

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Kevin M. O'Neill,

Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-65871; File No. SR-DTC-2011-09]

### Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing of Proposed Rule Change To Modify a Practice in Order To Mitigate Systemic Risk, Specifically Liquidity Related, Associated With DTC End of Day Net Funds Settlement

December 2, 2011.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder notice is hereby given that on November 21, 2011, 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 primarily by DTC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

As more fully set forth below, the proposed change DTC is proposing to temporarily reduce each Participant's maximum net debit cap for night cycle processing of valued transactions over weekends and holidays and to restore such debit cap at the start of day cycle processing for the next settlement date (*i.e.*, the first business day following the weekend or holiday).

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Corporation 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 Corporation has prepared summaries,

set forth in sections A, B, and C below, of the most significant aspects of such statements.

#### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(i) Under the proposed change, DTC would temporarily reduce each Participant's maximum net debit cap for night cycle processing<sup>3</sup> of valued transactions over weekends and holidays and would restore such debit cap at the start of day cycle processing for the next settlement date (*i.e.*, the first business day following the weekend or holiday). In doing so, DTC believes it would reduce the systemic risk associated with a liquidity shortfall and would enhance the safety and soundness of the U.S. settlement system.

#### Background on DTC Settlement and the Net Debit Cap Control

DTC's Settlement System is structured so that Participants may make intraday book-entry deliveries versus payment of securities held in their DTC accounts. These transfers generate debits to the settlement account of each receiving Participant and credits to the settlement account of each delivering Participant. As debits and credits of multiple transactions net over the course of the business day a Participant will have either a net debit balance or net credit balance from time to time and at settlement will be in either a net debit or net credit balance position. Participants having a net debit balance for settlement owe payments of the amount of the net debit to DTC. In order that DTC has the resources to achieve end-of-day settlement among non-defaulting Participants, DTC maintains liquidity resources sufficient to complete settlement, notwithstanding the failure of its largest Participant to pay, by covering the net debit balance of a defaulting Participant. The key risk management control in this process is the net debit cap, which limits the net debit balance of a Participant, intraday and at settlement, to available liquidity resources. (The net debit balance must also be collateralized by sufficient collateral measured by the collateral monitor risk control.) DTC assigns a net debit cap to each Participant based on

<sup>3</sup> DTC processes settlement in two cycles per business day: (i) A night cycle that begins at approximately 9 p.m. and finishes at approximately 11:30 p.m. and (ii) a day cycle that begins at approximately 3 a.m. and completes at 3:30 p.m. For Monday settlement, the night cycle begins on the preceding Friday evening at 9 p.m. and ends at 11:30 p.m. that night; the day cycle does not begin until 3 a.m. on Monday.

the Participant's activity and currently limits the maximum net debit cap for a Participant to \$1.8 billion and for a family of related Participants to \$3 billion aggregate.<sup>4</sup> This settlement structure is designed to support the efficient recycling of intraday liquidity to facilitate the settlement of transactions while limiting systemic risk due to Participant failure.

With Friday night cycle processing over weekends and holidays, however, Participants may accrue net debit balances for end-of-day settlement on the next business day, which is two to three calendar days away from the actual settlement. DTC has recognized that during such extended processing, external credit events may occur, including, in particular, the possibility of a weekend insolvency.

#### Change in Night Cycle Processing

To address the liquidity risk<sup>5</sup> over the extended periods for weekends and holidays, DTC is proposing to reduce the maximum net debit cap temporarily over the extended period for any Participant or any family of related Participants to \$1.5 billion at the open of night cycle processing on any DTC business day for which the succeeding calendar day is not a business day. DTC would then restore the net debit cap of any affected Participant to its full net debit cap at the open of day cycle processing for the next business day in the ordinary course of business.<sup>6</sup>

#### Risk Reduction and Anticipated Minimal Settlement System and Participant Impact

The purpose of this proposed change in processing practice is to minimize systemic risk to U.S. markets and to DTC Participants as well as to minimize direct liquidity risk to DTC by the

<sup>4</sup> These net debit caps are supported by \$3.2 billion of liquidity resources at DTC in the form of a \$1.3 billion all-cash Participants Fund and a \$1.9 billion committed line of credit available for settlement in the event that a Participant fails to pay its net debit balance at settlement.

<sup>5</sup> "Liquidity risk" refers to the financial risk associated with access to liquidity to cover the failure of a Participant to fund its net settlement obligation to DTC.

<sup>6</sup> Today, DTC may reduce a Participant's net debit cap (*see, e.g.*, DTC Rule 1, definition of Net Debit Cap which permits DTC to set the Net Debit Cap of a Participant at "any other amount determined by [DTC], in its sole discretion."). Accordingly, after a temporary weekend or holiday reduction as proposed herein, DTC may elect not to restore the net debit cap of any affected Participant. By way of example only, and in line with the purpose of this proposed change in practice, DTC would not expect to restore the net debit cap of a Participant that had become insolvent in the intervening non-business days or as to which DTC is concerned with its credit status. (DTC would take the same approach to holidays, that is, whenever two business days are not successive.)

<sup>13</sup> 17 CFR 200.30-3(a)(12).

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

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

management of net debit balances over extended processing periods such as weekends and holidays.

The highest net debit caps at DTC are established primarily to support the settlement of Money Market Instrument (“MMI”) transactions. MMI transactions are high value, same day settling transactions that are processed principally in the afternoon on any settlement day. Because these transactions are processed during the day cycle only, they should not be affected by the proposed modification to processing in the night-cycle for weekends and holidays.

In order to determine the potential effects of lowering the net debit caps for certain night cycle processing as proposed in this rule filing, DTC conducted a simulation study in which the maximum net debit cap for a Participant and for a Participant family was set at \$1.5 billion. The study found that net debit cap related blockage increased by only 1.13% on average, representing a gross value of approximately \$913 million out of approximately \$70 billion processed in each night cycle for settlement on the next business day. For Participants that might encounter transaction blockage, this blockage could be further minimized at their discretion by improving their processing systems by instructing deliveries versus payment that would generate credits to offset debits. With the proposed revised practice, at the time net debit caps are restored for same-day settlement, any transactions that pending due to the lower net debit cap would be reprocessed and would be completed at the start of the day cycle, assuming no other changes.<sup>7</sup> DTC recognizes that this change in practice may affect transaction management for certain Participants and has taken the initiative to discuss the proposal with all of those Participants and has received no objections. Certain Participants indicated that they would consider changes that could lessen the impact by implementing their own night cycle process improvements.

Accordingly, DTC submits that the proposed rule change would mitigate systemic risk due to any potential shortfall in liquidity associated with net settlement failure with only minimal Participant and processing impact.

<sup>7</sup> The Participants with increased blockage in the simulation often have large net debits in the night cycle because they do not send in Night Deliver Orders (“NDOs”) or they exempt or withhold from night cycle processing many or all of their Institutional Deliveries that would otherwise create credits.

(ii) The proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to DTC as well as with the CPSS/IOSCO Recommendations for Securities Settlement Systems applicable to DTC in that it supports efficient, timely, and final net funds settlement. The proposed change is designed to facilitate the prompt and accurate clearance and settlement of securities transactions by promoting efficiencies and enhancing the risk management controls associated with the funds settlement of securities transactions.

#### *B. Self-Regulatory Organization’s Statement on Burden on Competition*

DTC does not believe that the proposed rule change will have any impact or impose any burden on competition.

#### *C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

Written comments relating to the proposed rule change have not yet 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 (i) As the Commission may designate up to 90 days of such date if it finds 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 shall: (a) By order approve or disapprove such proposed rule change or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

### **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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR–DTC–2011–09 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–DTC–2011–09. This file number should be included on the subject line if email 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 Web site (<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 Web site 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 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at DTC’s principal office and on DTC’s Web site at <http://www.dtc.org>. 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–2011–09 and should be submitted on or before December 29, 2011.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>8</sup>

**Kevin M. O’Neill,**

*Deputy Secretary.*

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<sup>8</sup> 17 CFR 200.30–3(a)(12).