complete settlement.¹⁷

DTC in the cash Participants Fund or under a committed line of credit from a syndicate of commercial lenders for \$1.9 BN (“Line of Credit”). Id.

¹² Settlement Guide, supra note 3 at 47-50.

¹³ Rule 4, Section 3, supra note 3. The term “Voluntary Participants Fund Deposit” of a Participant means, any amount the Participant has Deposited to the Participants Fund in excess of its Required Participants Fund Deposit. Rule 1, Section 1, supra note 3.

¹⁴ Settlement Guide, supra note 3 at 47-50.

¹⁵ Id.

¹⁶ Id.

¹⁷ See Rule 4, supra note 3. See also Settlement Guide, supra note 3 at 47-50.

The Required Participants Fund Deposit of each Participant is calculated on a daily basis.¹⁸ As the calculation of the Required Participants Fund Deposit of a Participant takes into account the 60-day Rolling Average, however, the Required Participants Fund Deposit remains stable and does not undergo material change from day-to-day. Therefore, the Settlement Guide only requires collection of the full amount of any Deficiency on a monthly basis unless an increase to its Required Participants Fund Deposit as calculated intra-month exceeds the Standard Threshold.¹⁹ In this regard, a Participant must satisfy any Deficiency as calculated on the last Business Day of a month.

Pursuant to the Settlement Guide, if there is a significant increase to the Participant's Required Participants Fund Deposit as calculated on an intra-month Business Day, such that the increase meets the Standard Threshold, the Participant is required to Deposit the difference between its Actual Participants Fund Deposit and its Required Participants Fund Deposit.²⁰ The Standard Threshold is met when the difference between the Participant's Required Participants Fund Deposit and the Reference Amount (a) equals or exceeds \$500,000 and (b) represents a percentage increase of 25 percent or more over the Reference Amount.²¹

Proposed Rule Changes

¹⁸ Rule 4, Section 1, supra note 3.

¹⁹ See Settlement Guide, supra note 3 at 50-51.

²⁰ See Id.

²¹ See Id.

As mentioned above, the proposed rule change would amend the Procedures set forth in the Settlement Guide relating to the amount a Participant is required to Deposit to the Participants Fund to satisfy a Deficiency, due to an increase to its Required Participants Fund Deposit, as calculated on an intra-month basis.²² Specifically, as mentioned above, the proposed rule change would codify the practices currently followed by DTC with respect to (i) determining the Reference Amount for a Participant (as described below) and (ii) the application of the Watch List Threshold, as described below. The proposed rule change would also include technical and clarifying changes to the text of the Settlement Guide (a) for enhanced readability, (b) to make grammatical corrections, and (c) to add new section headings, as discussed below.

Proposed Clarification of Reference Amount

The Settlement Guide does not specify the Reference Amount used for the purpose of determining the Standard Threshold. In practice, DTC designates the Reference Amount for a Participant to be the Participant's Required Participants Fund Deposit relating to the most recent event that required the Participant to Deposit an additional amount to the Participants Fund. This would be the most recent occurrence, as it relates to the Participant, of (a) a month-end calculation, (b) an intra-month calculation that meets the Standard Threshold resulting in a collection of a Deficiency, or (c) an adjustment to the Participant's Required Participants Fund Deposit pursuant to Rule 9(A),²³ as described below. Pursuant to the proposed rule change, DTC would codify this practice, and would update it to take into account increases that a Participant would be

²² See Id.

²³ Rule 9(A), Section 2, supra note 3. See also Settlement Guide, supra note 1 at 50 (describing adjustments that may be made pursuant to Rule 9(A)).

required to Deposit because of an increase in its Required Participants Fund Deposit that meets the Watch List Threshold, as described below. In this regard, the proposed rule change would amend the Settlement Guide to state that the Reference Amount for the determination of the Standard Threshold and the Watch List Threshold for a Participant, on a given intra-month Business Day, would equal the Participant's Required Participants Fund Deposit as previously calculated on the latter of:

- (a) the last Business Day of the prior month;
- (b) the most recent intra-month Business Day (prior to the then current Business Day), when the amount resulting from daily calculation of the Participant's Required Participants Fund Deposit met or exceeded either the Standard Threshold or the Watch List Threshold and a deficit collection was effectuated pursuant to the intra-month collection procedures specified in the Settlement Guide; or
- (c) the most recent intra-month Business Day (prior to the then current Business Day) when DTC effected an adjustment to the Participant's Required Participants Fund Deposit pursuant to Rule 9(A).²⁴

Proposed Watch List Threshold

Pursuant to the Rules and Settlement Guide, DTC maintains the ability to seek additional assurances²⁵ and tools allowing it to conduct enhanced surveillance²⁶ of Participants that present heightened risk to DTC.

²⁴ Rule 9(A), Section 2, supra note 3.

²⁵ Infra note 30.

In this regard, DTC uses the Credit Risk Rating Matrix, the Watch List and the enhanced surveillance to manage and monitor default risks of Participants on an ongoing basis.²⁷ The level and frequency of such monitoring for a Participant is determined by the Participant's risk of default as assessed by DTC.²⁸ Participants that are deemed by DTC to pose a heightened risk to DTC and its Participants are subject to, among other things, closer and more frequent monitoring and enhanced reporting requirements.²⁹

In addition to the above, pursuant to Rule 9(A), if DTC becomes concerned with a Participant's operational or financial soundness, DTC may require adequate assurances of financial or operational capacity from the Participant, as a risk mitigant,³⁰ including requiring the Participant to Deposit an additional amount to the Participants Fund.³¹ Any

²⁶ Infra note 29.

²⁷ See Securities Exchange Act Release No. 80734 (May 19, 2017), 82 FR 24177 (May 25, 2017) (SR-DTC-2017-002)

²⁸ See Id.

²⁹ Rule 2, Section 10, supra note 3. Section 10 of Rule 2 states: "A Participant being subject to enhanced surveillance or being placed on the Watch List shall result in more thorough monitoring of the Participant's financial condition and/or operational capability, which could include, for example, on-site visits or additional due diligence information requests from the Corporation. In addition, the Corporation may require a Participant placed on the Watch List and/or subject to enhanced surveillance to make more frequent financial disclosures, including, without limitation, interim and/or pro forma reports. Participants that are subject to enhanced surveillance are also reported to the Corporation's management committees and regularly reviewed by a cross-functional team comprised of senior management of the Corporation. The Corporation may also take such additional actions with regard to any Participant (including a Participant placed on the Watch List and/or subject to enhanced surveillance) as are permitted by the Rules and Procedures." Id.

³⁰ Rule 9(A), Section 2, supra note 3.

³¹ Any such additional amount shall be part of the Required Participants Fund Deposit of the Participant. See Rule 4, Section 1(a), supra note 3.

additional requirements are designed to provide appropriate incentives to affected Participant(s) to address the underlying condition or activity.

In determining whether it is appropriate to require a Participant to Deposit an additional amount to the Participants Fund for a Participant, DTC takes into account credit, market, operational or other concerns regarding the Participant. Typically, the following factors may be considered, including: (i) the Participant's liquidity arrangements; (ii) the Participant's overall financial condition; (iii) published news or reports and/or regulatory observations relating to the Participant; and (iv) the Participant's internal credit rating, if any.³²

As a further mitigant of risks presented by Participants that present heightened risk to DTC, and in light of the fact that a Participant's internal credit rating is a contributing factor to both DTC's determination to add a Participant to the Watch List and/or make an adjustment with respect to the Participant's Required Participants Required Participants Fund Deposit, the proposed rule change would amend the Settlement Guide to add the Watch List Threshold.

As mentioned above, the proposed rule change relating to the Watch List Threshold would reflect criteria DTC currently uses in practice for Participants that have been placed on the Watch List, to determine whether a Participant that has been placed on the Watch List must Deposit additional amount to the Participants Fund to satisfy a Deficiency. The Watch List Threshold is lower than the Standard Threshold and, when met, would require the Participant to Deposit the full amount of any Deficiency. The proposed rule change would add text to the Settlement Guide stating that the Watch List

³² See Settlement Guide, supra note 3 at 50.

Threshold would apply to a Participant if its Required Participants Fund Deposit increases and the difference between the Required Participants Fund Deposit and the Reference Amount equals or is greater than 10 percent of the Reference Amount.

Technical and Clarifying Changes

The proposed rule change would also include technical and clarifying changes to the text of the “Settlement of Participants Fund Deposits” section of the Settlement Guide:

- (a) to revise and re-order existing text for enhanced readability and flow of content;
- (b) to add subheadings with respect to provisions relating to (i) settlement of Required Participants Fund Deposits calculated at the end of a month, (ii) collection of Required Participants Fund Deposits calculated on an intra-month basis, (iii) return of any amount by which a Participant’s Actual Participants Fund Deposit exceeds its Required Participants Fund Deposit;
- (c) to revise informal references to terms already defined in the Rules to use the actual defined terms, as applicable, including changing references from (i) “requirement” to “Required Participants Fund Deposit, (ii) referring informally to a Participant’s “deposit” to “Actual Participants Fund Deposit” and (iii) “business day” to “Business Day”; and
- (d) to make grammatical corrections.

Implementation Timeframe

The proposed rule change would be effective upon approval of the proposed rule change by the Commission.

2. Statutory Basis

Section 17A(b)(3)(F) of the Securities Exchange Act of 1934, as amended (“Act”)³³ requires, inter alia, that the Rules promote the prompt and accurate clearance and settlement of securities transactions. DTC believes that the proposed rule changes are consistent with this provision because they would (i) add provisions in the Settlement Guide that provide for, among other things, the criteria currently used by DTC to determine whether a Participant must increase the amount of its Actual Participants Fund Deposit on an intra-month basis, and (ii) include technical and clarifying changes to the text of the Settlement Guide (a) for enhanced readability, (b) to make grammatical corrections and (c) to add new section headings, as discussed above. In this regard, the proposed changes would enhance the transparency and clarity of the applicable provisions of the Settlement Guide, which would facilitate stakeholders’ ability to understand DTC’s criteria the determination of whether a Participant would be required to make an additional Deposit to the Participants Fund based on the intra-month calculation of its Required Participants Fund Deposit. As mentioned above, the Participants Fund provides DTC with the liquidity to complete end-of-day settlement notwithstanding the failure to settle of the Participant or Affiliated Family of Participants with the largest settlement obligation. Therefore, by providing stakeholders with enhanced transparency with regard to the criteria and related Procedures related to whether a Participant must Deposit additional amounts to satisfy a Deficiency, DTC believes that the proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions consistent with Section 17A(b)(3)(F) of the Act.

³³ 15 U.S.C. 78q-1(b)(3)(F).

The proposed rule change is also designed to be consistent with Rule 17Ad-22(e)(23)(ii) of the Act.³⁴ Rule 17Ad-22(e)(ii) requires DTC, inter alia, to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide sufficient information to enable participants to identify and evaluate the risks and material costs they incur by participating in the covered clearing agency.³⁵ As discussed above, the proposed rule change would (i) provide greater transparency in the Settlement Guide with respect to, the methodology used by DTC to determine whether a Participant must Deposit an additional amount to the Participants Fund based on an intra-month calculation of its Required Participants Fund Deposit and (ii) make other clarifying changes for readability and grammatical changes to the text of the Settlement Guide in this regard. By providing for greater transparency and clarity in this regard, DTC believes that the proposed rule change is consistent with Rule 17Ad-22(e)(23)(ii), cited above.

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

DTC does not believe that the proposed rule change to add provisions to the Settlement Guide relating to the Watch List Threshold, as discussed above, would impact competition.³⁶ The proposed rule change codifies a procedure that is consistent with the existing core concept relating to DTC's authority to impose an adjustment on a Required

³⁴ 17 CFR 240.17Ad-22(e)(23)(ii).

³⁵ DTC is a "covered clearing agency" as defined by new Rule 17Ad-22(a)(5) and must comply with subsection (e) of Rule 17Ad-22. See Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14).

³⁶ 15 U.S.C. 78q-1(b)(3)(I).

Participants Fund Deposit on a Participant because of its internal credit rating,³⁷ i.e., relating to Credit Risk Rating Matrix, which determines a Participant's placement on the Watch List, as described above. Based on the foregoing, DTC believes that the proposed rule change relating to addition of provisions to the Settlement Guide relating to the Watch List Threshold would not have any impact on competition.

DTC does not believe that the proposed rule change to codify in the Settlement Guide the criteria DTC currently uses to determine the Reference Amount would impact competition.³⁸ The proposed rule change consists of changes to the Settlement Guide that do not alter the methodology by which Required Participants Fund Deposits are calculated and collected. Based on the foregoing, DTC believes that the proposed rule change clarifying the criteria for determining the Reference Amount would not have any impact on competition.

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

Written comments relating to this proposed rule change have not been solicited or received. 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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds

³⁷ See Settlement Guide at 50 (stating that a Participant's internal credit rating is a factor DTC may take into consideration in determining whether to increase the Participant's Required Participants Fund Deposit, pursuant to Rule 9(A), cited above).

³⁸ Supra note 36.

such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self- regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change

should be disapproved.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

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. Please include File Number SR-DTC-2017-024 on the subject line.

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-2017-024. 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. 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-2017-024 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.³⁹

Eduardo A. Aleman
Assistant Secretary

³⁹ 17 CFR 200.30-3(a)(12).