

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-81990; File No. SR-DTC-2017-020)

October 31, 2017

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Establish a Special Segregation Account for a Participant or Pledgee that is a Derivatives Clearing Organization or Futures Commission Merchant

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> notice is hereby given that on October 20, 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 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)(6) thereunder.<sup>4</sup> 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 proposal would add new Rule 37 (Segregated Accounts for Customer Property) to provide that a Participant<sup>5</sup> or Pledgee may establish a specifically designated

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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)(6).

<sup>5</sup> 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 (the “Rules”), available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>.

Account to which Eligible Securities may be credited that the Participant or Pledgee wishes to segregate as the property of its customers that trade commodities, options, swaps, and other products (“Customer Property”) subject to the Customer Property Segregation Rules.<sup>6</sup> Based on this segregation structure and the representations and warranties made by the Participant or Pledgee under the proposed Rule, DTC would, upon the request of the Participant or Pledgee, provide an acknowledgment of the segregation of such Customer Property,<sup>7</sup> as further described below.

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

In its filing with the Commission, DTC 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. DTC 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

The proposal would add new Rule 37 (Segregated Accounts for Customer

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<sup>6</sup> “Customer Property Segregation Rules” means the rules and regulations of the Commodity Futures Trading Commission (“CFTC”), relating to the deposit of customer property (including money, securities and other property) held by derivatives clearing organizations (“DCOs”) or futures commission merchants (“FCMs”) for customers that trade commodities, options, swaps and other products. 7 U.S.C. 6d; 17 CFR 1.20-1.30, 22, 30. Under the proposed rule change, only Deposited Securities credited to an appropriately designated Account may constitute “Customer Property” for purposes of such Customer Property Segregation Rules; DTC does not, and will not under the proposed rule change, segregate money.

<sup>7</sup> See 7 U.S.C. 6d(a)(2); 7 U.S.C. 6d(f); 17 CFR 1.20(d); 1.20(g); 1.26; 22.5; 30.7.

Property) to provide that a Participant or Pledgee may establish a specifically designated Account to which Eligible Securities may be credited that the Participant or Pledgee wishes to segregate as Customer Property subject to the Customer Property Segregation Rules. Based on this segregation structure and the representations and warranties made by the Participant or Pledgee under the proposed Rule, DTC would, upon the request of the Participant or Pledgee, provide an acknowledgment of the segregation of such Customer Property, as further described below.

A. Background

a. DTC Omnibus Account Structure

DTC maintains omnibus Accounts for its Participants and Pledgees.<sup>8</sup> That is, it

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<sup>8</sup> DTC holds Eligible Securities collectively on behalf of Participants and reflects the transfer of interests in those Eligible Securities among Participants by computerized book-entry. Eligible Securities Deposited with DTC for book-entry transfer services are registered in the name of its nominee, Cede & Co. (“Cede”), a New York partnership. When the Eligible Securities are registered in the name of Cede, DTC acquires legal title to the Eligible Securities and, when DTC credits interests in these Eligible Securities to the Securities Accounts of Participants, those Participants acquire a beneficial interest in the Eligible Securities and a Security Entitlement with respect to those Eligible Securities is credited to their Accounts. A Security Entitlement is both a package of personal rights against the securities intermediary [in this case, DTC] and an interest in the property held by the securities intermediary. NYUCC § 8-102(14)(i); NYUCC § 8-102(17) and OFF. CMT. 17. A security entitlement is not, however, a specific property interest in any [security] held by the securities intermediary or by the clearing corporation through which the securities intermediary holds the [security]. NYUCC § 8-102(17) and OFF. CMT. 17. Thus, a Participant does not have a right to any particular security; each Participant has a proportionate interest in the fungible total inventory of the issue held by DTC.

Participants, in many cases, are themselves securities intermediaries, maintaining securities accounts for the benefit of their customers, crediting a portion of the amount of any issue of a Security held in their Account(s) to one or more customers, as securities entitlements of their customers against them. That is, their customers are entitlement holders, holding the rights and property interest represented by the amount of the security credited to their account(s) vis a vis the Participant. Some customers of a Participant may also be securities

does not distinguish among Accounts that Participants or Pledges may use for activities that are proprietary or conducted by the Participant or Pledgee for the benefit of customer(s). The Rules expressly provide that “[a] Participant or Pledgee which utilizes the services of [DTC] for another Person shall, so far as the rights of [DTC], and other Participants and Pledges are concerned, be liable as principal.”<sup>9</sup>

The Rules provide for Segregated Accounts that Participants have typically used to separate Securities held for their customers. The characteristics of a Segregated Account are, chiefly, that DTC has no lien on or claim to the Securities credited thereto to secure any obligation of the Participant to DTC.<sup>10</sup> Participants therefore use Segregated

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intermediaries, holding on behalf of, and maintaining securities accounts for, their own customers, and so forth. DTC does not know whether a Participant is holding interest in the Securities for itself or on behalf of its customers, as their securities intermediary.

This tiered system of intermediaries holding interests in securities for their respective customers is generally described as the “indirect holding system.” Id. Any entitlement holder may only assert its rights to a security entitlement against its own securities intermediary; Participants and Pledges are in contractual privity with DTC; their customers are not and do not have any claim against DTC to the security entitlement of the Participant. Such customers of a Participant would have securities entitlements against the Participant that is acting on their behalf as their “securities intermediary.” Such customers only have rights against the Participant, and not against the Participant’s securities intermediary; i.e., DTC. See NYUCC § 8-503 OFF. CMT. 2. (“The entitlement holder cannot assert rights directly against other persons, such as other intermediaries [DTC] through whom the intermediary [the Participants] holds the positions . . .”). Moreover, DTC does not owe any duties to such customers. See NYUCC §8-115 OFF. CMT. 4. (“[T]his section embodies one of the fundamental principles of the Article 8 indirect holding system rules – that a securities intermediary [DTC] owes duties only to its own entitlement holders [its Participants]”).

<sup>9</sup> Rule 2, Section 2, supra note 5.

<sup>10</sup> Rule 1, Section 1, supra note 5.

Accounts to separately identify customer property.<sup>11</sup>

The Rules also provide that Securities Pledged to a Pledgee (when credited to the Account of the Pledgee in a Free Pledge or, in a Pledge Versus Payment), are held free of any lien or other interest of DTC.<sup>12</sup> Thus, the Pledge mechanism is a tool that may be used by a Pledgee to segregate Securities at DTC.

If a Participant or Pledgee holds Segregated or Pledged Securities on behalf of customers, that would be reflected in the accounts maintained by the Participant or Pledgee for its customers. DTC has no knowledge of whether Securities credited in that manner are held by the Participant or Pledgee for customers. It is the sole responsibility of the Participant or Pledgee to maintain appropriate records on its own books to identify customer Securities separately.

b. Customer Property Segregation Rules of the CFTC

Because DTC is agnostic as to whether, when and how any Participant or Pledgee may be utilizing its Account for the benefit of customers, DTC cannot independently verify that any particular Securities are “customer securities” vis-à-vis the Participant or Pledgee. However, FCMs and DCOs have statutory requirements for the separate identification of Customer Property pursuant to the Customer Property Segregation

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<sup>11</sup> Participants that are registered broker-dealers use Segregation Accounts as a tool to maintain compliance with their obligations under Rule 15c3-3 of the Act (“Customer Protection Rule”). 17 CFR 240.15c3-3. The Customer Protection Rule requires, among other things, that broker-dealers maintain control of all fully-paid or excess margin Securities they hold for the accounts of customers. Compliance with those obligations by such broker-dealers is external to DTC. See Rule 2, supra note 5.

<sup>12</sup> Rule 4(A), supra note 5.

Rules.<sup>13</sup> To accommodate this need of certain Participants or Pledges that are FCMs or DCOs, DTC proposes this rule change, pursuant to which DTC would provide acknowledgment of Customer Property credited to the specified Accounts, in reliance on the representations of the Participant or Pledgee provided in the proposed Rule.<sup>14</sup>

The Customer Property Segregation Rules require that each FCM and DCO separately account for, and segregate from its own proprietary funds, all money, securities, or other property deposited by futures customers<sup>15</sup> for trading on designated contract markets.<sup>16</sup> The Customer Property Segregation Rules also provide that an FCM or DCO may only deposit futures customer property with a bank or trust company, and, additionally, an FCM may deposit with a DCO or another FCM (each, a “depository”).<sup>17</sup> FCMs and DCOs are required to obtain a written acknowledgment from the depository in which the depository acknowledges and agrees to requirements and conditions set forth below (“Acknowledgment Letter”).<sup>18</sup> The Customer Property Segregation Rules

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<sup>13</sup> See supra note 6.

<sup>14</sup> DTC is proposing this rule change to provide Participants and Pledges that may be FCMs or DCOs a mechanism to comply with their obligations under the Customer Property Segregation Rules.

<sup>15</sup> “Futures Customer” means, with certain exceptions outlined in 17 CFR 1.3(iiii), any person who uses a futures commission merchant, introducing broker, commodity trading advisor, or commodity pool operator as an agent in connection with trading in any contract for the purchase or sale of a commodity for future delivery or any option on such contract. See 17 CFR 1.3(iiii).

<sup>16</sup> See 17 CFR 1.20.

<sup>17</sup> 17 CFR 1.20(d); 1.20(g); 1.26; 22.5; 30.7. An FCM may also deposit customer property at a DCO or another FCM.

<sup>18</sup> 17 CFR 1.20, 1.26, 30.7. Although the Acknowledgment Letter requirement may relate to DTC, it is the sole obligation of the FCM or DCO. DTC is not subject to

prescribe the precise form of Acknowledgment Letter that is required for each the entity type (FCM and DCO) and the type of Customer Property.<sup>19</sup>

c. CFTC Required Acknowledgment Letter

Each Acknowledgment Letter must be executed in the form specified in the Customer Property Segregation Rules with no additions, deletions or modifications permitted.<sup>20</sup> In the Acknowledgement Letter, the depository is required to acknowledge and agree, among other things:

(1) that the FCM/DCO has opened or will open the subject account for the purpose of depositing, Customer Property, as required by Customer Property Segregation Rules, including Regulation 1.20, as amended;

(2) that the Customer Property held by the depository after being deposited into the subject account will be separately accounted for and segregated on the depository's books from the FCM/DCO's own funds and from any other funds or accounts held by the FCM/DCO in accordance with the Customer Property Segregation Rules;

(3) that such Customer Property may not be used by the depository or by the FCM/DCO to secure or guarantee any obligations that the FCM/DCO might owe the depository, and they may not be used by FCM/DCO to secure or obtain credit from the

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the Customer Property Segregation Rules, including without limitation, with respect to the Acknowledgement Letter.

<sup>19</sup> The Acknowledgment Letter requirements are set forth in 17 CFR 1.20(d) and 1.26 (with respect to futures customer funds), 22.5 (with respect to cleared swaps customer collateral) and 30.7(d) (with respect to 30.7 customer funds-applicable to FCMs only). See Appendices A and B to 17 CFR 1.20; Appendix A to 17 CFR 1.26; Appendix E to 17 CFR 30.

<sup>20</sup> 17 CFR 1.20(d)(2), 22.5(a) and 30.7(d)(2).

depository; and

(4) that the Customer Property in the subject account shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities the FCM/DCO has or may have owing to the depository.

An FCM Acknowledgment Letter has additional examination, connectivity, and information requirements.<sup>21</sup>

B. The Proposed Rule

DTC would, pursuant to the proposed rule change, establish an Account type that a Participant or Pledgee could use to segregate its Customer Property and provide DTC with the representations needed in order for DTC to execute FCM and DCO Acknowledgment Letters for such Accounts, as may be requested. Because DTC does not have independent knowledge of whether a Participant or Pledgee is utilizing an Account for the benefit of customers, in the absence of such representations, DTC would not be able to sign an Acknowledgement Letter.

The proposed rule change would add Rule 37 to the Rules, to provide for:

- (1) the establishment and maintenance by a Participant or Pledgee that is a DCO or FCM (respectively, “DCO Party” and “FCM Party”) of one or more segregated Accounts (respectively, a “Segregated DCO Account” or “Segregated FCM Account”) for the purpose of holding interests in Customer Property;
- (2) credits to and debits from Segregated DCO Accounts and Segregated FCM Accounts in the manner otherwise provided by in the Rules and Procedures;
- (3) the representation of each DCO Party to DTC:

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<sup>21</sup> See Appendix A to 17 CFR 1.20.



i. that the only interests in property that such DCO Party shall cause or allow to be credited to its Segregated DCO Account (or Accounts) shall be interests in Deposited Securities that constitute Customer Property;

ii. that interests in Customer Property credited to its Segregated DCO Account (or Accounts) shall not be used by such DCO Party to secure or otherwise guarantee any obligations that such DCO Party might owe to DTC;

iii. that interests in Customer Property credited to its Segregated DCO Account (or Accounts) shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities that such DCO Party may have owing to DTC; and

iv. that DTC shall be entitled to rely on the representations of such DCO Party in connection with any acknowledgment that DTC may be required to provide to such DCO Party and/or the CFTC pursuant to the Customer Property Segregation Rules or for any other purpose;

(4) the representation of each FCM Party to DTC:

i. that the only interests in property that such FCM Party shall cause or allow to be credited to its Segregated FCM Account (or Accounts) shall be interests in Deposited Securities that constitute Customer Property;

ii. that interests in Customer Property credited to its Segregated FCM Account (or Accounts) shall not be used by such FCM Party to secure or otherwise guarantee any obligations that such FCM Party might owe to DTC;

iii. that interests in Customer Property credited to its Segregated FCM Account (or Accounts) shall not be subject to any right of offset or lien for or on account

of any indebtedness, obligations or liabilities that such FCM Party may have owing to DTC; and

iv. that DTC shall be entitled to rely on the representations of such FCM Party in connection with any acknowledgment that DTC may be required to provide to such FCM Party and/or the CFTC pursuant to the Customer Property Segregation Rules or for any other purpose;

(5) the representation of DTC to each DCO Party that interests in Customer Property credited to the Segregated DCO Account (or Accounts) of such DCO Party:

i. may not be used by DTC to secure or guarantee any obligations that such DCO Party might owe to DTC;

ii. may not be used by such DCO Party to secure or obtain credit from DTC; and

iii. shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities such DCO Party may have owing to DTC; provided, however, that this prohibition does not affect the right of DTC to recover funds advanced in the form of cash transfers, lines of credit, repurchase agreements or other liquidity arrangements DTC makes in lieu of liquidating non-cash assets held in the Segregated DCO Account (or Accounts) of such DCO Party or in lieu of converting cash held in the Segregated DCO Account (or Accounts) of such DCO Party to cash in a different currency;

(6) the representation of DTC to each FCM Party that interests in Customer Property credited to the Segregated FCM Account (or Accounts) of such FCM Party:

i. may not be used by DTC to secure or guarantee any obligations

that such FCM Party might owe to DTC;

ii. may not be used by such FCM Party to secure or obtain credit from DTC; and

iii. shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities such FCM Party may have owing to DTC; provided, however, that this prohibition does not affect the right of DTC to recover funds advanced in the form of cash transfers, lines of credit, repurchase agreements or other liquidity arrangements DTC makes in lieu of liquidating non-cash assets held in the Segregated FCM Account (or Accounts) of such FCM Party or in lieu of converting cash held in the Segregated FCM Account (or Accounts) of such FCM Party to cash in a different currency;

(7) DTC's disclaimer of liability:

i. to any DCO Party or FCM Party as a result of DTC acting on an instruction from such DCO Party or FCM Party to credit to or debit from interests in Customer Property from a Segregated DCO Account or Segregated FCM Account, respectively;

ii. to any DCO Party or FCM Party as a result of (x) any loss or liability suffered or incurred by such DCO Party or FCM Party arising out of or relating to the matters subject to proposed Rule 37, unless caused directly by the gross negligence or willful misconduct of DTC or by a violation of Federal securities law by DTC for which there is a private right of action, or (y) any force majeure, market disruption or technical malfunction that prevents DTC from performing its obligations to such DCO Party or FCM Party pursuant to proposed Rule 37; and

iii. to any third party (including without limitation any customer of any DCO Party or FCM Party) for any reason; and

(8) a provision stating that in the event of a conflict between proposed Rule 37 and the provisions of any other Rule, the provisions of Proposed Rule 37 would govern.

#### Implementation Timeframe

The proposed rule change would be implemented 30 days after the date of filing, or such shorter time as the Commission may designate.

#### 2. Statutory Basis

DTC believes that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder applicable to DTC, in particular Section 17A(b)(3)(F) of the Act<sup>22</sup> and Rule 17Ad-22(e)(21) thereunder.<sup>23</sup>

Section 17A(b)(3)(F) of the Act requires, inter alia, that the rules of the clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>24</sup> The proposed rule change provides a basis on which DTC may provide Acknowledgement Letters, affording the efficiency of DTC book-entry transfers for securities transactions relating to Customer Property. By establishing special segregated Accounts for Participants and Pledges to use for Customer Property held at DTC, where they otherwise would have the administrative burden of segregating Customer Property at another depository in compliance with the Customer Property

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<sup>22</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>23</sup> 17 CFR 240.17Ad-22(e)(21).

<sup>24</sup> 15 U.S.C. 78q-1(b)(3)(F).

Segregation Rules, proposed Rule 37 is designed to promote the prompt and accurate clearance and settlement of securities transactions, consistent with the requirements of the Act, in particular Section 17A(b)(3)(F), cited above.

Rule 17Ad-22(e)(21) requires, inter alia, that each 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.<sup>25</sup> Pursuant to the proposed rule change, the Rules would be updated to establish a framework for DTC to provide Acknowledgement Letters to Participants and Pledges who are DCOs or FCMs that would allow them to meet their requirements under the Customer Property Segregation Rules, while utilizing the efficiency provided by DTC book-entry transfers, consistent with the requirements of Rule 17Ad-22(e)(21), cited above.

(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 the proposed Rule and its features would be available to all Participants and Pledges equally on a non-discriminatory basis.

Participants and Pledges will be charged fees applicable to the maintenance of Accounts and transaction fees that are not different from established published fees.

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

DTC has not solicited and does not intend to solicit comments regarding the proposed rule change. DTC has not received any unsolicited written comments from interested parties. To the extent DTC receives written comments on the proposed rule

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<sup>25</sup> 17 CFR 240.17Ad-22(e)(21).

change, DTC will forward such comments to the Commission.

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

Because the foregoing proposed rule change does not:

- (i) significantly affect the protection of investors or the public interest;
- (ii) impose any significant burden on competition; and
- (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>26</sup> and Rule 19b-4(f)(6) thereunder.<sup>27</sup>

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-

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<sup>26</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>27</sup> 17 CFR 240.19b-4(f)(6).

DTC-2017-020 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-DTC-2017-020. 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 20549-1090 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-2017-020 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>28</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>28</sup> 17 CFR 200.30-3(a)(12).