

May 31, 2022

Self-Regulatory Organizations; The Depository Trust Company; Order Approving the Proposed Rule Change to Provide Settlement Services for Transactions Entered Into Under the Proposed Securities Financing Transaction Clearing Service of the National Securities Clearing Corporation

## **I. INTRODUCTION**

On March 28, 2022, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-DTC-2022-002 (“Proposed Rule Change”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> The Proposed Rule Change was published for comment in the Federal Register on April 18, 2022.<sup>3</sup> For the reasons discussed below, the Commission is approving the Proposed Rule Change.<sup>4</sup>

## **II. DESCRIPTION OF THE PROPOSED RULE CHANGE**

### **A. Background**

DTC serves as a central securities depository providing, in part, custodial services for equity securities, which include the safekeeping, record keeping, book-entry transfer,

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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> Securities Exchange Act Release No. 94692 (April 12, 2022), 87 Fed. Reg. 22971 (April 18, 2022) (SR-DTC-2022-002) (“Notice of Filing”).

<sup>4</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 (“Rules”), the DTC Settlement Service Guide (“Settlement Guide”), and the Guide to the 2020 DTC Fee Schedule (“Fee Guide”), available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>.

and pledge of securities among its Participants.<sup>5</sup> The National Securities Clearing Corporation (“NSCC”) provides clearing and settlement services for trades, including equity securities.<sup>6</sup> NSCC relies on an interface with DTC for the book-entry movement of securities to settle transactions.<sup>7</sup>

NSCC has proposed to introduce a new central clearing for securities financing transactions (“SFTs”).<sup>8</sup> In general, SFTs involve transactions where the parties exchange equity securities against cash and simultaneously agree to exchange the same securities and cash, plus or minus a daily interest (referred to as a rate payment), on a future date. Through its central clearing service, NSCC would novate SFT transactions entered into by its Members. The proposed SFTs between counterparties that are Members of NSCC would be settled through their respective Participant accounts at DTC.

In order to settle SFTs arising from NSCC’s proposed service, DTC proposes to

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<sup>5</sup> See The Depository Trust Company, Disclosure Framework for Covered Clearing Agencies and Financial Market Infrastructures at 7, 9-10 (December 2021) available at [https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/DTC\\_Disclosure\\_Framework.pdf](https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/DTC_Disclosure_Framework.pdf).

<sup>6</sup> See National Securities Clearing Corporation, Disclosure Framework for Covered Clearing Agencies and Financial Market Infrastructures at 7-10 (December 2021), available at [https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/NSCC\\_Disclosure\\_Framework.pdf](https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/NSCC_Disclosure_Framework.pdf).

<sup>7</sup> Id. at 10.

<sup>8</sup> Securities Exchange Act Release No. 94694 (April 12, 2022), 87 Fed. Reg. 23372 (April 19, 2022) (SR-NSCC-2022-003). NSCC also filed the proposal contained in the Proposed Rule Change as advance notice SR-NSCC-2022-801 with the Commission pursuant to Section 806(e)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010. 12 U.S.C. 5465(e)(1); 17 CFR 240.19b-4(n)(1)(i). Securities Exchange Act Release No. 94695 (April 12, 2022), 87 Fed. Reg. 23328 (April 19, 2022) (SR-NSCC-2022-801).

amend the Rules, the Settlement Guide, and the Fee Guide to (i) establish new definitions, instructions, and accounts, (ii) apply a modified look-ahead process to the new account that NSCC would maintain at DTC, (iii) establish a fee for a new transaction, and (iv) make conforming and technical changes.

**B. New Definitions, Instructions, and Accounts for the SFT Service**

DTC proposes to revise its Rules, Settlement Guide, and Fee Guide to add new definitions, instructions, and accounts to provide for the settlement of SFTs. Specifically, for SFT purposes, NSCC would act as the special representative for DTC Participants who are also NSCC Members and would have the authority to instruct DTC, on behalf of the Participant, to make a transfer of securities from the Participant's DTC account to an account that NSCC maintains at DTC.<sup>9</sup>

The proposal would revise the Settlement Guide to include a new section describing settlement of SFTs. To effectuate a DVP transaction between Participants, NSCC would send DTC a pair of DVP instructions: (i) one instruction, as the Special Representative of the securities lending Participant, to deliver the subject securities versus payment from the delivering Participant to the NSCC SFT Account, and (ii) one instruction, on NSCC's own behalf, to deliver the subject securities versus payment from the NSCC SFT Account to the Account of the securities borrowing Participant.<sup>10</sup>

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<sup>9</sup> The proposal would also establish a new special representative SFT account to be used in connection with SFT service.

<sup>10</sup> Under the proposal, it is possible that the securities lending Participant could submit its own DVP instruction to deliver the subject securities to the NSCC SFT account. NSCC would then have to make the corresponding instruction to deliver the securities to the securities borrowing participant, or the trade would be rejected.

Effectively, pursuant to the DVPs, the subject securities would move from the security lending Participant to NSCC, and then from NSCC to the security borrowing Participant.

When an SFT completes, NSCC would again submit a pair of DVP instructions: (i) one instruction as the special representative of the security borrowing Participant to deliver the subject securities to the special representative SFT account, and (ii) one instruction on NSCC's own behalf to deliver the subject securities from the special representative SFT. If the pair of instructions satisfy DTC risk management controls and the modified look-ahead process,<sup>11</sup> DTC would process the deliveries.

The proposal would also provide that DTC would process SFT price differential payment orders, which are payment orders for the crediting and debiting of payment amounts between Participants relating to SFT activity at NSCC. Specifically, NSCC would be able to submit a SFT price differential payment order (i) as the special representative of the payee Participant to credit the amount to the payee Participant account, and (ii) as the special representative of the payor Participant to debit the amount to the payor Participant account. The two instructions would effectively cause DTC to transfer the payment orders from one Participant to NSCC, and from NSCC to another Participant. If the pair of instructions satisfy DTC risk management controls and the modified look-ahead, DTC would process the payments.<sup>12</sup>

### **C. Modified Look-Ahead Processing**

DTC uses certain risk management controls, the Collateral Monitor and Net Debit Cap, to manage its credit risk. These two controls work together to protect the DTC

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<sup>11</sup> See Section II.C and text accompanying note 13 infra.

<sup>12</sup> See Section II.C and text accompanying note 13 infra.

settlement system in the event of a Participant default. The Collateral Monitor requires net debit settlement obligations, as they accrue intraday, to be fully collateralized; the Net Debit Cap limits the amount of any Participant's net debit settlement obligation to an amount that can be satisfied with DTC liquidity resources.<sup>13</sup> DTC uses a look-ahead processing to reduce transaction blockage by applying the net amount of offsetting receive and deliver transactions in the same security rather than the gross amount of the receive transaction to a Participant's Net Debit Cap. The look-ahead process calculates and processes submitted transactions in the same CUSIP that, when processed simultaneously, would not violate the risk management controls of the involved Participants.<sup>14</sup>

The special representative SFT account is designed to be a pass-through account for SFTs between Participants that are NSCC SFT counterparties, and accordingly, NSCC's obligations to DTC with respect to all SFTs to which the special representative SFT account was a party should be netted to zero.<sup>15</sup> DTC states that in an effort to help ensure that there would not be any net settlement obligation against the special representative SFT account, and to prevent transaction blockage due to risk management controls on the special representative SFT account, DTC proposes to use a modified look-

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<sup>13</sup> See Settlement Guide, supra note 4, at 64-67.

<sup>14</sup> Specifically, the look-ahead process identifies a receive transaction pending due to a net debit cap insufficiency and determines whether an offsetting delivery transaction pending because of a quantity deficiency in the same security would permit both transactions to be completed in compliance with DTC risk management controls. See Settlement Guide, supra note 4, at 45.

<sup>15</sup> See Notice of Filing, supra note 3, at 22973.

ahead process for the instructions it receives from NSCC in connection with the Special Representative SFT Account.<sup>16</sup>

Pursuant to the proposal, upon receipt of SFT-related instructions from NSCC, DTC would only complete a transaction when (i) the pair of instructions from NSCC are consistent in terms of the number of subject shares and/or dollar amount, CUSIP, and DTCC Reference ID,<sup>17</sup> and (ii) the net effect of processing the instructions would not violate the respective Net Debit Caps, Collateral Monitor or other risk management system controls of the Participants that are on each side of the SFTs.

In addition, because the modified look-ahead relies on the completion of offsetting transactions for a particular SFT and not a net amount like regular look-ahead processing, transactions to and from the NSCC SFT Account would not be subject to either reclaims or Receiver Authorized Delivery (“RAD”).<sup>18</sup> DTC represents that because both reclaims and RAD effectively permit one side of the transaction to reject or reverse the transaction, allowing such activity would interfere with the ability of the modified look-ahead to rely on the completion of the offsetting transactions.<sup>19</sup>

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<sup>16</sup> See id.

<sup>17</sup> The DTCC Reference ID is the fourteen-digit UTC Loan ID that NSCC assigns to each SFT transaction.

<sup>18</sup> A reclaim is the return of various orders and transactions received by a Participant. RAD is a control mechanism that allows a Participant to review transactions prior to completion of processing. See Settlement Guide, supra note 4, at 6.

<sup>19</sup> See Notice of Filing, supra note 3, at 22973.

**D. SFT Price Differential Fee**

DTC proposes to amend the Fee Guide to establish a fee for SFT price differential payment orders.<sup>20</sup> DTC proposes a fee of \$0.005 for an SFT price differential payment order, which would be charged to payors and payees per item delivered or received.

According to DTC, the fee is lower than the \$0.10 fee charged for an order for delivery or receipt in connection with uncleared stock loan transactions.<sup>21</sup> DTC states that the reason for a lower fee is because NSCC's SFT service would require a higher volume of payment orders compared to stock loan transactions processed bilaterally.<sup>22</sup> DTC believes that NSCC's SFT service would require a higher volume of payment orders because SFT Counterparties would pay and collect price differentials at the individual transaction level, while in a bilateral transaction, the counterparties would typically pay and collect at the CUSIP level, inclusive of all open stock loan transactions of a given counterparty.<sup>23</sup>

**E. Conforming and Technical Changes**

DTC proposes to make conforming changes to reflect the SFT activities, correct technical errors, add headings, and replace undefined terms with defined terms in order to

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<sup>20</sup> The proposal establishes a fee for SFT Price Differential payment orders because DTC does not currently process such payment orders. DTC would apply other currently existing fees that are relevant to SFTs pursuant to its Fee Guide. For example, for a DVP transaction in connection with an SFT, DTC would charge a stock loan and return fee of \$0.18 to payors and payees per item delivered and received.

<sup>21</sup> See Notice of Filing, supra note 3, at 22973.

<sup>22</sup> Id.

<sup>23</sup> See Notice of Filing, supra note 3, at 22973.

ensure consistency and clarity of the Rules and the Settlement Guide.

### **III. DISCUSSION AND COMMISSION FINDINGS**

Section 19(b)(2)(C) of the Act<sup>24</sup> directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. After careful consideration, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations applicable to DTC. In particular, the Commission finds that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) and 17A(b)(3)(D) of the Act<sup>25</sup> and Rules 17Ad-22(e)(21)<sup>26</sup> thereunder.

#### **A. Consistency with Section 17A(b)(3)(F) of the Act**

Section 17A(b)(3)(F) of the Act<sup>27</sup> requires, in part, that the rules of a clearing agency, such as DTC, be designed to promote the prompt and accurate clearance and settlement of securities transactions and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.

As described above in Section II.A., DTC proposes to revise its Rules, Settlement Guide, and Fee Guide to be able to provide Participants with settlement services for SFTs cleared through the proposed NSCC service. As stated in Section II.B., the proposal would provide new definitions, instructions, and accounts to effectuate SFTs, and provide

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<sup>24</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>25</sup> 15 U.S.C. 78q-1(b)(3)(F) and (3)(D).

<sup>26</sup> 17 CFR 240.17Ad-22(e)(21).

<sup>27</sup> 15 U.S.C. 78q-1(b)(3)(F).

a basis for DTC to accept and rely on NSCC's instructions in connections with the proposed SFT service. Specifically, DTC would amend its Rules to provide for the additional authority of NSCC, as the special representative of a Participant, to submit DVP instructions and SFT price differential payment orders to DTC, on behalf of Participants. By providing NSCC with the authority to submit these instructions on behalf of the Participants, the Proposed Rule Change supports the efficient settlement of cleared SFTs, thereby promoting the prompt and accurate clearance and settlement of securities transactions.

Furthermore, as described in Section II.C., the Proposed Rule Change would apply a modified look-ahead process to the new special representative SFT account in order to (i) ensure that there would not be any net settlement obligation against the special representative SFT account, and (ii) prevent transaction blockage that could occur from unsatisfied risk management controls on the special representative SFT account. By applying a modified look-ahead, the Commission believes that the proposal is designed to promote efficient processing of SFTs, thereby promoting the prompt and accurate clearance and settlement of securities transactions.

Lastly, as described in Section II.E., DTC proposes to make conforming and technical changes. The Commission believes that the changes would help ensure that the Rules and the Settlement Guide remain consistent, clear, and accurate. Having consistent, clear, and accurate Rules and Settlement Guide would help Participants to better understand their rights and obligations regarding DTC settlement services in connection with the NSCC SFT service. The Commission believes that better enabling Participants to understand and thus comply with the Rules and the Settlement Guide

would promote the prompt and accurate clearance and settlement of securities transactions.

The Commission further believes that the Proposed Rule Change is reasonably designed to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions. As described above in Section II.A., DTC proposes to amend its Rules, Settlement Guide, and Fee Guide to be able to process SFTs arising from NSCC's proposed SFT service. Although NSCC provides clearing and settlement services for transactions, it relies on an interface with DTC for the book-entry movement of securities to settle transactions. Without DTC's actions, NSCC would not be able to settle SFTs at DTC. Accordingly, the Commission believes that establishing new definitions, instructions, and accounts to effectuate SFTs, modifying look-ahead processing, and making conforming and technical changes would foster cooperation and coordination between NSCC and DTC.

For the reasons stated above, the Commission believes that the Proposed Rule Change is reasonably designed to promote the prompt and accurate clearance and settlement of securities transactions, and foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions. The Commission believes, therefore, that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act.<sup>28</sup>

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<sup>28</sup> Id.

**B. Consistency with Section 17A(b)(3)(D) of the Act**

Section 17A(b)(3)(D) of the Act requires that the rules of a clearing agency provide for the equitable allocation of reasonable dues, fees, and other charges among its participants.<sup>29</sup>

As described above in Section II.D., DTC would establish a fee of \$0.005 per item delivered or received, which would be charged to the payor and the payee of an SFT price differential payment order. The Commission believes that the proposed fee for SFT price differential payment orders would provide for the equitable allocation of reasonable dues, fees, and other charges among Participants. First, the proposed fee of \$0.005 is less than the \$0.10 fee for payment order applicable for uncleared bilateral stock loan transactions.<sup>30</sup> Second, the Commission understands that due to the lack of history for cleared SFT activity,<sup>31</sup> DTC cannot estimate at this time the average number of SFT Price Differential payment orders that would be processed and cannot, therefore, quantify a precise fee.<sup>32</sup> Accordingly, the Commission believes that the proposed fee, which is designed to take into account the imbalance between the amount of payment orders that would be required for cleared SFTs and the amount required for uncleared bilateral stock loan transactions, is reasonable. The Commission also believes that the proposed fee

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<sup>29</sup> 15 U.S.C. 78q-1(b)(3)(D).

<sup>30</sup> See Notice of Filing, supra note 3, at 22973.

<sup>31</sup> NSCC would be offering central clearing for overnight SFTs for the first time, and accordingly, NSCC would not be able to anticipate the size and composition of the SFT activities. See Securities Exchange Act Release No. 94694 (April 12, 2022), 87 Fed. Reg. 23372, 22375 (April 19, 2022) (SR-NSCC-2022-003).

<sup>32</sup> See Notice of Filing, supra note 3, at 22973.

would be equitably allocated because the fee would be charged to payors and payees per item delivered or received in accordance with their use of SFT price differential payment orders and all such payors and payees would be treated equally with respect to the fee.

Therefore, the Commission believes that the Proposed Rule Change establishing a fee for the delivery and receipt of an SFT price differential payment order is designed to provide for the equitable allocation of reasonable dues, fees, and other charges among participants, consistent with Section 17A(b)(3)(D) of the Act.<sup>33</sup>

**C. Consistency with Rule 17Ad-22(e)(21)**

Rule 17Ad-22(e)(21) promulgated under the Act requires, in part, a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to be efficient and effective in meeting the requirements of its participants and the markets it serves, including the clearing agency's clearing and settlement arrangements and the scope of products cleared or settled.<sup>34</sup>

As described above in Section II.A., DTC proposes to revise its Rules, Settlement Guide, and Fee Guide to be able to process SFTs arising from NSCC's proposed SFT service. By doing so, DTC would assist NSCC to efficiently and effectively execute its new service, which is to clear and settle a new product. Also, as stated in Section II.B., the proposal would (i) provide a basis for DTC to accept and rely on the instructions from NSCC as special representative of DTC's Participants for SFTs, and (ii) establish a new type of instructions for SFT price differential payment orders. As stated in Section II.C., the proposal would revise the look-ahead processing to accommodate SFTs and ensure

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<sup>33</sup> 15 U.S.C. 78q-1(b)(3)(D).

<sup>34</sup> 17 CFR 240.17Ad-22(e)(21).

that SFTs would be processed timely and efficiently. As stated in Section II.D., the proposal would also revise DTC's fee guide to clearly establish a fee for SFT price differential payment orders, which are new transactions for DTC. Without such changes, NSCC would not be able to clear and settle SFTs at DTC.

For the reasons stated above, the Commission believes that the Proposed Rule Change is reasonably designed to be efficient and effective in meeting the requirements of its participants and the market it serves, and consistent with Rule 17Ad-22(e)(21).<sup>35</sup>

#### **IV. CONCLUSION**

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>36</sup> and the rules and regulations promulgated thereunder.

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<sup>35</sup> Id.

<sup>36</sup> 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act<sup>37</sup> that Proposed Rule Change SR-DTC-2022-002, be, and hereby is, APPROVED.<sup>38</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>39</sup>

J. Matthew DeLesDernier,  
Assistant Secretary.

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<sup>37</sup> 15 U.S.C. 78s(b)(2).

<sup>38</sup> In approving the Proposed Rule Change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>39</sup> 17 CFR 200.30-3(a)(12).