

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 108	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4		File No.* SR - 2017 - * 804	Amendment No. (req. for Amendments *)
Filing by The Depository Trust Company Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934				
Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>
			Section 19(b)(3)(B) * <input type="checkbox"/>	
			Rule	
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(6)
Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010			Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934	
Section 806(e)(1) * <input checked="" type="checkbox"/>		Section 806(e)(2) * <input type="checkbox"/>	Section 3C(b)(2) * <input type="checkbox"/>	
Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>			
<b>Description</b>				
Provide a brief description of the action (limit 250 characters, required when Initial is checked *).				
<input type="text" value="Amend the loss allocation rules and make other changes."/>				
<b>Contact Information</b>				
Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.				
First Name *	<input type="text" value="Aimee"/>	Last Name *	<input type="text" value="Bandler"/>	
Title *	<input type="text" value="Assistant General Counsel"/>			
E-mail *	<input type="text" value="abandler@dtcc.com"/>			
Telephone *	<input type="text" value="(212) 855-3148"/>	Fax	<input type="text"/>	
<b>Signature</b>				
Pursuant to the requirements of the Securities Exchange Act of 1934,				
has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.				
(Title *)				
Date	<input type="text" value="12/18/2017"/>	<input type="text" value="Managing Director and Deputy General Counsel"/>		
By	<input type="text" value="Lois J. Radisch"/>	<input type="text" value=""/>		
(Name *)				
NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.				
		<input type="button" value="lradisch@dtcc.com"/>		

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

## 1. Text of Advance Notice

(a) This advance notice is filed by The Depository Trust Company (“DTC”) in connection with proposed modifications to the Rules, By-Laws and Organization Certificate of DTC (“Rules”).<sup>1</sup> The proposed rule change would revise Rule 4 (Participants Fund and Participants Investment) to (i) provide separate sections for (x) the use of the Participants Fund as a liquidity resource for settlement and (y) loss allocation among Participants of losses and liabilities arising out of Participant defaults or due to non-default events; and (ii) enhance the resiliency of DTC’s loss allocation process so that DTC can take timely action to contain multiple loss events that occur in succession during a short period of time. In connection therewith, the proposed rule change would (i) align the loss allocation rules of the three clearing agencies of The Depository Trust & Clearing Corporation (“DTCC”), namely DTC, National Securities Clearing Corporation (“NSCC”), and Fixed Income Clearing Corporation (“FICC”) (collectively, the “DTCC Clearing Agencies”),<sup>2</sup> so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies, (ii) increase transparency and accessibility of the provisions relating to the use of the Participants Fund as a liquidity resource for settlement and the loss allocation provisions, by enhancing their readability and clarity, (iii) require a defined corporate contribution to losses and liabilities that are incurred by DTC prior to any allocation among Participants, whether such losses and liabilities arise out of Participant defaults or due to non-default events, (iv) reduce the time within which DTC is required to return a former Participant’s Actual Participants Fund Deposit, and (v) make conforming and technical changes. The proposed rule change would also amend Rule 1 (Definitions; Governing Law) to add cross-references to terms that would be defined in proposed Rule 4, as discussed below. The proposed changes to the Rules are attached hereto as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

## 2. Procedures of the Self-Regulatory Organization

The filing of this advance notice with the Securities and Exchange Commission (“Commission”) was approved by DTC’s Board of Directors on October 18, 2017.

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<sup>1</sup> Each capitalized term not otherwise defined herein has its respective meaning as set forth in the Rules, available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>.

<sup>2</sup> On December 18, 2017, NSCC and FICC submitted proposed rule changes and advance notices to enhance their rules regarding allocation of losses. See SR-NSCC-2017-018, SR-FICC-2017-022 and SR-NSCC-2017-806, SR-FICC-2017-806, which were filed with the Securities and Exchange Commission (“Commission”) and the Board of Governors of the Federal Reserve System, respectively, available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

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

Not applicable.

**4. Self-Regulatory Organization's Statement on Burden on Competition**

Not applicable.

**5. Self-Regulatory Organization's Statement on Comments on the Advance Notice Received from Members, Participants, or Others**

Written comments relating to this proposal have not been solicited or received. DTC will notify the Commission of any written comments received by DTC.

**6. Extension of Time Period for Commission Action**

Not applicable.

**7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

(a) Not applicable.

(b) Not applicable.

(c) Not applicable.

(d) Not applicable.

**8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

Not applicable.

**9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Exchange Act**

Not applicable.

**10. Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act of 2010**

*Nature of the Proposed Change*

The proposed rule change would revise Rule 4 (Participants Fund and Participants Investment) to (i) provide separate sections for (x) the use of the Participants Fund as a liquidity resource for settlement and (y) loss allocation among Participants of losses and liabilities arising out of Participant defaults or due to non-default events; and (ii) enhance the resiliency of DTC's loss allocation process so that DTC can take timely action to contain multiple loss events that

occur in succession during a short period of time. In connection therewith, the proposed rule change would (i) align the loss allocation rules of the DTCC Clearing Agencies, so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies, (ii) increase transparency and accessibility of the provisions relating to the use of the Participants Fund as a liquidity resource for settlement and the loss allocation provisions, by enhancing their readability and clarity, (iii) require a defined corporate contribution to losses and liabilities that are incurred by DTC prior to any allocation among Participants, whether such losses and liabilities arise out of Participant defaults or due to non-default events, (iv) reduce the time within which DTC is required to return a former Participant's Actual Participants Fund Deposit, and (v) make conforming and technical changes. The proposed rule change would also amend Rule 1 (Definitions; Governing Law) to add cross-references to terms that would be defined in proposed Rule 4, as discussed below.

(i) Background

Current Rule 4 provides a single set of tools and a common process for the use of the Participants Fund for both liquidity purposes to complete settlement among non-defaulting Participants, if one or more Participants fails to settle,<sup>3</sup> and for the satisfaction of losses and liabilities due to Participant defaults or certain other losses or liabilities incident to the business of DTC.<sup>4</sup> The proposed rule change would amend and add provisions to separate use of the Participants Fund as a liquidity resource to complete settlement, reflected in proposed Section 4 of Rule 4, and for loss allocation, reflected in proposed Section 5 of Rule 4.

The proposed rule change would retain the core principles of current Rule 4 for both application of the Participants Fund as a liquidity resource to complete settlement and for loss allocation, while clarifying or refining certain provisions and introducing certain new concepts relating to loss allocation. In connection with the use of the Participants Fund as a liquidity resource to complete settlement when a Participant fails to settle, the proposed rule would introduce the term "pro rata settlement charge," for the use of the Participants Fund to complete

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<sup>3</sup> DTC's primary objective is to complete settlement on each Business Day in reliance on liquidity resources comprised of, primarily, the Participants Fund and a committed secured line of credit from a syndicate of lenders. Settlement obligations of each Participant are limited by the amount of these liquidity resources through its Net Debit Cap and fully secured by Collateral of the Participant measured by its Collateral Monitor. These risk management controls are designed so that DTC may complete settlement notwithstanding the failure to settle of a Participant or Affiliated Family of Participants with the largest settlement obligation on any Business Day. The proposed rule change clarifies the use of the Participants Fund in this respect. The Actual Participants Fund Deposits of defaulting Participants would be applied to satisfy their settlement obligations and, should those be insufficient, the balance of the Participants Fund is also available as a liquidity resource. Collateral of defaulting Participants may be pledged to secure a borrowing under the committed line of credit.

<sup>4</sup> It may be noted that absent extreme circumstances, DTC believes that it is unlikely that DTC would need to act under proposed Sections 4 or 5 of Rule 4.

settlement as apportioned among non-defaulting Participants. The existing term generically applied to such a use or to a loss allocation is simply a “pro rata charge”.<sup>5</sup>

For loss allocation, the proposed rule change, like current Rule 4, would continue to apply to both default and non-default losses and liabilities, and, to the extent allocated among Participants, would be charged ratably in accordance with their Required Participants Fund Deposits.<sup>6</sup> A new provision would require DTC to contribute to a loss or liability, either arising from a Participant default or non-default event, prior to any allocation among Participants. The proposed rule change would also introduce the new concepts of an “Event Period” and a “round” to address the allocation of losses arising from multiple events that occur in succession during a short period of time. These proposed rule changes would be substantially similar in these respects to analogous proposed rule changes for NSCC and FICC.

*Current Rule 4 Provides for Application of the Participants Fund Through Pro Rata Charges*

Current Rule 4 addresses the Participants Fund and Participants Investment requirements and, among other things, the permitted uses of the Participants Fund and Participants Investment.<sup>7</sup> Pursuant to current Rule 4, DTC maintains a cash Participants Fund. The Required Participants Fund Deposit for any Participant is based on the liquidity risk it poses to DTC relative to other Participants.<sup>8</sup>

Default of a Participant. Under Section 3 of current Rule 4, if a Participant is obligated to DTC and fails to satisfy any obligation, DTC may, in such order and in such amounts as DTC shall determine in its sole discretion: (a) apply some or all of the Actual Participants Fund Deposit of such Participant to such obligation; (b) Pledge some or all of the shares of Preferred Stock of such Participant to its lenders as collateral security for a loan under the End-of-Day Credit Facility;<sup>9</sup> and/or (c) sell some or all of the shares of Preferred Stock of such Participant to

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<sup>5</sup> See Rule 4, Section 5, supra note 1.

<sup>6</sup> It may be noted that for NSCC and FICC, the proposed rule changes for loss allocation include a “look-back” period to calculate a member’s pro rata share and cap. The concept of a look-back or average is already built into DTC’s calculation of Participants Fund requirements, which are based on a rolling sixty (60) day average of a Participant’s six highest intraday net debit peaks.

<sup>7</sup> Each Participant is required to invest in DTC Series A Preferred Stock, ratably on a basis calculated in substantially the same manner as the Required Participants Fund Deposit. The Preferred Stock constitutes capital of DTC and is also available for use as provided in current and proposed Section 3 of Rule 4. This proposed rule change does not alter the Required Preferred Stock Investment.

<sup>8</sup> Supra note 3.

<sup>9</sup> As part of its liquidity risk management regime, DTC maintains a 364-day committed revolving line of credit with a syndicate of commercial lenders, renewed every year. The

other Participants (who shall be required to purchase such shares pro rata their Required Preferred Stock Investments at the time of such purchase), and apply the proceeds of such sale to satisfy such obligation.

Application of the Participants Fund. Section 4 of current Rule 4 addresses the application of the Participants Fund if DTC incurs a loss or liability, which would include application of the Participants Fund to complete settlement or the allocation of losses once determined, including non-default losses. For both liquidity and loss scenarios, Section 4 of current Rule 4 provides that an application of the Participants Fund would be apportioned among Participants ratably in accordance with their Required Participants Fund Deposits, less any additional amount that a Participant was required to Deposit to the Participants Fund pursuant to Section 2 of Rule 9(A).<sup>10</sup> It also provides for the optional use of an amount of DTC's retained earnings and undivided profits.

After the Participants Fund is applied pursuant to current Section 4, DTC must promptly notify each Participant and the Commission of the amount applied and the reasons therefor.

Current Rule 4 further requires Participants whose Actual Participants Fund Deposits have been ratably charged to restore their Required Participants Fund Deposits, if such charges create a deficiency. Such payments are due upon demand. Iterative pro rata charges relating to the same loss or liability are permitted in order to satisfy the loss or liability.

Rule 4 currently provides that a Participant may, within ten (10) Business Days after receipt of notice of any pro rata charge, notify DTC of its election to terminate its business with DTC, and the exposure of the terminating Participant for pro rata charges would be capped at the greater of (a) the amount of its Aggregate Required Deposit and Investment, as fixed immediately prior to the time of the first pro rata charge, plus 100% of the amount thereof, or (b) the amount of all prior pro rata charges attributable to the same loss or liability with respect to which the Participant has not timely exercised its right to terminate.

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committed aggregate amount of the End-of-Day Credit Facility (currently \$1.9 billion) together with the Participants Fund constitute DTC's liquidity resources for settlement. Based on these amounts, DTC sets Net Debit Caps that limit settlement obligations.

<sup>10</sup> Section 2 of Rule 9(A) provides, in part, "At the request of the Corporation, a Participant or Pledgee shall immediately furnish the Corporation with such assurances as the Corporation shall require of the financial ability of the Participant or Pledgee to fulfill its commitments and shall conform to any conditions which the Corporation deems necessary for the protection of the Corporation, other Participants or Pledgees, including deposits to the Participants Fund . . ." Pursuant to the proposed rule change, the additional amount that a Participant is required to Deposit to the Participants Fund pursuant to Section 2 of Rule 9(A) would be defined as an "Additional Participants Fund Deposit." This is not a new concept, only the addition of a defined term for greater clarity. In the proposed rule change, this amount continues to be included or excluded as provided in current Rule 4, as noted below.

Overview of the Proposed Rule Changes

A. Application of Participants Fund to Participant Default and for Settlement

Proposed Section 3 of Rule 4 would retain the concept that when a Participant is obligated to DTC and fails to satisfy such obligation, which would be defined as a “Participant Default,” DTC may apply the Actual Participants Fund Deposit of the Participant to such obligation to satisfy the Participant Default. The proposed definition of “Participant Default” is for drafting clarity and use in related provisions.

Proposed Section 4 would address the situation of a Participant failure to settle (which is one type of Participant Default) if the application of the Actual Participants Fund Deposit of that Participant, pursuant to proposed Section 3, is not sufficient to complete settlement among non-defaulting Participants.

Proposed Section 4 would expressly state that the Participants Fund may be applied by DTC, in such amounts as it may determine, in its sole discretion, to fund settlement among non-defaulting Participants in the event of the failure of a Participant to satisfy its settlement obligation on any Business Day. Such an application of the Participants Fund would be charged ratably to the Actual Participants Fund Deposits of the non-defaulting Participants on that Business Day. The pro rata charge per non-defaulting Participant would be based on the ratio of its Required Participants Fund Deposit to the sum of the Required Participants Fund Deposits of all such Participants on that Business Day (excluding any Additional Participants Fund Deposits in both the numerator and denominator of such ratio). The proposed rule change would identify this as a “pro rata settlement charge,” in order to distinguish application of the Participants Fund to fund settlement from pro rata loss allocation charges that would be established in proposed Section 5 of Rule 4.

The calculation of each non-defaulting Participant’s pro rata settlement charge would be similar to the current Section 4 calculation of a pro rata charge except that, for greater simplicity, it would not include the current distinction for common members of another clearing agency pursuant to a Clearing Agency Agreement.<sup>11</sup> For enhanced clarity as to the date of determination of the ratio, it would be based on the Required Participants Fund Deposits as fixed on the Business Day of the application of the Participants Fund, as opposed to the current language “at the time the loss or liability was discovered.”<sup>12</sup>

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<sup>11</sup> Rule 4, Section 4(a)(1), supra note 1. DTC has determined that this option is unnecessary because, in practice, DTC would never have liability under a Clearing Agency Agreement that exceeds the excess assets of the Participant that defaulted.

<sup>12</sup> DTC believes that this change would provide an objective date that is more appropriate for the application of the Participants Fund to complete settlement, because the “time the loss or liability was discovered” would necessarily have to be the day the Participants Fund was applied to complete settlement.



The proposed rule change would retain the concept that requires DTC, following the application of the Participants Fund to complete settlement, to notify each Participant and the Commission of the charge and the reasons therefor (“Settlement Charge Notice”).

The proposed rule change also would retain the concept of providing each non-defaulting Participant an opportunity to elect to terminate its business with DTC and thereby cap its exposure to further pro rata settlement charges. The proposed rule change would shorten the notification period for the election to terminate from ten (10) Business Days to five (5) Business Days,<sup>13</sup> and would also change the beginning date of such notification period from the receipt of the notice to the date of the issuance of the Settlement Charge Notice.<sup>14</sup> A Participant that elects to terminate its business with DTC would, subject to its cap, remain responsible for (i) its pro rata settlement charge that was the subject of the Settlement Charge Notice and (ii) all other pro rata settlement charges until the Participant Termination Date (as defined below and in the proposed rule change). The proposed cap on pro rata settlement charges of a Participant that has timely notified DTC of its election to terminate its business with DTC would be the amount of its Aggregate Required Deposit and Investment, as fixed on the day of the pro rata settlement charge that was the subject of the Settlement Charge Notice, plus 100% of the amount thereof. The proposed cap would be no greater than the current cap.<sup>15</sup>

The pro rata application of the Actual Participants Fund Deposits of non-defaulting Participants to complete settlement when there is a Participant Default is not the allocation of a loss. A pro rata settlement charge would relate solely to the completion of settlement. New proposed loss allocation concepts described below, including, but not limited to, a “round,” “Event Period,” and “Corporate Contribution,” would not apply to pro rata settlement charges.<sup>16</sup>

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<sup>13</sup> DTC believes this shorter period would be sufficient for a Participant to decide whether to give notice to terminate its business with DTC in response to a settlement charge. In addition, a five (5) Business Day pro rata settlement charge notification period would conform to the proposed loss allocation notification period in this proposed rule change and in the proposed rule changes for NSCC and FICC. See infra note 28. See also supra note 2.

<sup>14</sup> DTC believes that setting the start date of the notification period to an objective date would enhance transparency and provide a common timeframe to all affected Participants.

<sup>15</sup> Section 8 of current Rule 4 provides for a cap that is equal to the greater of (a) the amount of its Aggregate Required Deposit and Investment, as fixed immediately prior to the time of the first pro rata charge, plus 100% of the amount thereof, or (b) the amount of all prior pro rata charges attributable to the same loss or liability with respect to which the Participant has not timely exercised its right to limit its obligation as provided above. Supra note 1. The alternative limit in clause (b) would be eliminated in proposed Section 8(a) in favor of a single defined standard.

<sup>16</sup> Proposed Sections 3, 4 and 5 of Rule 4 together relate, in whole or in part, to what may happen when there is a Participant Default. Proposed Section 3 is the basic provision of

B. Changes to Enhance Resiliency of DTC's Loss Allocation Process

In order to enhance the resiliency of DTC's loss allocation process and to align, to the extent practicable and appropriate, its loss allocation approach to that of the other DTCC Clearing Agencies, DTC proposes to introduce certain new concepts and to modify other aspects of its loss allocation waterfall. The proposed rule change would adopt an enhanced allocation approach for losses, whether arising from Default Loss Events or Declared Non-Default Loss Events (as defined below). In addition, the proposed rule change would clarify the loss allocation process as it relates to losses arising from or relating to multiple default or non-default events in a short period of time.

Accordingly, DTC is proposing four (4) key changes to enhance DTC's loss allocation process:

(1) Mandatory Corporate Contribution.

Section 4 of current Rule 4 provides that if there is an unsatisfied loss or liability, DTC may, in its sole discretion and in such amount as DTC would determine, "charge the existing retained earnings and undivided profits" of DTC.

Under the proposed rule change, DTC would replace the discretionary application of an unspecified amount of retained earnings and undivided profits with a mandatory, defined

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remedies if a Participant fails to satisfy an obligation to DTC. Proposed Section 4 is a specific remedy for a failure to settle, i.e., a specific type of Participant Default. Proposed Section 5 is also a remedial provision for a Participant Default when, additionally, DTC ceases to act for the Participant and there are remaining losses or liabilities. If a Participant Default occurs, the application of proposed Section 3 would be required, the application of proposed Section 4 would be at the discretion of DTC and the application of proposed Section 5 would only be triggered by the determination of DTC to cease to act for the defaulting Participant coupled with losses or liabilities incurred by DTC. Whether or not proposed Section 4 has been applied, once there is a loss due to a Participant Default and DTC ceases to act for the defaulting Participant, proposed Section 5 would apply.

A principal type of Participant Default is a failure to settle. A Participant's obligation to pay any amount due in settlement is secured by Collateral of the Participant. When the Participant fails to pay its settlement obligation, under Rule 9(B), Section 2, DTC has the right to Pledge or sell such Collateral to satisfy the obligation. Supra note 1. (It is more likely that DTC would borrow against the Collateral to complete settlement on the Business Day, because it is unlikely to be able to liquidate Collateral for same day funds in time to settle on that Business Day.) If DTC Pledges the Collateral to secure a loan to fund settlement (e.g., under the End-of-Day Credit Facility), the Collateral would have to be sold to obtain funds to repay the loan. In any such sale of the Collateral, there is a risk, heightened in times of market stress, that the proceeds of the sale would be insufficient to repay the loan. That deficiency would be a liability or loss to which proposed Section 5 of Rule 4 would apply, i.e., a Default Loss Event.

Corporate Contribution (as defined below and in the proposed rule change). The Corporate Contribution would be used for losses and liabilities that are incurred by DTC with respect to an Event Period (as defined below and in the proposed rule change), whether arising from a Default Loss Event or Declared Non-Default Loss Event, before the allocation of losses to Participants.

The proposed “Corporate Contribution” would be defined to be an amount equal to fifty percent (50%) of DTC’s General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period.<sup>17</sup> DTC’s General Business Risk Capital Requirement, as defined in DTC’s Clearing Agency Policy on Capital Requirements,<sup>18</sup> is, at a minimum, equal to the regulatory capital that DTC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Securities Exchange Act of 1934, as amended (the “Act”).<sup>19</sup> The Corporate Contribution would be held in addition to DTC’s General Business Risk Capital Requirement.

The proposed Corporate Contribution would apply to losses arising from Default Loss Events and Declared Non-Default Loss Events, and would be a mandatory contribution of DTC prior to any allocation among Participants.<sup>20</sup> As proposed, if the proposed Corporate Contribution is fully or partially used against a loss or liability relating to an Event Period, the Corporate Contribution would be reduced to the remaining unused amount, if any, during the following two hundred fifty (250) Business Days in order to permit DTC to replenish the Corporate Contribution.<sup>21</sup> To ensure transparency, Participants would receive notice of any such reduction to the Corporate Contribution.

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<sup>17</sup> DTC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (i) an amount determined based on its general business profile, (ii) an amount determined based on the time estimated to execute a recovery or orderly wind-down of DTC’s critical operations, and (iii) an amount determined based on an analysis of DTC’s estimated operating expenses for a six (6) month period.

<sup>18</sup> See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-DTC-2017-003).

<sup>19</sup> 17 CFR 240.17Ad-22(e)(15).

<sup>20</sup> The proposed rule change would not require a Corporate Contribution with respect to a pro rata settlement charge. However, as discussed above, if, after a Participant Default, the proceeds of the sale of the Collateral of the Participant are insufficient to replenish the Participants Fund and/or repay the lenders under the End-of-Day Credit Facility, and DTC has ceased to act for the Participant, the shortfall would be a loss arising from a Default Loss Event, subject to the Corporate Contribution.

<sup>21</sup> DTC believes that two hundred fifty (250) Business Days would be a reasonable estimate of the time frame that DTC would require to replenish the Corporate Contribution by equity in accordance with DTC’s Clearing Agency Policy on Capital Requirements, including a conservative additional period to account for any potential delays and/or unknown exigencies in times of distress.

By requiring a defined contribution of DTC corporate funds towards losses and liabilities arising from Default Loss Events and Declared Non-Default Loss Events, the proposed rule change would limit Participant obligations to the extent of such Corporate Contribution and thereby provide greater clarity and transparency to Participants as to the calculation of their exposure to losses and liabilities.

Proposed Rule 4 would also further clarify that DTC can voluntarily apply amounts greater than the Corporate Contribution against any loss or liability (including non-default losses) of DTC, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

The proposed rule changes relating to the calculation and mandatory application of the Corporate Contribution are set forth in proposed Section 5 of Rule 4.

(2) Introducing an Event Period.

The proposed rule change would clearly define the obligations of DTC and its Participants regarding the allocation of losses or liabilities (i) relating to or arising out of a Participant Default which is not satisfied pursuant to proposed Section 3 of Rule 4 and DTC has ceased to act for such Participant (a “Default Loss Event”) and/or (ii) otherwise incident to the business of DTC,<sup>22</sup> as determined in proposed Rule 4 (a “Declared Non-Default Loss Event”). In order to balance the need to manage the risk of sequential loss events against Participants’ need for certainty concerning maximum loss allocation exposures, DTC is proposing to introduce the concept of an “Event Period” to address the losses and liabilities that may arise from or relate to multiple Default Loss Events and/or Declared Non-Default Loss Events that arise in quick succession. Specifically, the proposal would group Default Loss Events and Declared Non-Default Loss Events occurring in a period of ten (10) Business Days (“Event Period”) for purposes of allocating losses to Participants in one or more rounds, subject to the limits of loss allocation set forth in the proposed rule change and as explained below.<sup>23</sup> In the case of a loss or liability arising from or relating to a Default Loss Event, an Event Period would begin on the day on which DTC notifies Participants that it has ceased to act for a Participant (or the next Business Day, if such day is not a Business Day). In the case of a Declared Non-Default Loss Event, the Event Period would begin on the day that DTC notifies Participants of the determination by the Board of Directors that the applicable loss or liability incident to the

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<sup>22</sup> Section 1(f) of Rule 4 defines the term “business” with respect to DTC as “the doing of all things in connection with or relating to the Corporation’s performance of the services specified in the first and second paragraphs of Rule 6 or the cessation of such services.” Supra note 1.

<sup>23</sup> DTC believes that having a ten (10) Business Day Event Period would provide a reasonable period of time to encompass potential sequential Default Loss Events and/or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or a severe market dislocation episode, while still providing appropriate certainty for Participants concerning their maximum exposure to allocated losses with respect to such events.

business of DTC may be a significant and substantial loss or liability that may materially impair the ability of DTC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Participants in order to ensure that DTC may continue to offer clearance and settlement services in an orderly manner. If a subsequent Default Loss Event or Declared Non-Default Loss Event occurs within the Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period. An Event Period may include both Default Loss Events and Declared Non-Default Loss Events, and there would not be separate Event Periods for Default Loss Events or Declared Non-Default Loss Events occurring within overlapping ten (10) Business Day periods.

The amount of losses that may be allocated by DTC, subject to the required Corporate Contribution, and to which a Loss Allocation Cap (as defined below and in the proposed rule change) would apply for any terminating Participant, would include any and all losses from any Default Loss Events and any Declared Non-Default Loss Events during the Event Period, regardless of the amount of time, during or after the Event Period, required for such losses to be crystallized and allocated.

The proposed rule changes relating to the implementation of an Event Period are set forth in proposed Section 5 of Rule 4.

- (3) Introducing the concept of “rounds” and Loss Allocation Notice.

Pursuant to the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Participants (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. DTC would continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Participants that have not submitted a Termination Notice (as defined below and in the proposed rule change) in accordance with proposed Section 6(b) of Rule 4.

The calculation of each Participant’s pro rata allocation charge would be similar to the current Section 4 calculation of a pro rata charge except that, for greater simplicity, it would not include the current distinction for common members of another clearing agency pursuant to a Clearing Agency Agreement.<sup>24</sup> In addition, for enhanced clarity as to the date of determination of the ratio, it would be based on the Required Participants Fund Deposits as fixed on the first

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<sup>24</sup> See supra note 11.

day of the Event Period, as opposed to the current language “at the time the loss or liability was discovered.”<sup>25</sup>

DTC would notify Participants subject to loss allocation of the amounts being allocated to them (“Loss Allocation Notice”) in successive rounds of loss allocations. Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. Participants would receive two (2) Business Days’ notice of a loss allocation,<sup>26</sup> and Participants would be required to pay the requisite amount no later than the second Business Day following the issuance of such notice.<sup>27</sup> Multiple Loss Allocation Notices may be issued with respect to each round, up to the round cap.

The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Participant in that round has five (5) Business Days<sup>28</sup> from the issuance<sup>29</sup> of such first Loss Allocation Notice for the round (such

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<sup>25</sup> DTC believes that this change would provide an objective date that is appropriate for the new proposed loss allocation process, which would be designed to allocate aggregate losses relating to an Event Period, rather than one loss at a time.

<sup>26</sup> DTC believes allowing Participants two (2) Business Days to satisfy their loss allocation obligations would provide Participants sufficient notice to arrange funding, if necessary, while allowing DTC to address losses in a timely manner.

<sup>27</sup> Section 4 of current Rule 4 provides that if the Participants Fund is applied to a loss or liability, DTC must notify each Participant of the charge and the reasons therefor. Proposed Section 5 would modify this process to (i) require DTC to give *prior* notice; and (ii) require Participants to pay loss allocation charges, rather than directly charging their Required Participants Fund Deposits. DTC believes that shifting from the two-step methodology of applying the Participants Fund and then requiring Participants to immediately replenish it to requiring direct payment would increase efficiency, while preserving the right to charge the Settlement Account of the Participant in the event the Participant doesn’t timely pay. Such a failure to pay would be, self-evidently, a Participant Default, triggering recourse to the Actual Participants Fund Deposit of the Participant under proposed Section 3 of Rule 4. In addition, this change would provide greater stability for DTC in times of stress by allowing DTC to retain the Participants Fund, its critical pre-funded resource, while charging loss allocations.

<sup>28</sup> Section 8 of current Rule 4 provides that the time period for a Participant to give notice of its election to terminate its business with DTC in respect of a pro rata charge is ten (10) Business Days after receiving notice of a pro rata charge. DTC believes that it is appropriate to shorten such time period from ten (10) Business Days to five (5) Business Days because DTC needs timely notice of which Participants would not be terminating their business with DTC for the purpose of calculating the loss allocation for any subsequent round. DTC believes that five (5) Business Days would provide Participants with sufficient time to decide whether to cap their loss allocation obligations by terminating their business with DTC.

period, a “Loss Allocation Termination Notification Period”) to notify DTC of its election to terminate its business with DTC pursuant to proposed Section 8(b) of Rule 4, and thereby benefit from its Loss Allocation Cap.

The round cap of any second or subsequent round may differ from the first or preceding round cap because there may be fewer Participants in a second or subsequent round if Participants elect to terminate their business with DTC as provided in proposed Section 8(b) of Rule 4 following the first Loss Allocation Notice in any round.

For example, for illustrative purposes only, after the required Corporate Contribution, if DTC has a \$4 billion loss determined with respect to an Event Period and the sum of Loss Allocation Caps for all Participants subject to the loss allocation is \$3 billion, the first round would begin when DTC issues the first Loss Allocation Notice for that Event Period. DTC could issue one or more Loss Allocation Notices for the first round until the sum of losses allocated equals \$3 billion. Once the \$3 billion is allocated, the first round would end and DTC would need a second round in order to allocate the remaining \$1 billion of loss. DTC would then issue a Loss Allocation Notice for the \$1 billion and this notice would be the first Loss Allocation Notice for the second round. The issuance of the Loss Allocation Notice for the \$1 billion would begin the second round.

The proposed rule change would link the Loss Allocation Cap to a round in order to provide Participants the option to limit their loss allocation exposure at the beginning of each round. As proposed, a Participant could limit its loss allocation exposure to its Loss Allocation Cap by providing notice of its election to terminate its business with DTC within five (5) Business Days after the issuance of the first Loss Allocation Notice in any round.

The proposed rule changes relating to the implementation of “rounds” and Loss Allocation Notices are set forth in proposed Section 5 of Rule 4.

- (4) Capping terminating Participants’ loss allocation exposure and related changes.

As discussed above, the proposed rule change would continue to provide Participants the opportunity to limit their loss allocation exposure by offering a termination option; however, the associated withdrawal process would be modified.

As proposed, if a Participant provides notice of its election to terminate its business with DTC as provided in proposed Section 8(b) of Rule 4, its maximum payment obligation with respect to any loss allocation round would be the amount of its Aggregate Required Deposit and Investment, as fixed on the first day of the Event Period, plus 100% of the amount thereof (“Loss Allocation Cap”),<sup>30</sup> provided that the Participant complies with the requirements of the termination process in proposed Section 6 of Rule 4. DTC may retain the entire Actual

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<sup>29</sup> See supra note 14.

<sup>30</sup> See supra note 15. The alternative limit in clause (b) would be eliminated in proposed Section 8(b) in favor of a single defined standard.

Participants Fund Deposit of a Participant subject to loss allocation, up to the Participant's Loss Allocation Cap. If a Participant's Loss Allocation Cap exceeds the Participant's then-current Required Participants Fund Deposit, it must still pay the excess amount.

As proposed, Participants would have five (5) Business Days from the issuance of the first Loss Allocation Notice in any round to decide whether to terminate its business with DTC, and thereby benefit from its Loss Allocation Cap. The start of each round<sup>31</sup> would allow a Participant the opportunity to notify DTC of its election to terminate its business with DTC after satisfaction of the losses allocated in such round.

Specifically, the first round and each subsequent round of loss allocation would allocate losses up to a round cap of the aggregate of all Loss Allocation Caps of those Participants included in the round. If a Participant provides notice of its election to terminate its business with DTC, it would be subject to loss allocation in that round, up to its Loss Allocation Cap. If the first round of loss allocation does not fully cover DTC's losses, a second round will be noticed to those Participants that did not elect to terminate in the previous round. As noted above, the amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Participants in a second or subsequent round if Participants elect to terminate their business with DTC as provided in proposed Section 8(b) of Rule 4 following the first Loss Allocation Notice in any round.

Pursuant to the proposed rule change, in order to avail itself of its Loss Allocation Cap, the Participant would need to follow the requirements in proposed Section 6 of Rule 4. In addition to retaining the substance of the existing requirements for any termination that are set forth in Section 6 of current Rule 4, proposed Section 6 also would provide that a Participant that provides a termination notice in connection with a loss allocation must: (1) specify in the termination notice an effective date of termination ("Participant Termination Date"), which date shall be no later than ten (10) Business Days following the last day of the applicable Loss Allocation Termination Notification Period; (2) cease all activity that would result in transactions being submitted to DTC for clearance and settlement after the Participant Termination Date; and (3) ensure that all activities and use of DTC services for which such Participant may have any obligation to DTC cease prior to the Participant Termination Date.

The proposed rule changes are designed to enable DTC to continue the loss allocation process in successive rounds until all of DTC's losses are allocated. Until all losses related to an Event Period are allocated and paid, DTC may retain the entire Actual Participants Fund Deposit of a Participant subject to loss allocation, up to the Participant's Loss Allocation Cap.

The proposed rule changes relating to capping terminating Participants' loss allocation exposure and related changes to the termination process are set forth in proposed Sections 5, 6, and 8 of Rule 4.

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<sup>31</sup> i.e., a Participant will only have the opportunity to terminate after the first Loss Allocation Notice in any round, and not after each Loss Allocation Notice in any round.



C. Clarifying Changes Relating to Loss Allocation for Non-Default Events

The proposed rule changes are intended to make the provisions in the Rules governing loss allocation more transparent and accessible to Participants. In particular, DTC is proposing the following change relating to loss allocation to provide clarity around the governance for the allocation of losses arising from a non-default event.<sup>32</sup>

Currently, DTC can use the Participants Fund to satisfy losses and liabilities arising from a Participant Default or arising from an event that is not due to a Participant Default (i.e., a non-default loss), provided that such loss or liability is incident to the business of DTC.<sup>33</sup>

DTC is proposing to clarify the governance around non-default losses that would trigger loss allocation to Participants by specifying that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of DTC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among the Participants in order to ensure that DTC may continue to offer clearance and settlement services in an orderly manner. The proposed rule change would provide that DTC would then be required to promptly notify Participants of this determination, which is referred to in the proposed rule as a Declared Non-Default Loss Event, as discussed above.

Finally, as previously discussed, pursuant to the proposed rule change, proposed Rule 4 would include language to clarify that (i) the Corporate Contribution would apply to losses or liabilities arising from a Default Loss Event or a Declared Non-Default Loss Event, and (ii) the loss allocation waterfall would be applied in the same manner regardless of whether a loss arises from a Default Loss Event or a Declared Non-Default Loss Event.

The proposed rule changes relating to Declared Non-Default Loss Events and Participants' obligations for such events are set forth in proposed Section 5 of Rule 4.

D. Changes to the Retention Time for the Actual Participants Fund Deposit of a Former Participant.

Current Rule 4 provides that after three months from when a Person has ceased to be a Participant, DTC shall return to such Person (or its successor in interest or legal representative) the amount of the Actual Participants Fund Deposit of the former Participant plus accrued and unpaid interest to the date of such payment (including any amount added to the Actual Participants Fund Deposit of the former Participant through the sale of the Participant's Preferred Stock), provided that DTC receives such indemnities and guarantees as DTC deems satisfactory with respect to the matured and contingent obligations of the former Participant to DTC. Otherwise, within four years after a Person has ceased to be a Participant, DTC shall return to

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<sup>32</sup> Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

<sup>33</sup> See supra note 22.

such Person (or its successor in interest or legal representative) the amount of the Actual Participants Fund Deposit of the former Participant plus accrued and unpaid interest to the date of such payment, except that DTC may offset against such payment the amount of any known loss or liability to DTC arising out of or related to the obligations of the former Participant to DTC.

DTC is proposing to reduce the time, after a Participant ceases to be a Participant, at which DTC would be required to return the amount of the Actual Participants Fund Deposit of the former Participant plus accrued and unpaid interest, whether the Participant ceases to be such because it elected to terminate its business with DTC in response to a Settlement Charge Notice or Loss Allocation Notice or otherwise. Pursuant to the proposed rule change, the time period would be reduced from four (4) years to two (2) years. All other requirements relating to the return of the Actual Participants Fund Deposit would remain the same.

The four (4) year retention period was implemented at a time when there were more deposits and processing of physical certificates, as well as added risks related to manual processing, and related claims could surface many years after an alleged event. DTC believes that the change to two (2) years is appropriate because, currently, as DTC and the industry continue to move toward automation and dematerialization, claims typically surface more quickly. Therefore, DTC believes that a shorter retention period of two (2) years would be sufficient to maintain a reasonable level of coverage for possible claims arising in connection with the activities of a former Participant, while allowing DTC to provide some relief to former Participants by returning their Actual Participants Fund Deposits more quickly.

(ii) Proposed Rule Changes

The foregoing changes as well as other changes (including a number of technical and conforming changes) that DTC is proposing in order to improve the transparency and accessibility of Rule 4 are described in detail below.

A. Changes Relating to the Retention of the Actual Participants Fund Deposit of a Former Participant

Section 1(h) (proposed Section 1(g))

As discussed above, DTC is proposing to replace “four” years with “two” years, in order to reduce the time within which DTC would be required to return the Actual Participants Fund Deposit of a former Participant. In addition, DTC is proposing to (i) add the heading “Return of Participants Fund Deposits to Participants” to proposed Section 1(g), (ii) update a cross reference, and (iii) correct two typographical errors.

B. Changes Relating to Participant Default, Pro Rata Settlement Charges and Loss Allocation

Section 3

As discussed above, Section 3 of current Rule 4 provides that, if a Participant fails to satisfy an obligation to DTC, DTC may, in such order and in such amounts as DTC determines,

apply the Actual Participants Fund Deposit of the defaulting Participant, Pledge the shares of Preferred Stock of the defaulting Participant to its lenders as collateral security for a loan, and/or sell the shares of Preferred Stock of the defaulting Participant to other Participants. Pursuant to the proposed rule change, Section 3 would retain most of these provisions, with the following modifications:

DTC proposes to add the term “Participant Default” in proposed Section 3 as a defined term for the failure of a Participant to satisfy an obligation to DTC, for drafting clarity and use in related provisions. In addition, the proposed rule change clarifies that, in the case of a Participant Default, DTC would first apply the Actual Participants Fund Deposit of the Participant to any unsatisfied obligations, before taking any other actions. This proposed clarification would reflect the current practice of DTC, and would provide Participants with enhanced transparency into the actions DTC would take with respect to the Participants Fund deposits and Participants Investment of a Participant that has failed to satisfy its obligations to DTC.

DTC proposes to correct the term “End-of-Day Facility,” to the existing defined term “End-of-Day Credit Facility.” DTC further proposes to clarify that, if DTC Pledges some or all of the shares of Preferred Stock of a Participant to its lenders as collateral security for a loan under the End-of-Day Credit Facility, DTC would apply the proceeds of such loan to the obligation the Participant had failed to satisfy, which is not expressly stated in Section 3 of current Rule 4.

In addition, DTC is proposing to make three ministerial changes to enhance readability by: (i) removing the duplicative “in,” in the phrase “in such order and in such amounts,” (ii) replacing the word “eliminate” with “satisfy,” and (iii) to conform to proposed changes, renumbering the list of actions that DTC may take when there is a Participant Default.

DTC is also proposing to add the heading “Application of Participants Fund Deposits and Preferred Stock Investments to Participant Default” to Section 3.

#### Section 4 and Section 5

As noted above, Section 4 of current Rule 4 provides that if DTC incurs a loss or liability which is not satisfied by charging the Participant responsible for the loss pursuant to Section 3 of Rule 4, then DTC may, in any order and in any amount as DTC may determine, in its sole discretion, to the extent necessary to satisfy such loss or liability, ratably apply some or all of the Actual Participants Fund Deposits of all other Participants to such loss or liability and/or charge the existing retained earnings and undivided profits of DTC. This provision relates to losses and liabilities that may be due to the failure of a Participant to satisfy obligations to DTC, if the Actual Participants Fund Deposit of that Participant does not fully satisfy the obligation, or to losses and liabilities for which no single Participant is obligated, i.e., a “non-default loss.”

As discussed above, current Rule 4 currently provides a single set of tools and common processes for using the Participants Fund as both a liquidity resource and for the satisfaction of other losses and liabilities. The proposed rule change would provide separate liquidity and loss allocation provisions. More specifically, proposed Section 4 of Rule 4 would reflect the process

for a “pro rata settlement charge,” the application of the Actual Participants Fund Deposits of non-defaulting Participants for liquidity purposes in order to complete settlement, when a Participant fails to satisfy its settlement obligation and the amount charged to its Actual Participants Fund Deposit by DTC pursuant to Section 3 of Rule 4 is insufficient to complete settlement. Proposed Section 5 of Rule 4 would contain the proposed loss allocation provisions.

*Proposed Section 4*

Pursuant to the proposed rule change, current Section 4 would be replaced in its entirety by proposed Section 4, and titled “Application of Participants Fund Deposits of Non-Defaulting Participants.” First, for clarity, proposed Section 4 would expressly state that “The Participants Fund shall constitute a liquidity resource which may be applied by the Corporation in such amounts as the Corporation shall determine, in its sole discretion, to fund settlement among non-defaulting Participants in the event of the failure of a Participant to satisfy its settlement obligation on any Business Day. If the amount charged to the Actual Participants Fund Deposit of a Participant pursuant to Section 3 of this Rule is not sufficient to complete settlement among non-defaulting Participants on that Business Day, the Corporation may apply the Actual Participants Fund Deposits of non-defaulting Participants as provided in this Section and/or apply such other liquidity resources as may be available to the Corporation from time to time, including the End-of-Day Credit Facility.”

Proposed Section 4 would retain the current principle that DTC must notify Participants and the Commission when it applies the Participants Fund deposits of non-defaulting Participants, by stating that if the Actual Participants Fund Deposits of non-defaulting Participants are applied to complete settlement, DTC must promptly notify each Participant and the Commission of the amount of the charge and the reasons therefor, and would define such notice as a Settlement Charge Notice.

Proposed Section 4 would retain the current calculation of pro rata charges by providing that each non-defaulting Participant’s<sup>34</sup> pro rata share of any such application of the Participants Fund, defined as a “pro rata settlement charge,” shall be equal to (i) its Required Participants Fund Deposit, as such Required Participants Fund Deposit was fixed on the Business Day of such application<sup>35</sup> less its Additional Participants Fund Deposit, if any, on that day, divided by (ii) the sum of the Required Participants Fund Deposits of all non-defaulting Participants, as such Required Participants Fund Deposits were fixed on that day, less the sum of the Additional Participants Fund Deposits, if any, of such non-defaulting Participants on that day.

Proposed Section 4 would also provide a period of time within which a Participant could notify DTC of its election to terminate its business with DTC and thereby cap its liability, by providing that a Participant shall have a period of five (5) Business Days following the issuance of a Settlement Charge Notice (“Settlement Charge Termination Notification Period”) to notify DTC of its election to terminate its business with DTC pursuant to proposed Section 8(a), and

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<sup>34</sup> See supra note 11.

<sup>35</sup> See supra note 12.

thereby benefit from its Settlement Charge Cap, as set forth in proposed Section 8(a).<sup>36</sup> Proposed Section 4 would also require that any Participant that gives DTC notice of its election to terminate its business with DTC must comply with proposed Section 6 of Rule 4,<sup>37</sup> and if it does not, its election to terminate shall be deemed void.

Proposed Section 4 would further provide that DTC may retain the entire amount of the Actual Participants Fund Deposit of a Participant subject to a pro rata settlement charge, up to the amount of the Participant's Settlement Charge Cap in accordance with proposed Section 8(a) of Rule 4.

Section 5 of current Rule 4 provides that "Except as provided in Section 8 of this Rule, if a pro rata charge is made pursuant to Section 4 of the current Rule against the Required Participants Fund Deposit of a Participant, and, as a consequence, the Actual Participants Fund Deposit of such Participant is less than its Required Participants Fund Deposit, the Participant shall, upon the demand of the Corporation, within such time as the Corporation shall require, Deposit to the Participants Fund the amount in cash needed to eliminate any resulting deficiency in its Required Participants Fund Deposit. If the Participant shall fail to make such deposit to the Participants Fund, the Corporation may take disciplinary action against the Participant pursuant to these Rules. Any disciplinary action which the Corporation takes pursuant to these Rules, or the voluntary or involuntary cessation of participation by the Participant, shall not affect the obligations of the Participant to the Corporation or any remedy to which the Corporation may be entitled under applicable law."

Proposed Section 4 would incorporate Section 5 of current Rule 4, modified as follows: (i) conformed to reflect the consolidation of Section 5 into proposed Section 4, (ii) replacement of "Except as provided in" with "Subject to," to harmonize with language used elsewhere in proposed Rule 4, and (iii) corrections of two typographical errors, in order to accurately reflect that the Actual Participants Fund Deposit of a Participant would be applied, and not the Required Participants Fund Deposit, and to capitalize the word "deposit" because it is a defined term.

#### Proposed Section 5

Proposed Section 5 of Rule 4 would address the substantially new and revised proposed loss allocation, which would apply to losses and liabilities relating to or arising out of a Default Loss Event or a Declared Non-Default Loss Event. Pursuant to the proposed rule change, DTC would restructure and modify its existing loss allocation waterfall as described below. The heading "Loss Allocation Waterfall" would be added to proposed Section 5.

Proposed Section 5 would establish the concept of an "Event Period" to provide for a clear and transparent way of handling multiple loss events occurring in a period of ten (10) Business Days, which would be grouped into an Event Period. As stated above, both Default Loss Events and Declared Non-Default Loss Events could occur within the same Event Period.

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<sup>36</sup> See supra note 13.

<sup>37</sup> Proposed Section 6 is discussed below.

The Event Period with respect to a Default Loss Event would begin on the day on which DTC notifies Participants that it has ceased to act for the Participant (or the next Business Day, if such day is not a Business Day). In the case of a Declared Non-Default Loss Event, the Event Period would begin on the day that DTC notifies Participants of the determination by the Board of Directors that the applicable loss or liability incident to the business of DTC may be a significant and substantial loss or liability that may materially impair the ability of DTC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Participants in order to ensure that DTC may continue to offer clearance and settlement services in an orderly manner. Proposed Section 5 would provide that if a subsequent Default Loss Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Under proposed Section 5, the loss allocation waterfall would begin with a new mandatory Corporate Contribution from DTC. Rule 4 currently provides that the use of any retained earnings and undivided profits by DTC is a voluntary contribution of a discretionary amount of its retained earnings. Proposed Section 5 of Rule 4 would, instead, require a defined corporate contribution to losses and liabilities that are incurred by DTC with respect to an Event Period. As proposed, the Corporate Contribution to losses or liabilities that are incurred by DTC with respect to an Event Period would be defined as an amount that is equal to fifty percent (50%) of the amount calculated by DTC in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period.<sup>38</sup> DTC's General Business Risk Capital Requirement, as defined in DTC's Clearing Agency Policy on Capital Requirements,<sup>39</sup> is, at a minimum, equal to the regulatory capital that DTC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.<sup>40</sup>

If DTC applies the Corporate Contribution to a loss or liability arising out of or relating to one or more Default Loss Events or Declared Non-Default Loss Events relating to an Event Period, then for any subsequent Event Periods that occur during the next two hundred fifty (250) Business Days, the Corporate Contribution would be reduced to the remaining unused portion of the Corporate Contribution amount that was applied for the first Event Period.<sup>41</sup> Proposed Section 5 would require DTC to notify Participants of any such reduction to the Corporate Contribution.

Proposed Section 5 of Rule 4 would provide that nothing in the Rules would prevent DTC from voluntarily applying amounts greater than the Corporate Contribution against any

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<sup>38</sup> See supra note 17.

<sup>39</sup> See supra note 18.

<sup>40</sup> 17 CFR 240.17Ad-22(e)(15).

<sup>41</sup> See supra note 21.

DTC loss or liability, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

Proposed Section 5 of Rule 4 would provide that DTC shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Default Loss Events and/or Declared Non-Default Loss Events that occur within an Event Period. The proposed rule change also provides that if losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, DTC would allocate such losses and liabilities to Participants, as described below.

Proposed Section 5 of Rule 4 would state that all Participants would be subject to loss allocation for losses and liabilities arising out of or relating to a Declared Non-Default Loss Event; however, in the case of losses and liabilities arising out of or relating to a Default Loss Event, only non-defaulting Participants would be subject to loss allocation. In addition, DTC is proposing to clarify that after a first round of loss allocations with respect to an Event Period, only Participants that have not submitted a Termination Notice in accordance with proposed Section 6(b) of Rule 4 would be subject to loss allocations with respect to subsequent rounds relating to that Event Period. The proposed change would also provide that DTC may retain the entire Actual Participants Fund Deposit of a Participant subject to loss allocation, up to the Participant's Loss Allocation Cap in accordance with proposed Section 8(b) of Rule 4.

Pursuant to the proposed rule change, DTC would notify Participants subject to loss allocation of the amounts being allocated to them by a Loss Allocation Notice in successive rounds of loss allocations. Proposed Section 5 would state that a loss allocation "round" would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Participants (a "round cap"). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. DTC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Participants that have not submitted a Termination Notice in accordance with proposed Section 6(b) of Rule 4.

Each loss allocation would be communicated to Participants by issuance of a Loss Allocation Notice. Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Participant in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round<sup>42</sup> to notify DTC of its election to terminate its business with DTC pursuant to proposed Section 8(b) of Rule 4, and thereby benefit from its Loss Allocation Cap.<sup>43</sup>

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<sup>42</sup> i.e., the Loss Allocation Termination Notification Period for that round.

<sup>43</sup> See supra note 28.

Loss allocation obligations would continue to be calculated based upon a Participant's pro rata share of the loss.<sup>44</sup> As proposed, each Participant's pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) (A) its Required Participants Fund Deposit, as such Required Participants Fund Deposit was fixed on the first day of the Event Period,<sup>45</sup> less (B) its Additional Participants Fund Deposit, if any, on such day, divided by (ii) (A) the sum of the Required Participants Fund Deposits of all Participants subject to loss allocation in such round, as such Required Participants Fund Deposits were fixed on such day, less (B) the sum of any Additional Participants Fund Deposits, if any, of all Participants subject to loss allocation in such round on such day.<sup>46</sup>

As proposed, Participants would have two (2) Business Days after DTC issues a first round Loss Allocation Notice to pay the amount specified in any such notice. In contrast to the current Section 4, under which DTC may apply the Actual Participants Fund Deposits of Participants directly to the satisfaction of loss allocation amounts, under proposed Section 5, DTC would require Participants to pay their loss allocation amounts (leaving their Actual Participants Fund Deposits intact).<sup>47</sup> On a subsequent round (i.e., if the first round did not cover the entire loss of the Event Period because DTC was only able to allocate up to the sum of the Loss Allocation Caps of those Participants included in the round), Participants would also have two (2) Business Days after notice by DTC to pay their loss allocation amounts (again subject to their Loss Allocation Caps), unless a Participant timely notified (or will timely notify) DTC of its election to terminate its business with DTC with respect to a prior loss allocation round.

Under the proposal, if a Participant fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, DTC would have the right to proceed against such Participant as a Participant that has failed to satisfy an obligation in accordance with proposed Section 3 of Rule 4 described above. Participants who wish to terminate their business with DTC would be required to comply with the requirements in proposed Section 6 of Rule 4, described further below. Specifically, proposed Section 5 would provide that if, after notifying DTC of its election to terminate its business with DTC pursuant to proposed Section 8(b) of Rule 4, the Participant fails to comply with the provisions of proposed Section 6 of Rule 4, its notice of termination would be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

### Section 6

Section 6 of Rule 4 currently provides that whenever a Participant ceases to be such, it continues to be obligated (a) to satisfy any deficiency in the amount of its Required Participants Fund Deposit and/or Required Preferred Stock Investment that it did not satisfy prior to such time, including (i) any deficiency resulting from a pro rata charge with respect to which the

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<sup>44</sup> See supra note 24.

<sup>45</sup> Supra note 12.

<sup>46</sup> Supra note 6.

<sup>47</sup> See supra note 27.



Participant has given notice to DTC of its election to terminate its business with DTC pursuant to Section 8 of Rule 4 and (ii) any deficiency the Participant is required to satisfy pursuant to Sections 3 (an obligation that a Participant failed to satisfy) or 5 (the requirement of a Participant to eliminate the deficiency in its Required Participants Fund Deposit) of Rule 4 and (b) to discharge any liability of the Participant to DTC resulting from the transactions of the Participant open at the time it ceases to be a Participant or on account of transactions occurring while it was a Participant.

Proposed Section 6 of Rule 4, titled “Obligations of Participant Upon Termination,” would consolidate the termination requirements from Section 6 of current Rule 4 into proposed Section 6(a), titled “Upon Any Termination,” and would modify them to conform to other proposed rule changes. Specifically, proposed Section 6(a) would state that, subject to proposed Section 8 of the Rule, whenever a Participant ceases to be such, it shall continue to be obligated (i) to satisfy any deficiency in the amounts of its Required Participants Fund Deposit and/or Required Preferred Stock Investment that it did not satisfy prior to such time, including any deficiency the Participant is required to satisfy pursuant to proposed Sections 3 or 4 of the Rule, and (ii) to discharge any liability of the Participant to DTC resulting from the transactions of the Participant open at the time it ceases to be a Participant or on account of transactions occurring while it was a Participant.

Proposed Section 6(b), titled “Upon Termination Following Settlement Charge or Loss Allocation,” would state that if a Participant timely notifies DTC of its election to terminate its business with DTC in respect of a pro rata settlement charge as set forth in proposed Section 4 of Rule 4 or a loss allocation as set forth in proposed Section 5 of Rule 4 (“Termination Notice”), the Participant would be required to: (1) specify in the Termination Notice a Participant Termination Date, which date shall be no later than ten Business Days following the last day of the applicable Settlement Charge Termination Notification Period or Loss Allocation Termination Notification Period; (2) cease all activity that would result in transactions being submitted to DTC for clearance and settlement after the Participant Termination Date; and (3) ensure that all activities and use of DTC services for which such Participant may have any obligation to DTC cease prior to the Participant Termination Date.

DTC is proposing to include a sentence in proposed Section 6(b) to make it clear that if the Participant fails to comply with the requirements set forth in this section, its Termination Notice will be deemed void, and the Participant will remain subject to further pro rata settlement charges pursuant to proposed Section 4 of Rule 4 or loss allocations pursuant to proposed Section 5 of Rule 4, as applicable, as if it had not given such notice.

### Section 8

Pursuant to the proposed rule change, Section 8 would be titled “Termination; Obligation for Pro Rata Settlement Charges and Loss Allocations,” and would be divided among proposed Section 8(a) “Settlement Charges,” proposed Section 8(b) “Loss Allocations,” proposed Section 8(c) “Maximum Obligation,” and proposed Section 8(d) “Obligation to Replenish Deposit.”

Pursuant to proposed Section 8(a), if a Participant, within five (5) Business Days after issuance of a Settlement Charge Notice pursuant to proposed Section 4 of Rule 4, gives notice to

DTC of its election to terminate its business with DTC, the Participant would remain obligated for (i) its pro rata settlement charge that was the subject of such Settlement Charge Notice and (ii) all other pro rata settlement charges made by DTC until the Participant Termination Date. Proposed Section 8(a) would provide that the terminating Participant's obligation would be limited to the amount of its Aggregate Required Deposit and Investment, as fixed on the day of the pro rata settlement charge that was the subject of the Settlement Charge Notice, plus 100% of the amount thereof, which is substantively the same limitation as provided for pro rata charges in Section 8 of current Rule 4.<sup>48</sup>

Pursuant to proposed Section 8(b), if a Participant, within five (5) Business Days after the issuance of a first Loss Allocation Notice for any round pursuant to proposed Section 5 of Rule 4 gives notice to DTC of its election to terminate its business with DTC, the Participant shall remain liable for (i) the loss allocation that was the subject of such notice and (ii) all other loss allocations made by DTC with respect to the same Event Period. The obligation of a Participant which elects to terminate its business with DTC would be limited to the amount of its Aggregate Required Deposit and Investment, as fixed on the first day of the Event Period, plus 100% of the amount thereof, which is substantively the same limitation as provided for pro rata charges in Section 8 of current Rule 4.<sup>49</sup>

Proposed Section 8(c) would provide that under no circumstances would the aggregate obligation of a Participant under proposed Section 8(a) and proposed Section 8(b) exceed the amount of its Aggregate Required Deposit and Investment, as fixed on the earlier of the (i) day of the pro rata settlement charge that was the subject of the Settlement Charge Notice giving rise to a Termination Notice, and (ii) first day of the Event Period that was the subject of the first Loss Allocation Notice in a round giving rise to a Termination Notice, plus 100% of the amount thereof. The purpose of proposed Section 8(c) is to address a situation where a Participant could otherwise be subject to both a Settlement Charge Cap and Loss Allocation Cap.

Proposed Section 8(d) would retain the last paragraph in Section 8 of current Rule 4, replacing "pro rata charge" with "pro rata settlement charge" and "loss allocation."<sup>50</sup> Proposed Section 8(d) would provide that if the amount of the Actual Participants Fund Deposit of a Participant is insufficient to satisfy a pro rata settlement charge pursuant to proposed Section 4 and proposed Section 8(a) or a loss allocation pursuant to proposed Section 5 and proposed Section 8(b), the Participant would be obligated to Deposit the amount of any such deficiency to the Participants Fund notwithstanding the fact that the Participant subsequently ceases to be a Participant.

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<sup>48</sup> See supra note 15.

<sup>49</sup> See supra note 30.

<sup>50</sup> This is a ministerial change because this paragraph currently applies to Section 4 of current Rule 4, which includes charges to complete settlement and for loss allocation, as would be provided in proposed Section 4 and proposed Section 5 of Rule 4.

Section 9

Pursuant to the proposed rule change, proposed Section 9 of Rule 4 would provide that the recovery and repayment provisions in current Rule 4 apply to both pro rata settlement charges and loss allocations.<sup>51</sup> Specifically, proposed Section 9 would provide that if an amount is charged ratably pursuant to proposed Section 4 or allocated ratably pursuant to proposed Section 5 and such amount is recovered by DTC, in whole or in part, the net amount of the recovery shall be repaid ratably (on the same basis that it was originally charged or allocated) to the Persons against which the amount was originally charged or allocated by (i) crediting the appropriate amounts to the Actual Participants Fund Deposits of Persons which are still Participants and (ii) paying the appropriate amounts in cash to Persons which are not still Participants.

DTC further proposes to add the heading “Recovery and Repayment” to proposed Section 9.

C. Other Proposed Clarifying, Conforming and Technical Changes to Rule 4

Section 1

Section 1(a) and Section 1(b). Section 1(a) addresses, among other things, the formula for determining the Required Participants Fund Deposits of Participants. DTC is proposing to insert the words “or wind-down” to make it clear that the formulas for determining the Required Participants Fund Deposits of Participants and the amount of the minimum Required Participants Fund Deposit would be fixed by DTC so as to assure that the aggregate amount of Required Participants Fund Deposits of Participants will be increased to provide for the costs and expenses incurred by it incidental to the wind-down of DTC, in addition to the voluntary liquidation of DTC.<sup>52</sup> Further, DTC proposes to delete the extraneous phrase “if any.” For increased clarity and readability, DTC is proposing to consolidate Section 1(b) into Section 1(a), and to relocate the sentences “The Corporation may require a Participant to Deposit an additional amount to the Participants Fund pursuant to Section 2 of Rule 9(A). Any such additional amount shall be part of the Required Participants Fund Deposit of such Participant.” from Section 1(a) to a new proposed Section 1(b). In addition to the relocation, DTC would add a defined term for such additional amount, as “Additional Participants Fund Deposit,” for drafting convenience and

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<sup>51</sup> This is a ministerial change because Section 9 currently applies to Section 4 of current Rule 4, which includes charges to complete settlement and for loss allocation, as would be provided in proposed Section 4 and proposed Section 5 of Rule 4.

<sup>52</sup> On December 18, 2017, DTC submitted a proposed rule change and advance notice to adopt the Recovery & Wind-down Plan of DTC, and amend the Rules in order to adopt Rule 32(A) (Wind-down of the Corporation) and Rule 38 (Market Disruption and Force Majeure). See SR-DTC-2017-021 and SR-DTC-2017-803, which were filed with the Commission and the Board of Governors of the Federal Reserve System, respectively, available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

transparency throughout proposed Rule 4. Further, DTC proposes to add the headings “Required Participants Fund Deposits” and “Additional Participants Fund Deposits” to Section 1(a) and proposed Section 1(b), respectively.

Section 1(c). For enhanced readability, DTC is proposing to add the heading “Voluntary Participants Fund Deposits” to Section 1(c) of Rule 4, and to replace the word “as” with “in the manner.”

Section 1(d). For enhanced clarity, DTC is proposing to modify Section 1(d) to make it clear that any Additional Participants Fund Deposit is required to be in cash. DTC is also proposing to delete the extraneous phrase “pursuant to this Section” and to replace language regarding Section 2 of Rule 9(A) with the proposed defined term “Additional Participants Fund Deposit.” Further, DTC proposes to add the heading “Cash Participants Fund” to Section 1(d) of Rule 4.

Section 1(e). For enhanced clarity, DTC is proposing to add the language “among Account Families” to clarify the scope of the allocation described in Section 1(e). In addition, DTC proposes to add the heading “Allocation of Participants Fund Deposits Among Account Families” to Section 1(e) of Rule 4.

Section 1(f). Section 1(f) addresses, among other things, the permitted use of the Participants Fund. For consistency with the balance of Section 1(f), the first paragraph would be amended to state that the Actual Participants Fund Deposits of Participants “may be used or invested” instead of stating “shall be applied.” Section 1(f) provides, in part, that the Participants Fund is limited to the satisfaction of losses or liabilities of DTC incident to the business of DTC. Section 1(f) currently defines “business” with respect to DTC as “the doing of all things in connection with or relating to [DTC’s] performance of the services specified in the first and second paragraphs of Rule 6 or the cessation of such services.” For enhanced transparency of the permitted uses of the Participants Fund, proposed Section 1(f) would be amended to explicitly state that the Actual Participants Fund Deposits of Participants may be used (i) to satisfy the obligations of Participants to DTC, as provided in proposed Section 3, (ii) to fund settlement among non-defaulting Participants, as provided in proposed Section 4 and (iii) to satisfy losses and liabilities of DTC incident to the business of DTC, as provided in proposed Section 5. Section 1(f) would also be amended to make the definition of “business” applicable to the entirety of Rule 4, instead of just Section 1(f), as the term would appear elsewhere in the rule pursuant to the proposed rule change. In addition, DTC proposes to add the heading “Maintenance, Permitted Use and Investment of Participants Fund” to Section 1(f) of Rule 4.

Section 1(g) (consolidated into proposed Section 1(f)). Pursuant to the proposed rule change, DTC would consolidate current Section 1(g) into proposed Section 1(f), and modify language to make it clear that DTC may invest cash in the Participants Fund in accordance with the Clearing Agency Investment Policy adopted by DTC.<sup>53</sup> Further, language would be streamlined by replacing “securities, repurchase agreements or deposits” with “financial assets,”

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<sup>53</sup> See Securities Exchange Act Release No. 79528 (December 12, 2016), 81 FR 91232 (December 16, 2016) (SR-DTC-2016-007).

and “securities and repurchase agreements in which such cash is invested” with “its investment of such cash.”

## Section 2

Pursuant to the proposed rule change, Section 2 of Rule 4 would be titled “Participants Investment.”

Section 2(a)-2(d) (Proposed Section 2(a)). For clarity, DTC is proposing to consolidate Sections 2(b)-2(d) into proposed Section 2(a) and would add the heading “Required Preferred Stock Investments” to proposed Section 2(a). In addition, DTC proposes to modify certain language to update references and cross-references to specific subsections to reflect the proposed changes to the numbering of the subsections in proposed Section 2 of Rule 4.

Section 2(e) (Proposed Section 2(b)). For enhanced clarity, DTC is proposing to add the language “among Account Families” to clarify the scope of the allocation described in proposed Section 2(b). In addition, DTC proposes to add the heading “Allocation of Preferred Stock Investments Among Account Families” to proposed Section 2(b) of Rule 4.

Section 2(f) (Proposed Section 2(c)). DTC is proposing to add language to clarify that when any Pledge of a Preferred Stock Security Interest pursuant to proposed Section 2(c) of Rule 4 is made by appropriate entries on the books of DTC, the Rules, in addition to such entries, shall be deemed to be a security agreement for purposes of the New York Uniform Commercial Code. In addition, DTC proposes to update a cross-reference to proposed Section 2(c). In addition, DTC proposes to add the heading “Security Interest in Preferred Stock Investments of Participants” to proposed Section 2(c).

Sections 2(g) – 2(i) (Proposed Sections 2(d) – 2(f)). DTC proposes to add the headings “Dividends on Preferred Stock Investments of Participants,” “Sale of Preferred Stock Investments of Participants,” and “Permitted Transfers of Preferred Stock Investments of Participants” to proposed Sections 2(d), 2(e), and 2(f), respectively. Proposed Sections 2(e) and 2(f) would be modified to update cross-references to certain subsections. In addition, proposed Section 2(f) would be modified to renumber paragraphs and internal lists for consistency with the numbering schemes in Rule 4.

Section 7. For clarity, DTC is proposing to amend Section 7 of Rule 4 to (i) replace language referencing Additional Participants Fund Deposits with the proposed defined term, (ii) update cross-references to reflect proposed renumbering, and (iii) add the headings “Increased Participants Fund Deposits and Preferred Stock Investments,” “Required Participants Fund Deposits,” and “Required Preferred Stock Investments” to proposed Sections 7, 7(a) and 7(b) of Rule 4, respectively.

## D. Proposed Changes to Rule 1

DTC is proposing to amend Rule 1 (Definitions; Governing Law) to add cross-references to proposed terms that would be defined in Rule 4, and to delete one defined term. The defined terms to be added are: “Additional Participants Fund Deposit,” “Corporate Contribution,” “Declared Non-Default Loss Event,” “Default Loss Event,” “Event Period,” “Loss Allocation

Cap,” “Loss Allocation Notice,” “Loss Allocation Termination Notification Period,” “Participant Default,” “Participant Termination Date,” “Settlement Charge Cap,” “Settlement Charge Notice,” “Settlement Charge Termination Notification Period,” and “Termination Notice”. The term “Section 8 Pro Rata Charge” would be deleted from Rule 1, because it would be deleted from proposed Rule 4 as no longer necessary.

#### Participant Outreach

Beginning in August 2017, DTC has conducted outreach to Participants in order to provide them with advance notice of the proposed changes. As of the date of this filing, no written comments relating to the proposed changes have been received in response to this outreach. The Commission will be notified of any written comments received.

#### Implementation Timeframe

Pending Commission approval, DTC expects to implement this proposal promptly. Participants would be advised of the implementation date of this proposal through issuance of a DTC Important Notice.

#### *Expected Effect on Risks to the Clearing Agency, its Participants and the Market*

DTC believes that the proposed rule changes to clarify the remedies available to DTC with respect to a Participant Default, including the application of the Participants Fund as a liquidity resource, and by clarifying and providing the related processes, would provide clarity as to the application of the Participants Fund to fund settlement and would mitigate any risk to settlement finality due to Participant Default.

DTC believes that the proposed rule change to enhance the resiliency of DTC’s loss allocation process and to shorten the time within which DTC is required to return the Actual Participants Fund Deposit of a former Participant would reduce the risk of uncertainty to DTC, its Participants and the market overall.

By replacing the discretionary application of DTC retained earnings to losses and liabilities with a mandatory and defined amount of the Corporate Contribution, the proposed rule change is designed to provide enhanced transparency and accessibility to Participants as to how much DTC would contribute in the event of a loss or liability. The proposed rule change also clarifies that the Corporate Contribution applies to both Default Loss Events and Declared Non-Default Loss Events. The proposed rule change would provide greater transparency as to the proposed replenishment period for the Corporate Contribution, which would allow Participants to better assess the adequacy of DTC’s loss allocation process. Taken together, the proposed rule changes with respect to the Corporate Contribution would enhance the overall resiliency of DTC’s loss allocation process by specifying the calculation and application of DTC’s Corporate Contribution, including the proposed replenishment period, and would allow Participants to better assess the adequacy of DTC’s loss allocation process.

By introducing the concept of an Event Period, DTC would be able to group Default Loss Events and Declared Non-Default Loss Events occurring within a period of ten (10) Business Days for purposes of allocating losses to Participants. DTC believes that the Event Period would

provide a defined structure for the loss allocation process to encompass potential sequential Default Loss Events or Declared Non-Default Loss Events that may or may not be closely linked to an initial event and/or a market dislocation episode. Having this structure would enhance the overall resiliency of DTC's loss allocation process because the proposed rule would expressly address losses that may arise from multiple Default Loss Events and/or Declared Non-Default Loss Events that arise in quick succession. Moreover, the proposed Event Period structure would provide certainty for Participants concerning their maximum exposure to mutualized loss allocation with respect to such events.

By introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Participant termination process in connection with the loss allocation process, DTC would (i) set forth a defined amount that it would allocate to Participants during each round (i.e., the round cap), (ii) advise Participants of loss allocation obligation information as well as round information through the issuance of Loss Allocation Notices, and (iii) provide Participants with the option to limit their loss allocation exposure after the issuance of the first Loss Allocation Notice in each round. These proposed rule changes would enhance the overall resiliency of DTC's loss allocation process because they would expressly permit DTC to continue the loss allocation process in successive rounds until all of DTC's losses are allocated and enable DTC to identify continuing Participants for purposes of calculating subsequent loss allocation obligations in successive rounds. Moreover, the proposed rule changes would define for Participants a clear manner and process in which they could cap their loss allocation exposure to DTC.

By reducing the time within which DTC is required to return the Actual Participants Fund Deposit of a former Participant, DTC would enable firms that have exited DTC to have access to their funds sooner than under current Rule 4 while maintaining the protection of DTC and its provision of clearance and settlement services. DTC would continue to be protected under the proposed rule change, which will maintain the provision that DTC may offset the return of funds against the amount of any loss or liability of DTC arising out of or relating to the obligations of the former Participant to DTC, and would provide that DTC could retain the funds for up to two (2) years. As such, DTC would maintain a necessary level of coverage for possible claims arising in connection with the DTC activities of a former Participant.

#### *Management of Identified Risks*

DTC is proposing the rule changes as described in detail above in order to (i) provide clarity as to the application of the Participants Fund to fund settlement when a Participant fails to settle, (ii) enhance the resiliency of DTC's loss allocation process, and (iii) provide clarity and certainty to Participants regarding DTC's loss allocation process.

#### *Consistency with the Clearing Supervision Act*

The proposed rule change would be consistent with Section 805(b) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act").<sup>54</sup> The objectives and

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<sup>54</sup> 12 U.S.C. 5464(b).

principles of Section 805(b) of the Clearing Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.<sup>55</sup>

The proposed rule change would provide clarity and certainty around the use of the Participants Fund in connection with a Participant Default by expressly providing for the application of the Actual Participants Fund Deposit of the defaulting Participant to its unpaid obligations, and by providing a defined process for pro rata settlement charges to non-defaulting Participants that is separate from the loss allocation process. Together, these proposed rule changes more clearly specify the rights and obligations of DTC and its Participants in respect of the application of the Participants Fund. Reducing the risk of uncertainty to DTC, its Participants, and the market overall would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, DTC believes that the proposed rule changes to provide clarity and certainty around the use of the Participants Fund in connection with a Participant Default, and to provide a defined process for pro rata settlement charges to the Actual Participants Fund Deposits of non-defaulting Participants, are consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

The proposed rule change would enhance the resiliency of DTC's loss allocation process by (1) requiring a defined contribution of DTC corporate funds to a loss, (2) introducing an Event Period, and (3) introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Participant termination process in connection with the loss allocation process. Together, these proposed rule changes would (i) create greater certainty for Participants regarding DTC's obligation towards a loss, (ii) more clearly specify DTC's and Participants' obligations toward a loss and balance the need to manage the risk of sequential defaults and other potential loss events against Participants' need for certainty concerning their maximum exposures, and (iii) provide Participants the opportunity to limit their exposure to DTC by capping their exposure to loss allocation. Reducing the risk of uncertainty to DTC, its Participants and the market overall would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, DTC believes that the proposed rule change to enhance the resiliency of DTC's loss allocation process is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

The proposed rule change is also consistent with Rules 17Ad-22(e)(7)(i), 17Ad-22(e)(13) and (e)(23)(i), promulgated under the Act.<sup>56</sup>

Rule 17Ad-22(e)(7)(i) under the Act requires, in part, that DTC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by DTC, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and

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<sup>55</sup> Id.

<sup>56</sup> 17 CFR 240.17Ad-22(e)(7)(i), (e)(13) and (e)(23)(i).



its use of intraday liquidity, by maintaining sufficient liquid resources to effect same-day settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios.<sup>57</sup> By clarifying the remedies available to DTC with respect to a Participant Default, including the application of the Participants Fund as a liquidity resource, and by clarifying and providing the related processes, the proposed rule change is designed so that DTC may manage its settlement and funding flows on a timely basis and apply the Participants Fund as a liquid resource in order to effect same day settlement of payment obligations with a high degree of confidence. Therefore, DTC believes that the proposed rule changes with respect to the application of the Actual Participants Fund Deposits of non-defaulting Participants to complete settlement are consistent with Rule 17Ad-22(e)(7)(i) under the Act.

Rule 17Ad-22(e)(13) under the Act requires, in part, that DTC establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure DTC has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations.<sup>58</sup> The proposed rule changes to (1) require a defined Corporate Contribution to a loss, (2) introduce an Event Period, (3) introduce the concept of “rounds” (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the Participant termination process in connection with the loss allocation process, taken together, are designed to enhance the resiliency of DTC’s loss allocation process. Having a resilient loss allocation process would help ensure that DTC can effectively and timely address losses relating to or arising out of Default Loss Events and/or Declared Non-Default Loss Events, which in turn would help DTC contain losses and continue to conduct its clearance and settlement business. In addition, by providing clarity as to the application of the Participants Fund to fund settlement in the event of a Participant Default, the proposed rule change is designed to clarify that DTC is authorized to use the Participants Fund to fund settlement. Therefore, DTC believes that the proposed rule changes to enhance the resiliency of DTC’s loss allocation process, and to provide clarity as to the application of the Participants Fund to fund settlement, are consistent with Rule 17Ad-22(e)(13) under the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires DTC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of DTC’s default rules and procedures.<sup>59</sup> The proposed rule changes to (i) separate the provisions for the use of the Participants Fund for settlement and for loss allocation, (ii) make clarifying changes to the provisions regarding the application of the Participants Fund to complete settlement and for the allocation of losses, (iii) further align the loss allocation rules of the DTCC Clearing Agencies, (iv) improve the overall transparency and accessibility of the provisions in the Rules governing loss allocation, and (v) make technical and conforming changes, would not only ensure that DTC’s loss allocation rules are, to the extent practicable and appropriate, consistent with the loss allocation rules of the other DTCC Clearing Agencies, but also would help to ensure that DTC’s loss allocation rules are

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<sup>57</sup> Id. at 240.17Ad-22(e)(7)(i).

<sup>58</sup> Id. at 240.17Ad-22(e)(13).

<sup>59</sup> Id. at 240.17Ad-22(e)(23)(i).

transparent and clear to Participants. Aligning the loss allocation rules of the DTCC Clearing Agencies would provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and clear loss allocation rules would enable Participants to better understand the key aspects of DTC's Rules and Procedures relating to Participant Default, as well as non-default events, and provide Participants with increased predictability and certainty regarding their exposures and obligations. As such, DTC believes that the proposed rule changes with respect to pro rata settlement charges, and to align the loss allocation rules across the DTCC Clearing Agencies and to improve the overall transparency and accessibility of DTC's loss allocation rules are consistent with Rule 17Ad-22(e)(23)(i) under the Act.

**11. Exhibits**

Exhibit 1 – Not applicable.

Exhibit 1A – Notice of proposed rule change for publication in the Federal Register.

Exhibit 2 – Not applicable.

Exhibit 3 – Not applicable.

Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the Rules.

**EXHIBIT 1A**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-[\_\_\_\_\_]; File No. SR-DTC-2017-804)

[DATE]

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing of Advance Notice to Amend the Loss Allocation Rules and Make Other Changes

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 (“Act”),<sup>2</sup> notice is hereby given that on December \_\_, 2017, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice SR-DTC-2017-804 (“Advance Notice”) as described in Items I, II and III below, which Items have been prepared by the clearing agency.<sup>3</sup> The Commission is publishing this notice to solicit comments on the Advance Notice from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by DTC in connection with proposed modifications to

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> On December \_\_, 2017, DTC filed this Advance Notice as a proposed rule change (SR-DTC-2017-022) with the Commission pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), and Rule 19b-4 thereunder, 17 CFR 240.19b-4. A copy of the proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

the Rules, By-Laws and Organization Certificate of DTC (“Rules”).<sup>4</sup> The proposed rule change would revise Rule 4 (Participants Fund and Participants Investment) to (i) provide separate sections for (x) the use of the Participants Fund as a liquidity resource for settlement and (y) loss allocation among Participants of losses and liabilities arising out of Participant defaults or due to non-default events; and (ii) enhance the resiliency of DTC’s loss allocation process so that DTC can take timely action to contain multiple loss events that occur in succession during a short period of time. In connection therewith, the proposed rule change would (i) align the loss allocation rules of the three clearing agencies of The Depository Trust & Clearing Corporation (“DTCC”), namely DTC, National Securities Clearing Corporation (“NSCC”), and Fixed Income Clearing Corporation (“FICC”) (collectively, the “DTCC Clearing Agencies”),<sup>5</sup> so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies, (ii) increase transparency and accessibility of the provisions relating to the use of the Participants Fund as a liquidity resource for settlement and the loss allocation provisions, by enhancing their readability and clarity, (iii) require a defined corporate contribution to losses and liabilities that are incurred by DTC prior to any allocation among Participants, whether such losses and liabilities arise out of Participant defaults or due to non-default events, (iv) reduce the

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<sup>4</sup> Each capitalized term not otherwise defined herein has its respective meaning as set forth in the Rules, available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>.

<sup>5</sup> On December \_\_, 2017, NSCC and FICC submitted proposed rule changes and advance notices to enhance their rules regarding allocation of losses. See SR-NSCC-2017-018, SR-FICC-2017-022 and SR-NSCC-2017-806, SR-FICC-2017-806, which were filed with the Commission and the Board of Governors of the Federal Reserve System, respectively, available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

time within which DTC is required to return a former Participant's Actual Participants Fund Deposit, and (v) make conforming and technical changes. The proposed rule change would also amend Rule 1 (Definitions; Governing Law) to add cross-references to terms that would be defined in proposed Rule 4, as discussed below.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the Advance Notice and discussed any comments it received on the Advance Notice. 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 and B below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

Written comments relating to this proposal have not been solicited or received.

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

(B) Advance Notice Filed Pursuant to Section 806(e) of the Clearing Supervision Act

Nature of the Proposed Change

The proposed rule change would revise Rule 4 (Participants Fund and Participants Investment) to (i) provide separate sections for (x) the use of the Participants Fund as a liquidity resource for settlement and (y) loss allocation among Participants of losses and liabilities arising out of Participant defaults or due to non-default events; and (ii) enhance the resiliency of DTC's loss allocation process so that DTC can take timely action to contain multiple loss events that occur in succession during a short period of time. In connection therewith, the proposed rule change would (i) align the loss allocation rules of

the DTCC Clearing Agencies, so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies, (ii) increase transparency and accessibility of the provisions relating to the use of the Participants Fund as a liquidity resource for settlement and the loss allocation provisions, by enhancing their readability and clarity, (iii) require a defined corporate contribution to losses and liabilities that are incurred by DTC prior to any allocation among Participants, whether such losses and liabilities arise out of Participant defaults or due to non-default events, (iv) reduce the time within which DTC is required to return a former Participant's Actual Participants Fund Deposit, and (v) make conforming and technical changes. The proposed rule change would also amend Rule 1 (Definitions; Governing Law) to add cross-references to terms that would be defined in proposed Rule 4, as discussed below.

(i) Background

Current Rule 4 provides a single set of tools and a common process for the use of the Participants Fund for both liquidity purposes to complete settlement among non-defaulting Participants, if one or more Participants fails to settle,<sup>6</sup> and for the satisfaction

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<sup>6</sup> DTC's primary objective is to complete settlement on each Business Day in reliance on liquidity resources comprised of, primarily, the Participants Fund and a committed secured line of credit from a syndicate of lenders. Settlement obligations of each Participant are limited by the amount of these liquidity resources through its Net Debit Cap and fully secured by Collateral of the Participant measured by its Collateral Monitor. These risk management controls are designed so that DTC may complete settlement notwithstanding the failure to settle of a Participant or Affiliated Family of Participants with the largest settlement obligation on any Business Day. The proposed rule change clarifies the use of the Participants Fund in this respect. The Actual Participants Fund Deposits of defaulting Participants would be applied to satisfy their settlement obligations and, should those be insufficient, the balance of the Participants Fund is also available as a liquidity resource. Collateral of defaulting Participants may be pledged to secure a borrowing under the committed line of credit.

of losses and liabilities due to Participant defaults or certain other losses or liabilities incident to the business of DTC.<sup>7</sup> The proposed rule change would amend and add provisions to separate use of the Participants Fund as a liquidity resource to complete settlement, reflected in proposed Section 4 of Rule 4, and for loss allocation, reflected in proposed Section 5 of Rule 4.

The proposed rule change would retain the core principles of current Rule 4 for both application of the Participants Fund as a liquidity resource to complete settlement and for loss allocation, while clarifying or refining certain provisions and introducing certain new concepts relating to loss allocation. In connection with the use of the Participants Fund as a liquidity resource to complete settlement when a Participant fails to settle, the proposed rule would introduce the term “pro rata settlement charge,” for the use of the Participants Fund to complete settlement as apportioned among non-defaulting Participants. The existing term generically applied to such a use or to a loss allocation is simply a “pro rata charge”.<sup>8</sup>

For loss allocation, the proposed rule change, like current Rule 4, would continue to apply to both default and non-default losses and liabilities, and, to the extent allocated among Participants, would be charged ratably in accordance with their Required Participants Fund Deposits.<sup>9</sup> A new provision would require DTC to contribute to a loss

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<sup>7</sup> It may be noted that absent extreme circumstances, DTC believes that it is unlikely that DTC would need to act under proposed Sections 4 or 5 of Rule 4.

<sup>8</sup> See Rule 4, Section 5, supra note 4.

<sup>9</sup> It may be noted that for NSCC and FICC, the proposed rule changes for loss allocation include a “look-back” period to calculate a member’s pro rata share and cap. The concept of a look-back or average is already built into DTC’s

or liability, either arising from a Participant default or non-default event, prior to any allocation among Participants. The proposed rule change would also introduce the new concepts of an “Event Period” and a “round” to address the allocation of losses arising from multiple events that occur in succession during a short period of time. These proposed rule changes would be substantially similar in these respects to analogous proposed rule changes for NSCC and FICC.

*Current Rule 4 Provides for Application of the Participants Fund Through Pro Rata Charges*

Current Rule 4 addresses the Participants Fund and Participants Investment requirements and, among other things, the permitted uses of the Participants Fund and Participants Investment.<sup>10</sup> Pursuant to current Rule 4, DTC maintains a cash Participants Fund. The Required Participants Fund Deposit for any Participant is based on the liquidity risk it poses to DTC relative to other Participants.<sup>11</sup>

Default of a Participant. Under Section 3 of current Rule 4, if a Participant is obligated to DTC and fails to satisfy any obligation, DTC may, in such order and in such amounts as DTC shall determine in its sole discretion: (a) apply some or all of the Actual Participants Fund Deposit of such Participant to such obligation; (b) Pledge some or all of the shares of Preferred Stock of such Participant to its lenders as collateral security for a

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calculation of Participants Fund requirements, which are based on a rolling sixty (60) day average of a Participant’s six highest intraday net debit peaks.

<sup>10</sup> Each Participant is required to invest in DTC Series A Preferred Stock, ratably on a basis calculated in substantially the same manner as the Required Participants Fund Deposit. The Preferred Stock constitutes capital of DTC and is also available for use as provided in current and proposed Section 3 of Rule 4. This proposed rule change does not alter the Required Preferred Stock Investment.

<sup>11</sup> Supra note 6.



loan under the End-of-Day Credit Facility;<sup>12</sup> and/or (c) sell some or all of the shares of Preferred Stock of such Participant to other Participants (who shall be required to purchase such shares pro rata their Required Preferred Stock Investments at the time of such purchase), and apply the proceeds of such sale to satisfy such obligation.

Application of the Participants Fund. Section 4 of current Rule 4 addresses the application of the Participants Fund if DTC incurs a loss or liability, which would include application of the Participants Fund to complete settlement or the allocation of losses once determined, including non-default losses. For both liquidity and loss scenarios, Section 4 of current Rule 4 provides that an application of the Participants Fund would be apportioned among Participants ratably in accordance with their Required Participants Fund Deposits, less any additional amount that a Participant was required to Deposit to the Participants Fund pursuant to Section 2 of Rule 9(A).<sup>13</sup> It also provides for the optional use of an amount of DTC's retained earnings and undivided profits.

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<sup>12</sup> As part of its liquidity risk management regime, DTC maintains a 364-day committed revolving line of credit with a syndicate of commercial lenders, renewed every year. The committed aggregate amount of the End-of-Day Credit Facility (currently \$1.9 billion) together with the Participants Fund constitute DTC's liquidity resources for settlement. Based on these amounts, DTC sets Net Debit Caps that limit settlement obligations.

<sup>13</sup> Section 2 of Rule 9(A) provides, in part, "At the request of the Corporation, a Participant or Pledgee shall immediately furnish the Corporation with such assurances as the Corporation shall require of the financial ability of the Participant or Pledgee to fulfill its commitments and shall conform to any conditions which the Corporation deems necessary for the protection of the Corporation, other Participants or Pledgees, including deposits to the Participants Fund . . ." Pursuant to the proposed rule change, the additional amount that a Participant is required to Deposit to the Participants Fund pursuant to Section 2 of Rule 9(A) would be defined as an "Additional Participants Fund Deposit." This is not a new concept, only the addition of a defined term for greater clarity. In the proposed rule change, this amount continues to be included or excluded as provided in current Rule 4, as noted below.

After the Participants Fund is applied pursuant to current Section 4, DTC must promptly notify each Participant and the Commission of the amount applied and the reasons therefor.

Current Rule 4 further requires Participants whose Actual Participants Fund Deposits have been ratably charged to restore their Required Participants Fund Deposits, if such charges create a deficiency. Such payments are due upon demand. Iterative pro rata charges relating to the same loss or liability are permitted in order to satisfy the loss or liability.

Rule 4 currently provides that a Participant may, within ten (10) Business Days after receipt of notice of any pro rata charge, notify DTC of its election to terminate its business with DTC, and the exposure of the terminating Participant for pro rata charges would be capped at the greater of (a) the amount of its Aggregate Required Deposit and Investment, as fixed immediately prior to the time of the first pro rata charge, plus 100% of the amount thereof, or (b) the amount of all prior pro rata charges attributable to the same loss or liability with respect to which the Participant has not timely exercised its right to terminate.

*Overview of the Proposed Rule Changes*

A. Application of Participants Fund to Participant Default and for Settlement

Proposed Section 3 of Rule 4 would retain the concept that when a Participant is obligated to DTC and fails to satisfy such obligation, which would be defined as a “Participant Default,” DTC may apply the Actual Participants Fund Deposit of the Participant to such obligation to satisfy the Participant Default. The proposed definition of “Participant Default” is for drafting clarity and use in related provisions.

Proposed Section 4 would address the situation of a Participant failure to settle (which is one type of Participant Default) if the application of the Actual Participants Fund Deposit of that Participant, pursuant to proposed Section 3, is not sufficient to complete settlement among non-defaulting Participants.

Proposed Section 4 would expressly state that the Participants Fund may be applied by DTC, in such amounts as it may determine, in its sole discretion, to fund settlement among non-defaulting Participants in the event of the failure of a Participant to satisfy its settlement obligation on any Business Day. Such an application of the Participants Fund would be charged ratably to the Actual Participants Fund Deposits of the non-defaulting Participants on that Business Day. The pro rata charge per non-defaulting Participant would be based on the ratio of its Required Participants Fund Deposit to the sum of the Required Participants Fund Deposits of all such Participants on that Business Day (excluding any Additional Participants Fund Deposits in both the numerator and denominator of such ratio). The proposed rule change would identify this as a “pro rata settlement charge,” in order to distinguish application of the Participants Fund to fund settlement from pro rata loss allocation charges that would be established in proposed Section 5 of Rule 4.

The calculation of each non-defaulting Participant’s pro rata settlement charge would be similar to the current Section 4 calculation of a pro rata charge except that, for greater simplicity, it would not include the current distinction for common members of another clearing agency pursuant to a Clearing Agency Agreement.<sup>14</sup> For enhanced

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<sup>14</sup> Rule 4, Section 4(a)(1), supra note 4. DTC has determined that this option is unnecessary because, in practice, DTC would never have liability under a

clarity as to the date of determination of the ratio, it would be based on the Required Participants Fund Deposits as fixed on the Business Day of the application of the Participants Fund, as opposed to the current language “at the time the loss or liability was discovered.”<sup>15</sup>

The proposed rule change would retain the concept that requires DTC, following the application of the Participants Fund to complete settlement, to notify each Participant and the Commission of the charge and the reasons therefor (“Settlement Charge Notice”).

The proposed rule change also would retain the concept of providing each non-defaulting Participant an opportunity to elect to terminate its business with DTC and thereby cap its exposure to further pro rata settlement charges. The proposed rule change would shorten the notification period for the election to terminate from ten (10) Business Days to five (5) Business Days,<sup>16</sup> and would also change the beginning date of such notification period from the receipt of the notice to the date of the issuance of the

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Clearing Agency Agreement that exceeds the excess assets of the Participant that defaulted.

<sup>15</sup> DTC believes that this change would provide an objective date that is more appropriate for the application of the Participants Fund to complete settlement, because the “time the loss or liability was discovered” would necessarily have to be the day the Participants Fund was applied to complete settlement.

<sup>16</sup> DTC believes this shorter period would be sufficient for a Participant to decide whether to give notice to terminate its business with DTC in response to a settlement charge. In addition, a five (5) Business Day pro rata settlement charge notification period would conform to the proposed loss allocation notification period in this proposed rule change and in the proposed rule changes for NSCC and FICC. See infra note 31. See also supra note 5.

Settlement Charge Notice.<sup>17</sup> A Participant that elects to terminate its business with DTC would, subject to its cap, remain responsible for (i) its pro rata settlement charge that was the subject of the Settlement Charge Notice and (ii) all other pro rata settlement charges until the Participant Termination Date (as defined below and in the proposed rule change). The proposed cap on pro rata settlement charges of a Participant that has timely notified DTC of its election to terminate its business with DTC would be the amount of its Aggregate Required Deposit and Investment, as fixed on the day of the pro rata settlement charge that was the subject of the Settlement Charge Notice, plus 100% of the amount thereof. The proposed cap would be no greater than the current cap.<sup>18</sup>

The pro rata application of the Actual Participants Fund Deposits of non-defaulting Participants to complete settlement when there is a Participant Default is not the allocation of a loss. A pro rata settlement charge would relate solely to the completion of settlement. New proposed loss allocation concepts described below, including, but not limited to, a “round,” “Event Period,” and “Corporate Contribution,” would not apply to pro rata settlement charges.<sup>19</sup>

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<sup>17</sup> DTC believes that setting the start date of the notification period to an objective date would enhance transparency and provide a common timeframe to all affected Participants.

<sup>18</sup> Section 8 of current Rule 4 provides for a cap that is equal to the greater of (a) the amount of its Aggregate Required Deposit and Investment, as fixed immediately prior to the time of the first pro rata charge, plus 100% of the amount thereof, or (b) the amount of all prior pro rata charges attributable to the same loss or liability with respect to which the Participant has not timely exercised its right to limit its obligation as provided above. Supra note 4. The alternative limit in clause (b) would be eliminated in proposed Section 8(a) in favor of a single defined standard.

<sup>19</sup> Proposed Sections 3, 4 and 5 of Rule 4 together relate, in whole or in part, to what may happen when there is a Participant Default. Proposed Section 3 is the basic

B. Changes to Enhance Resiliency of DTC's Loss Allocation Process

In order to enhance the resiliency of DTC's loss allocation process and to align, to the extent practicable and appropriate, its loss allocation approach to that of the other DTCC Clearing Agencies, DTC proposes to introduce certain new concepts and to modify other aspects of its loss allocation waterfall. The proposed rule change would adopt an enhanced allocation approach for losses, whether arising from Default Loss Events or Declared Non-Default Loss Events (as defined below). In addition, the proposed rule change would clarify the loss allocation process as it relates to losses arising from or relating to multiple default or non-default events in a short period of time.

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provision of remedies if a Participant fails to satisfy an obligation to DTC. Proposed Section 4 is a specific remedy for a failure to settle, i.e., a specific type of Participant Default. Proposed Section 5 is also a remedial provision for a Participant Default when, additionally, DTC ceases to act for the Participant and there are remaining losses or liabilities. If a Participant Default occurs, the application of proposed Section 3 would be required, the application of proposed Section 4 would be at the discretion of DTC and the application of proposed Section 5 would only be triggered by the determination of DTC to cease to act for the defaulting Participant coupled with losses or liabilities incurred by DTC. Whether or not proposed Section 4 has been applied, once there is a loss due to a Participant Default and DTC ceases to act for the defaulting Participant, proposed Section 5 would apply.

A principal type of Participant Default is a failure to settle. A Participant's obligation to pay any amount due in settlement is secured by Collateral of the Participant. When the Participant fails to pay its settlement obligation, under Rule 9(B), Section 2, DTC has the right to Pledge or sell such Collateral to satisfy the obligation. Supra note 4. (It is more likely that DTC would borrow against the Collateral to complete settlement on the Business Day, because it is unlikely to be able to liquidate Collateral for same day funds in time to settle on that Business Day.) If DTC Pledges the Collateral to secure a loan to fund settlement (e.g., under the End-of-Day Credit Facility), the Collateral would have to be sold to obtain funds to repay the loan. In any such sale of the Collateral, there is a risk, heightened in times of market stress, that the proceeds of the sale would be insufficient to repay the loan. That deficiency would be a liability or loss to which proposed Section 5 of Rule 4 would apply, i.e., a Default Loss Event.

Accordingly, DTC is proposing four (4) key changes to enhance DTC's loss allocation process:

(1) Mandatory Corporate Contribution.

Section 4 of current Rule 4 provides that if there is an unsatisfied loss or liability, DTC may, in its sole discretion and in such amount as DTC would determine, "charge the existing retained earnings and undivided profits" of DTC.

Under the proposed rule change, DTC would replace the discretionary application of an unspecified amount of retained earnings and undivided profits with a mandatory, defined Corporate Contribution (as defined below and in the proposed rule change). The Corporate Contribution would be used for losses and liabilities that are incurred by DTC with respect to an Event Period (as defined below and in the proposed rule change), whether arising from a Default Loss Event or Declared Non-Default Loss Event, before the allocation of losses to Participants.

The proposed "Corporate Contribution" would be defined to be an amount equal to fifty percent (50%) of DTC's General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period.<sup>20</sup> DTC's General Business Risk Capital Requirement, as defined in DTC's Clearing Agency Policy on Capital Requirements,<sup>21</sup> is, at a minimum, equal to the regulatory capital that DTC is

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<sup>20</sup> DTC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (i) an amount determined based on its general business profile, (ii) an amount determined based on the time estimated to execute a recovery or orderly wind-down of DTC's critical operations, and (iii) an amount determined based on an analysis of DTC's estimated operating expenses for a six (6) month period.

<sup>21</sup> See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-DTC-2017-003).

required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.<sup>22</sup> The Corporate Contribution would be held in addition to DTC's General Business Risk Capital Requirement.

The proposed Corporate Contribution would apply to losses arising from Default Loss Events and Declared Non-Default Loss Events, and would be a mandatory contribution of DTC prior to any allocation among Participants.<sup>23</sup> As proposed, if the proposed Corporate Contribution is fully or partially used against a loss or liability relating to an Event Period, the Corporate Contribution would be reduced to the remaining unused amount, if any, during the following two hundred fifty (250) Business Days in order to permit DTC to replenish the Corporate Contribution.<sup>24</sup> To ensure transparency, Participants would receive notice of any such reduction to the Corporate Contribution.

By requiring a defined contribution of DTC corporate funds towards losses and liabilities arising from Default Loss Events and Declared Non-Default Loss Events, the proposed rule change would limit Participant obligations to the extent of such Corporate

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<sup>22</sup> 17 CFR 240.17Ad-22(e)(15).

<sup>23</sup> The proposed rule change would not require a Corporate Contribution with respect to a pro rata settlement charge. However, as discussed above, if, after a Participant Default, the proceeds of the sale of the Collateral of the Participant are insufficient to replenish the Participants Fund and/or repay the lenders under the End-of-Day Credit Facility, and DTC has ceased to act for the Participant, the shortfall would be a loss arising from a Default Loss Event, subject to the Corporate Contribution.

<sup>24</sup> DTC believes that two hundred fifty (250) Business Days would be a reasonable estimate of the time frame that DTC would require to replenish the Corporate Contribution by equity in accordance with DTC's Clearing Agency Policy on Capital Requirements, including a conservative additional period to account for any potential delays and/or unknown exigencies in times of distress.



Contribution and thereby provide greater clarity and transparency to Participants as to the calculation of their exposure to losses and liabilities.

Proposed Rule 4 would also further clarify that DTC can voluntarily apply amounts greater than the Corporate Contribution against any loss or liability (including non-default losses) of DTC, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

The proposed rule changes relating to the calculation and mandatory application of the Corporate Contribution are set forth in proposed Section 5 of Rule 4.

(2) Introducing an Event Period.

The proposed rule change would clearly define the obligations of DTC and its Participants regarding the allocation of losses or liabilities (i) relating to or arising out of a Participant Default which is not satisfied pursuant to proposed Section 3 of Rule 4 and DTC has ceased to act for such Participant (a “Default Loss Event”) and/or (ii) otherwise incident to the business of DTC,<sup>25</sup> as determined in proposed Rule 4 (a “Declared Non-Default Loss Event”). In order to balance the need to manage the risk of sequential loss events against Participants’ need for certainty concerning maximum loss allocation exposures, DTC is proposing to introduce the concept of an “Event Period” to address the losses and liabilities that may arise from or relate to multiple Default Loss Events and/or Declared Non-Default Loss Events that arise in quick succession. Specifically, the proposal would group Default Loss Events and Declared Non-Default Loss Events

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<sup>25</sup> Section 1(f) of Rule 4 defines the term “business” with respect to DTC as “the doing of all things in connection with or relating to the Corporation’s performance of the services specified in the first and second paragraphs of Rule 6 or the cessation of such services.” Supra note 4.

occurring in a period of ten (10) Business Days (“Event Period”) for purposes of allocating losses to Participants in one or more rounds, subject to the limits of loss allocation set forth in the proposed rule change and as explained below.<sup>26</sup> In the case of a loss or liability arising from or relating to a Default Loss Event, an Event Period would begin on the day on which DTC notifies Participants that it has ceased to act for a Participant (or the next Business Day, if such day is not a Business Day). In the case of a Declared Non-Default Loss Event, the Event Period would begin on the day that DTC notifies Participants of the determination by the Board of Directors that the applicable loss or liability incident to the business of DTC may be a significant and substantial loss or liability that may materially impair the ability of DTC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Participants in order to ensure that DTC may continue to offer clearance and settlement services in an orderly manner. If a subsequent Default Loss Event or Declared Non-Default Loss Event occurs within the Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period. An Event Period may include both Default Loss Events and Declared Non-Default Loss Events, and there would not be separate Event Periods for

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<sup>26</sup> DTC believes that having a ten (10) Business Day Event Period would provide a reasonable period of time to encompass potential sequential Default Loss Events and/or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or a severe market dislocation episode, while still providing appropriate certainty for Participants concerning their maximum exposure to allocated losses with respect to such events.

Default Loss Events or Declared Non-Default Loss Events occurring within overlapping ten (10) Business Day periods.

The amount of losses that may be allocated by DTC, subject to the required Corporate Contribution, and to which a Loss Allocation Cap (as defined below and in the proposed rule change) would apply for any terminating Participant, would include any and all losses from any Default Loss Events and any Declared Non-Default Loss Events during the Event Period, regardless of the amount of time, during or after the Event Period, required for such losses to be crystallized and allocated.

The proposed rule changes relating to the implementation of an Event Period are set forth in proposed Section 5 of Rule 4.

(3) Introducing the concept of “rounds” and Loss Allocation Notice.

Pursuant to the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Participants (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. DTC would continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Participants that have not submitted a Termination Notice (as defined below and in the proposed rule change) in accordance with proposed Section 6(b) of Rule 4.

The calculation of each Participant’s pro rata allocation charge would be similar to the current Section 4 calculation of a pro rata charge except that, for greater simplicity,

it would not include the current distinction for common members of another clearing agency pursuant to a Clearing Agency Agreement.<sup>27</sup> In addition, for enhanced clarity as to the date of determination of the ratio, it would be based on the Required Participants Fund Deposits as fixed on the first day of the Event Period, as opposed to the current language “at the time the loss or liability was discovered.”<sup>28</sup>

DTC would notify Participants subject to loss allocation of the amounts being allocated to them (“Loss Allocation Notice”) in successive rounds of loss allocations. Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. Participants would receive two (2) Business Days’ notice of a loss allocation,<sup>29</sup> and Participants would be required to pay the requisite amount no later than the second Business Day following the issuance of such notice.<sup>30</sup> Multiple Loss Allocation Notices may be issued with respect to each round, up to the round cap.

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<sup>27</sup> See supra note 14.

<sup>28</sup> DTC believes that this change would provide an objective date that is appropriate for the new proposed loss allocation process, which would be designed to allocate aggregate losses relating to an Event Period, rather than one loss at a time.

<sup>29</sup> DTC believes allowing Participants two (2) Business Days to satisfy their loss allocation obligations would provide Participants sufficient notice to arrange funding, if necessary, while allowing DTC to address losses in a timely manner.

<sup>30</sup> Section 4 of current Rule 4 provides that if the Participants Fund is applied to a loss or liability, DTC must notify each Participant of the charge and the reasons therefor. Proposed Section 5 would modify this process to (i) require DTC to give *prior* notice; and (ii) require Participants to pay loss allocation charges, rather than directly charging their Required Participants Fund Deposits. DTC believes that shifting from the two-step methodology of applying the Participants Fund and then requiring Participants to immediately replenish it to requiring direct payment would increase efficiency, while preserving the right to charge the Settlement Account of the Participant in the event the Participant doesn’t timely pay. Such a failure to pay would be, self-evidently, a Participant Default, triggering recourse to the Actual Participants Fund Deposit of the Participant under proposed Section 3 of Rule 4. In addition, this change would provide greater stability for DTC in

The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Participant in that round has five (5) Business Days<sup>31</sup> from the issuance<sup>32</sup> of such first Loss Allocation Notice for the round (such period, a “Loss Allocation Termination Notification Period”) to notify DTC of its election to terminate its business with DTC pursuant to proposed Section 8(b) of Rule 4, and thereby benefit from its Loss Allocation Cap.

The round cap of any second or subsequent round may differ from the first or preceding round cap because there may be fewer Participants in a second or subsequent round if Participants elect to terminate their business with DTC as provided in proposed Section 8(b) of Rule 4 following the first Loss Allocation Notice in any round.

For example, for illustrative purposes only, after the required Corporate Contribution, if DTC has a \$4 billion loss determined with respect to an Event Period and the sum of Loss Allocation Caps for all Participants subject to the loss allocation is \$3 billion, the first round would begin when DTC issues the first Loss Allocation Notice for

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times of stress by allowing DTC to retain the Participants Fund, its critical pre-funded resource, while charging loss allocations.

<sup>31</sup> Section 8 of current Rule 4 provides that the time period for a Participant to give notice of its election to terminate its business with DTC in respect of a pro rata charge is ten (10) Business Days after receiving notice of a pro rata charge. DTC believes that it is appropriate to shorten such time period from ten (10) Business Days to five (5) Business Days because DTC needs timely notice of which Participants would not be terminating their business with DTC for the purpose of calculating the loss allocation for any subsequent round. DTC believes that five (5) Business Days would provide Participants with sufficient time to decide whether to cap their loss allocation obligations by terminating their business with DTC.

<sup>32</sup> See supra note 17.

that Event Period. DTC could issue one or more Loss Allocation Notices for the first round until the sum of losses allocated equals \$3 billion. Once the \$3 billion is allocated, the first round would end and DTC would need a second round in order to allocate the remaining \$1 billion of loss. DTC would then issue a Loss Allocation Notice for the \$1 billion and this notice would be the first Loss Allocation Notice for the second round. The issuance of the Loss Allocation Notice for the \$1 billion would begin the second round.

The proposed rule change would link the Loss Allocation Cap to a round in order to provide Participants the option to limit their loss allocation exposure at the beginning of each round. As proposed, a Participant could limit its loss allocation exposure to its Loss Allocation Cap by providing notice of its election to terminate its business with DTC within five (5) Business Days after the issuance of the first Loss Allocation Notice in any round.

The proposed rule changes relating to the implementation of “rounds” and Loss Allocation Notices are set forth in proposed Section 5 of Rule 4.

(4) Capping terminating Participants’ loss allocation exposure and related changes.

As discussed above, the proposed rule change would continue to provide Participants the opportunity to limit their loss allocation exposure by offering a termination option; however, the associated withdrawal process would be modified.

As proposed, if a Participant provides notice of its election to terminate its business with DTC as provided in proposed Section 8(b) of Rule 4, its maximum payment obligation with respect to any loss allocation round would be the amount of its Aggregate Required Deposit and Investment, as fixed on the first day of the Event Period,

plus 100% of the amount thereof (“Loss Allocation Cap”),<sup>33</sup> provided that the Participant complies with the requirements of the termination process in proposed Section 6 of Rule 4. DTC may retain the entire Actual Participants Fund Deposit of a Participant subject to loss allocation, up to the Participant’s Loss Allocation Cap. If a Participant’s Loss Allocation Cap exceeds the Participant’s then-current Required Participants Fund Deposit, it must still pay the excess amount.

As proposed, Participants would have five (5) Business Days from the issuance of the first Loss Allocation Notice in any round to decide whether to terminate its business with DTC, and thereby benefit from its Loss Allocation Cap. The start of each round<sup>34</sup> would allow a Participant the opportunity to notify DTC of its election to terminate its business with DTC after satisfaction of the losses allocated in such round.

Specifically, the first round and each subsequent round of loss allocation would allocate losses up to a round cap of the aggregate of all Loss Allocation Caps of those Participants included in the round. If a Participant provides notice of its election to terminate its business with DTC, it would be subject to loss allocation in that round, up to its Loss Allocation Cap. If the first round of loss allocation does not fully cover DTC’s losses, a second round will be noticed to those Participants that did not elect to terminate in the previous round. As noted above, the amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Participants in a second or subsequent round if Participants elect to terminate their

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<sup>33</sup> See supra note 18. The alternative limit in clause (b) would be eliminated in proposed Section 8(b) in favor of a single defined standard.

<sup>34</sup> i.e., a Participant will only have the opportunity to terminate after the first Loss Allocation Notice in any round, and not after each Loss Allocation Notice in any round.

business with DTC as provided in proposed Section 8(b) of Rule 4 following the first Loss Allocation Notice in any round.

Pursuant to the proposed rule change, in order to avail itself of its Loss Allocation Cap, the Participant would need to follow the requirements in proposed Section 6 of Rule 4. In addition to retaining the substance of the existing requirements for any termination that are set forth in Section 6 of current Rule 4, proposed Section 6 also would provide that a Participant that provides a termination notice in connection with a loss allocation must: (1) specify in the termination notice an effective date of termination (“Participant Termination Date”), which date shall be no later than ten (10) Business Days following the last day of the applicable Loss Allocation Termination Notification Period; (2) cease all activity that would result in transactions being submitted to DTC for clearance and settlement after the Participant Termination Date; and (3) ensure that all activities and use of DTC services for which such Participant may have any obligation to DTC cease prior to the Participant Termination Date.

The proposed rule changes are designed to enable DTC to continue the loss allocation process in successive rounds until all of DTC’s losses are allocated. Until all losses related to an Event Period are allocated and paid, DTC may retain the entire Actual Participants Fund Deposit of a Participant subject to loss allocation, up to the Participant’s Loss Allocation Cap.

The proposed rule changes relating to capping terminating Participants’ loss allocation exposure and related changes to the termination process are set forth in proposed Sections 5, 6, and 8 of Rule 4.



C. Clarifying Changes Relating to Loss Allocation for Non-Default Events

The proposed rule changes are intended to make the provisions in the Rules governing loss allocation more transparent and accessible to Participants. In particular, DTC is proposing the following change relating to loss allocation to provide clarity around the governance for the allocation of losses arising from a non-default event.<sup>35</sup>

Currently, DTC can use the Participants Fund to satisfy losses and liabilities arising from a Participant Default or arising from an event that is not due to a Participant Default (i.e., a non-default loss), provided that such loss or liability is incident to the business of DTC.<sup>36</sup>

DTC is proposing to clarify the governance around non-default losses that would trigger loss allocation to Participants by specifying that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of DTC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among the Participants in order to ensure that DTC may continue to offer clearance and settlement services in an orderly manner. The proposed rule change would provide that DTC would then be required to promptly notify Participants of this determination, which is referred to in the proposed rule as a Declared Non-Default Loss Event, as discussed above.

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<sup>35</sup> Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

<sup>36</sup> See supra note 25.

Finally, as previously discussed, pursuant to the proposed rule change, proposed Rule 4 would include language to clarify that (i) the Corporate Contribution would apply to losses or liabilities arising from a Default Loss Event or a Declared Non-Default Loss Event, and (ii) the loss allocation waterfall would be applied in the same manner regardless of whether a loss arises from a Default Loss Event or a Declared Non-Default Loss Event.

The proposed rule changes relating to Declared Non-Default Loss Events and Participants' obligations for such events are set forth in proposed Section 5 of Rule 4.

D. Changes to the Retention Time for the Actual Participants Fund Deposit of a Former Participant.

Current Rule 4 provides that after three months from when a Person has ceased to be a Participant, DTC shall return to such Person (or its successor in interest or legal representative) the amount of the Actual Participants Fund Deposit of the former Participant plus accrued and unpaid interest to the date of such payment (including any amount added to the Actual Participants Fund Deposit of the former Participant through the sale of the Participant's Preferred Stock), provided that DTC receives such indemnities and guarantees as DTC deems satisfactory with respect to the matured and contingent obligations of the former Participant to DTC. Otherwise, within four years after a Person has ceased to be a Participant, DTC shall return to such Person (or its successor in interest or legal representative) the amount of the Actual Participants Fund Deposit of the former Participant plus accrued and unpaid interest to the date of such payment, except that DTC may offset against such payment the amount of any known loss or liability to DTC arising out of or related to the obligations of the former Participant to DTC.

DTC is proposing to reduce the time, after a Participant ceases to be a Participant, at which DTC would be required to return the amount of the Actual Participants Fund Deposit of the former Participant plus accrued and unpaid interest, whether the Participant ceases to be such because it elected to terminate its business with DTC in response to a Settlement Charge Notice or Loss Allocation Notice or otherwise. Pursuant to the proposed rule change, the time period would be reduced from four (4) years to two (2) years. All other requirements relating to the return of the Actual Participants Fund Deposit would remain the same.

The four (4) year retention period was implemented at a time when there were more deposits and processing of physical certificates, as well as added risks related to manual processing, and related claims could surface many years after an alleged event. DTC believes that the change to two (2) years is appropriate because, currently, as DTC and the industry continue to move toward automation and dematerialization, claims typically surface more quickly. Therefore, DTC believes that a shorter retention period of two (2) years would be sufficient to maintain a reasonable level of coverage for possible claims arising in connection with the activities of a former Participant, while allowing DTC to provide some relief to former Participants by returning their Actual Participants Fund Deposits more quickly.

(ii) Proposed Rule Changes

The foregoing changes as well as other changes (including a number of technical and conforming changes) that DTC is proposing in order to improve the transparency and accessibility of Rule 4 are described in detail below.

A. Changes Relating to the Retention of the Actual Participants Fund Deposit of a Former Participant

Section 1(h) (proposed Section 1(g))

As discussed above, DTC is proposing to replace “four” years with “two” years, in order to reduce the time within which DTC would be required to return the Actual Participants Fund Deposit of a former Participant. In addition, DTC is proposing to (i) add the heading “Return of Participants Fund Deposits to Participants” to proposed Section 1(g), (ii) update a cross reference, and (iii) correct two typographical errors.

B. Changes Relating to Participant Default, Pro Rata Settlement Charges and Loss Allocation

Section 3

As discussed above, Section 3 of current Rule 4 provides that, if a Participant fails to satisfy an obligation to DTC, DTC may, in such order and in such amounts as DTC determines, apply the Actual Participants Fund Deposit of the defaulting Participant, Pledge the shares of Preferred Stock of the defaulting Participant to its lenders as collateral security for a loan, and/or sell the shares of Preferred Stock of the defaulting Participant to other Participants. Pursuant to the proposed rule change, Section 3 would retain most of these provisions, with the following modifications:

DTC proposes to add the term “Participant Default” in proposed Section 3 as a defined term for the failure of a Participant to satisfy an obligation to DTC, for drafting clarity and use in related provisions. In addition, the proposed rule change clarifies that, in the case of a Participant Default, DTC would first apply the Actual Participants Fund Deposit of the Participant to any unsatisfied obligations, before taking any other actions. This proposed clarification would reflect the current practice of DTC, and would provide Participants with enhanced transparency into the actions DTC would take with respect to

the Participants Fund deposits and Participants Investment of a Participant that has failed to satisfy its obligations to DTC.

DTC proposes to correct the term “End-of-Day Facility,” to the existing defined term “End-of-Day Credit Facility.” DTC further proposes to clarify that, if DTC Pledges some or all of the shares of Preferred Stock of a Participant to its lenders as collateral security for a loan under the End-of-Day Credit Facility, DTC would apply the proceeds of such loan to the obligation the Participant had failed to satisfy, which is not expressly stated in Section 3 of current Rule 4.

In addition, DTC is proposing to make three ministerial changes to enhance readability by: (i) removing the duplicative “in,” in the phrase “in such order and in such amounts,” (ii) replacing the word “eliminate” with “satisfy,” and (iii) to conform to proposed changes, renumbering the list of actions that DTC may take when there is a Participant Default.

DTC is also proposing to add the heading “Application of Participants Fund Deposits and Preferred Stock Investments to Participant Default” to Section 3.

Section 4 and Section 5

As noted above, Section 4 of current Rule 4 provides that if DTC incurs a loss or liability which is not satisfied by charging the Participant responsible for the loss pursuant to Section 3 of Rule 4, then DTC may, in any order and in any amount as DTC may determine, in its sole discretion, to the extent necessary to satisfy such loss or liability, ratably apply some or all of the Actual Participants Fund Deposits of all other Participants to such loss or liability and/or charge the existing retained earnings and undivided profits of DTC. This provision relates to losses and liabilities that may be due

to the failure of a Participant to satisfy obligations to DTC, if the Actual Participants Fund Deposit of that Participant does not fully satisfy the obligation, or to losses and liabilities for which no single Participant is obligated, i.e., a “non-default loss.”

As discussed above, current Rule 4 currently provides a single set of tools and common processes for using the Participants Fund as both a liquidity resource and for the satisfaction of other losses and liabilities. The proposed rule change would provide separate liquidity and loss allocation provisions. More specifically, proposed Section 4 of Rule 4 would reflect the process for a “pro rata settlement charge,” the application of the Actual Participants Fund Deposits of non-defaulting Participants for liquidity purposes in order to complete settlement, when a Participant fails to satisfy its settlement obligation and the amount charged to its Actual Participants Fund Deposit by DTC pursuant to Section 3 of Rule 4 is insufficient to complete settlement. Proposed Section 5 of Rule 4 would contain the proposed loss allocation provisions.

*Proposed Section 4*

Pursuant to the proposed rule change, current Section 4 would be replaced in its entirety by proposed Section 4, and titled “Application of Participants Fund Deposits of Non-Defaulting Participants.” First, for clarity, proposed Section 4 would expressly state that “The Participants Fund shall constitute a liquidity resource which may be applied by the Corporation in such amounts as the Corporation shall determine, in its sole discretion, to fund settlement among non-defaulting Participants in the event of the failure of a Participant to satisfy its settlement obligation on any Business Day. If the amount charged to the Actual Participants Fund Deposit of a Participant pursuant to Section 3 of this Rule is not sufficient to complete settlement among non-defaulting Participants on

that Business Day, the Corporation may apply the Actual Participants Fund Deposits of non-defaulting Participants as provided in this Section and/or apply such other liquidity resources as may be available to the Corporation from time to time, including the End-of-Day Credit Facility.”

Proposed Section 4 would retain the current principle that DTC must notify Participants and the Commission when it applies the Participants Fund deposits of non-defaulting Participants, by stating that if the Actual Participants Fund Deposits of non-defaulting Participants are applied to complete settlement, DTC must promptly notify each Participant and the Commission of the amount of the charge and the reasons therefor, and would define such notice as a Settlement Charge Notice.

Proposed Section 4 would retain the current calculation of pro rata charges by providing that each non-defaulting Participant’s<sup>37</sup> pro rata share of any such application of the Participants Fund, defined as a “pro rata settlement charge,” shall be equal to (i) its Required Participants Fund Deposit, as such Required Participants Fund Deposit was fixed on the Business Day of such application<sup>38</sup> less its Additional Participants Fund Deposit, if any, on that day, divided by (ii) the sum of the Required Participants Fund Deposits of all non-defaulting Participants, as such Required Participants Fund Deposits were fixed on that day, less the sum of the Additional Participants Fund Deposits, if any, of such non-defaulting Participants on that day.

Proposed Section 4 would also provide a period of time within which a Participant could notify DTC of its election to terminate its business with DTC and

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<sup>37</sup> See supra note 14.

<sup>38</sup> See supra note 15.

thereby cap its liability, by providing that a Participant shall have a period of five (5) Business Days following the issuance of a Settlement Charge Notice (“Settlement Charge Termination Notification Period”) to notify DTC of its election to terminate its business with DTC pursuant to proposed Section 8(a), and thereby benefit from its Settlement Charge Cap, as set forth in proposed Section 8(a).<sup>39</sup> Proposed Section 4 would also require that any Participant that gives DTC notice of its election to terminate its business with DTC must comply with proposed Section 6 of Rule 4,<sup>40</sup> and if it does not, its election to terminate shall be deemed void.

Proposed Section 4 would further provide that DTC may retain the entire amount of the Actual Participants Fund Deposit of a Participant subject to a pro rata settlement charge, up to the amount of the Participant’s Settlement Charge Cap in accordance with proposed Section 8(a) of Rule 4.

Section 5 of current Rule 4 provides that “Except as provided in Section 8 of this Rule, if a pro rata charge is made pursuant to Section 4 of the current Rule against the Required Participants Fund Deposit of a Participant, and, as a consequence, the Actual Participants Fund Deposit of such Participant is less than its Required Participants Fund Deposit, the Participant shall, upon the demand of the Corporation, within such time as the Corporation shall require, Deposit to the Participants Fund the amount in cash needed to eliminate any resulting deficiency in its Required Participants Fund Deposit. If the Participant shall fail to make such deposit to the Participants Fund, the Corporation may take disciplinary action against the Participant pursuant to these Rules. Any disciplinary

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<sup>39</sup> See supra note 16.

<sup>40</sup> Proposed Section 6 is discussed below.



action which the Corporation takes pursuant to these Rules, or the voluntary or involuntary cessation of participation by the Participant, shall not affect the obligations of the Participant to the Corporation or any remedy to which the Corporation may be entitled under applicable law.”

Proposed Section 4 would incorporate Section 5 of current Rule 4, modified as follows: (i) conformed to reflect the consolidation of Section 5 into proposed Section 4, (ii) replacement of “Except as provided in” with “Subject to,” to harmonize with language used elsewhere in proposed Rule 4, and (iii) corrections of two typographical errors, in order to accurately reflect that the Actual Participants Fund Deposit of a Participant would be applied, and not the Required Participants Fund Deposit, and to capitalize the word “deposit” because it is a defined term.

*Proposed Section 5*

Proposed Section 5 of Rule 4 would address the substantially new and revised proposed loss allocation, which would apply to losses and liabilities relating to or arising out of a Default Loss Event or a Declared Non-Default Loss Event. Pursuant to the proposed rule change, DTC would restructure and modify its existing loss allocation waterfall as described below. The heading “Loss Allocation Waterfall” would be added to proposed Section 5.

Proposed Section 5 would establish the concept of an “Event Period” to provide for a clear and transparent way of handling multiple loss events occurring in a period of ten (10) Business Days, which would be grouped into an Event Period. As stated above, both Default Loss Events and Declared Non-Default Loss Events could occur within the same Event Period.

The Event Period with respect to a Default Loss Event would begin on the day on which DTC notifies Participants that it has ceased to act for the Participant (or the next Business Day, if such day is not a Business Day). In the case of a Declared Non-Default Loss Event, the Event Period would begin on the day that DTC notifies Participants of the determination by the Board of Directors that the applicable loss or liability incident to the business of DTC may be a significant and substantial loss or liability that may materially impair the ability of DTC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Participants in order to ensure that DTC may continue to offer clearance and settlement services in an orderly manner. Proposed Section 5 would provide that if a subsequent Default Loss Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Under proposed Section 5, the loss allocation waterfall would begin with a new mandatory Corporate Contribution from DTC. Rule 4 currently provides that the use of any retained earnings and undivided profits by DTC is a voluntary contribution of a discretionary amount of its retained earnings. Proposed Section 5 of Rule 4 would, instead, require a defined corporate contribution to losses and liabilities that are incurred by DTC with respect to an Event Period. As proposed, the Corporate Contribution to losses or liabilities that are incurred by DTC with respect to an Event Period would be defined as an amount that is equal to fifty percent (50%) of the amount calculated by DTC in respect of its General Business Risk Capital Requirement as of the end of the

calendar quarter immediately preceding the Event Period.<sup>41</sup> DTC's General Business Risk Capital Requirement, as defined in DTC's Clearing Agency Policy on Capital Requirements,<sup>42</sup> is, at a minimum, equal to the regulatory capital that DTC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.<sup>43</sup>

If DTC applies the Corporate Contribution to a loss or liability arising out of or relating to one or more Default Loss Events or Declared Non-Default Loss Events relating to an Event Period, then for any subsequent Event Periods that occur during the next two hundred fifty (250) Business Days, the Corporate Contribution would be reduced to the remaining unused portion of the Corporate Contribution amount that was applied for the first Event Period.<sup>44</sup> Proposed Section 5 would require DTC to notify Participants of any such reduction to the Corporate Contribution.

Proposed Section 5 of Rule 4 would provide that nothing in the Rules would prevent DTC from voluntarily applying amounts greater than the Corporate Contribution against any DTC loss or liability, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

Proposed Section 5 of Rule 4 would provide that DTC shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Default Loss Events and/or Declared Non-Default Loss Events that occur within an Event Period. The proposed rule change also provides that if losses and liabilities with respect to such Event

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<sup>41</sup> See supra note 20.

<sup>42</sup> See supra note 21.

<sup>43</sup> 17 CFR 240.17Ad-22(e)(15).

<sup>44</sup> See supra note 24.

Period remain unsatisfied following application of the Corporate Contribution, DTC would allocate such losses and liabilities to Participants, as described below.

Proposed Section 5 of Rule 4 would state that all Participants would be subject to loss allocation for losses and liabilities arising out of or relating to a Declared Non-Default Loss Event; however, in the case of losses and liabilities arising out of or relating to a Default Loss Event, only non-defaulting Participants would be subject to loss allocation. In addition, DTC is proposing to clarify that after a first round of loss allocations with respect to an Event Period, only Participants that have not submitted a Termination Notice in accordance with proposed Section 6(b) of Rule 4 would be subject to loss allocations with respect to subsequent rounds relating to that Event Period. The proposed change would also provide that DTC may retain the entire Actual Participants Fund Deposit of a Participant subject to loss allocation, up to the Participant's Loss Allocation Cap in accordance with proposed Section 8(b) of Rule 4.

Pursuant to the proposed rule change, DTC would notify Participants subject to loss allocation of the amounts being allocated to them by a Loss Allocation Notice in successive rounds of loss allocations. Proposed Section 5 would state that a loss allocation "round" would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Participants (a "round cap"). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. DTC may continue the loss allocation process in successive rounds until all

losses from the Event Period are allocated among Participants that have not submitted a Termination Notice in accordance with proposed Section 6(b) of Rule 4.

Each loss allocation would be communicated to Participants by issuance of a Loss Allocation Notice. Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Participant in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round<sup>45</sup> to notify DTC of its election to terminate its business with DTC pursuant to proposed Section 8(b) of Rule 4, and thereby benefit from its Loss Allocation Cap.<sup>46</sup>

Loss allocation obligations would continue to be calculated based upon a Participant's pro rata share of the loss.<sup>47</sup> As proposed, each Participant's pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) (A) its Required Participants Fund Deposit, as such Required Participants Fund Deposit was fixed on the first day of the Event Period,<sup>48</sup> less (B) its Additional Participants Fund Deposit, if any, on such day, divided by (ii) (A) the sum of the Required Participants Fund Deposits of all Participants subject to loss allocation in such round, as such Required Participants Fund Deposits were fixed on such day, less (B) the sum of any Additional Participants

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<sup>45</sup> i.e., the Loss Allocation Termination Notification Period for that round.

<sup>46</sup> See supra note 31.

<sup>47</sup> See supra note 27.

<sup>48</sup> Supra note 15.

Fund Deposits, if any, of all Participants subject to loss allocation in such round on such day.<sup>49</sup>

As proposed, Participants would have two (2) Business Days after DTC issues a first round Loss Allocation Notice to pay the amount specified in any such notice. In contrast to the current Section 4, under which DTC may apply the Actual Participants Fund Deposits of Participants directly to the satisfaction of loss allocation amounts, under proposed Section 5, DTC would require Participants to pay their loss allocation amounts (leaving their Actual Participants Fund Deposits intact).<sup>50</sup> On a subsequent round (i.e., if the first round did not cover the entire loss of the Event Period because DTC was only able to allocate up to the sum of the Loss Allocation Caps of those Participants included in the round), Participants would also have two (2) Business Days after notice by DTC to pay their loss allocation amounts (again subject to their Loss Allocation Caps), unless a Participant timely notified (or will timely notify) DTC of its election to terminate its business with DTC with respect to a prior loss allocation round.

Under the proposal, if a Participant fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, DTC would have the right to proceed against such Participant as a Participant that has failed to satisfy an obligation in accordance with proposed Section 3 of Rule 4 described above. Participants who wish to terminate their business with DTC would be required to comply with the requirements in proposed Section 6 of Rule 4, described further below. Specifically, proposed Section 5 would provide that if, after notifying DTC of its election to terminate its business with

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<sup>49</sup> Supra note 9.

<sup>50</sup> See supra note 30.

DTC pursuant to proposed Section 8(b) of Rule 4, the Participant fails to comply with the provisions of proposed Section 6 of Rule 4, its notice of termination would be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

Section 6

Section 6 of Rule 4 currently provides that whenever a Participant ceases to be such, it continues to be obligated (a) to satisfy any deficiency in the amount of its Required Participants Fund Deposit and/or Required Preferred Stock Investment that it did not satisfy prior to such time, including (i) any deficiency resulting from a pro rata charge with respect to which the Participant has given notice to DTC of its election to terminate its business with DTC pursuant to Section 8 of Rule 4 and (ii) any deficiency the Participant is required to satisfy pursuant to Sections 3 (an obligation that a Participant failed to satisfy) or 5 (the requirement of a Participant to eliminate the deficiency in its Required Participants Fund Deposit) of Rule 4 and (b) to discharge any liability of the Participant to DTC resulting from the transactions of the Participant open at the time it ceases to be a Participant or on account of transactions occurring while it was a Participant.

Proposed Section 6 of Rule 4, titled “Obligations of Participant Upon Termination,” would consolidate the termination requirements from Section 6 of current Rule 4 into proposed Section 6(a), titled “Upon Any Termination,” and would modify them to conform to other proposed rule changes. Specifically, proposed Section 6(a) would state that, subject to proposed Section 8 of the Rule, whenever a Participant ceases to be such, it shall continue to be obligated (i) to satisfy any deficiency in the amounts of

its Required Participants Fund Deposit and/or Required Preferred Stock Investment that it did not satisfy prior to such time, including any deficiency the Participant is required to satisfy pursuant to proposed Sections 3 or 4 of the Rule, and (ii) to discharge any liability of the Participant to DTC resulting from the transactions of the Participant open at the time it ceases to be a Participant or on account of transactions occurring while it was a Participant.

Proposed Section 6(b), titled “Upon Termination Following Settlement Charge or Loss Allocation,” would state that if a Participant timely notifies DTC of its election to terminate its business with DTC in respect of a pro rata settlement charge as set forth in proposed Section 4 of Rule 4 or a loss allocation as set forth in proposed Section 5 of Rule 4 (“Termination Notice”), the Participant would be required to: (1) specify in the Termination Notice a Participant Termination Date, which date shall be no later than ten Business Days following the last day of the applicable Settlement Charge Termination Notification Period or Loss Allocation Termination Notification Period; (2) cease all activity that would result in transactions being submitted to DTC for clearance and settlement after the Participant Termination Date; and (3) ensure that all activities and use of DTC services for which such Participant may have any obligation to DTC cease prior to the Participant Termination Date.

DTC is proposing to include a sentence in proposed Section 6(b) to make it clear that if the Participant fails to comply with the requirements set forth in this section, its Termination Notice will be deemed void, and the Participant will remain subject to further pro rata settlement charges pursuant to proposed Section 4 of Rule 4 or loss



allocations pursuant to proposed Section 5 of Rule 4, as applicable, as if it had not given such notice.

Section 8

Pursuant to the proposed rule change, Section 8 would be titled “Termination; Obligation for Pro Rata Settlement Charges and Loss Allocations,” and would be divided among proposed Section 8(a) “Settlement Charges,” proposed Section 8(b) “Loss Allocations,” proposed Section 8(c) “Maximum Obligation,” and proposed Section 8(d) “Obligation to Replenish Deposit.”

Pursuant to proposed Section 8(a), if a Participant, within five (5) Business Days after issuance of a Settlement Charge Notice pursuant to proposed Section 4 of Rule 4, gives notice to DTC of its election to terminate its business with DTC, the Participant would remain obligated for (i) its pro rata settlement charge that was the subject of such Settlement Charge Notice and (ii) all other pro rata settlement charges made by DTC until the Participant Termination Date. Proposed Section 8(a) would provide that the terminating Participant’s obligation would be limited to the amount of its Aggregate Required Deposit and Investment, as fixed on the day of the pro rata settlement charge that was the subject of the Settlement Charge Notice, plus 100% of the amount thereof, which is substantively the same limitation as provided for pro rata charges in Section 8 of current Rule 4.<sup>51</sup>

Pursuant to proposed Section 8(b), if a Participant, within five (5) Business Days after the issuance of a first Loss Allocation Notice for any round pursuant to proposed Section 5 of Rule 4 gives notice to DTC of its election to terminate its business with

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<sup>51</sup> See supra note 18.

DTC, the Participant shall remain liable for (i) the loss allocation that was the subject of such notice and (ii) all other loss allocations made by DTC with respect to the same Event Period. The obligation of a Participant which elects to terminate its business with DTC would be limited to the amount of its Aggregate Required Deposit and Investment, as fixed on the first day of the Event Period, plus 100% of the amount thereof, which is substantively the same limitation as provided for pro rata charges in Section 8 of current Rule 4.<sup>52</sup>

Proposed Section 8(c) would provide that under no circumstances would the aggregate obligation of a Participant under proposed Section 8(a) and proposed Section 8(b) exceed the amount of its Aggregate Required Deposit and Investment, as fixed on the earlier of the (i) day of the pro rata settlement charge that was the subject of the Settlement Charge Notice giving rise to a Termination Notice, and (ii) first day of the Event Period that was the subject of the first Loss Allocation Notice in a round giving rise to a Termination Notice, plus 100% of the amount thereof. The purpose of proposed Section 8(c) is to address a situation where a Participant could otherwise be subject to both a Settlement Charge Cap and Loss Allocation Cap.

Proposed Section 8(d) would retain the last paragraph in Section 8 of current Rule 4, replacing “pro rata charge” with “pro rata settlement charge” and “loss allocation.”<sup>53</sup> Proposed Section 8(d) would provide that if the amount of the Actual Participants Fund

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<sup>52</sup> See supra note 33.

<sup>53</sup> This is a ministerial change because this paragraph currently applies to Section 4 of current Rule 4, which includes charges to complete settlement and for loss allocation, as would be provided in proposed Section 4 and proposed Section 5 of Rule 4.

Deposit of a Participant is insufficient to satisfy a pro rata settlement charge pursuant to proposed Section 4 and proposed Section 8(a) or a loss allocation pursuant to proposed Section 5 and proposed Section 8(b), the Participant would be obligated to Deposit the amount of any such deficiency to the Participants Fund notwithstanding the fact that the Participant subsequently ceases to be a Participant.

Section 9

Pursuant to the proposed rule change, proposed Section 9 of Rule 4 would provide that the recovery and repayment provisions in current Rule 4 apply to both pro rata settlement charges and loss allocations.<sup>54</sup> Specifically, proposed Section 9 would provide that if an amount is charged ratably pursuant to proposed Section 4 or allocated ratably pursuant to proposed Section 5 and such amount is recovered by DTC, in whole or in part, the net amount of the recovery shall be repaid ratably (on the same basis that it was originally charged or allocated) to the Persons against which the amount was originally charged or allocated by (i) crediting the appropriate amounts to the Actual Participants Fund Deposits of Persons which are still Participants and (ii) paying the appropriate amounts in cash to Persons which are not still Participants.

DTC further proposes to add the heading “Recovery and Repayment” to proposed Section 9.

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<sup>54</sup> This is a ministerial change because Section 9 currently applies to Section 4 of current Rule 4, which includes charges to complete settlement and for loss allocation, as would be provided in proposed Section 4 and proposed Section 5 of Rule 4.

C. Other Proposed Clarifying, Conforming and Technical Changes to Rule 4

Section 1

Section 1(a) and Section 1(b). Section 1(a) addresses, among other things, the formula for determining the Required Participants Fund Deposits of Participants. DTC is proposing to insert the words “or wind-down” to make it clear that the formulas for determining the Required Participants Fund Deposits of Participants and the amount of the minimum Required Participants Fund Deposit would be fixed by DTC so as to assure that the aggregate amount of Required Participants Fund Deposits of Participants will be increased to provide for the costs and expenses incurred by it incidental to the wind-down of DTC, in addition to the voluntary liquidation of DTC.<sup>55</sup> Further, DTC proposes to delete the extraneous phrase “if any.” For increased clarity and readability, DTC is proposing to consolidate Section 1(b) into Section 1(a), and to relocate the sentences “The Corporation may require a Participant to Deposit an additional amount to the Participants Fund pursuant to Section 2 of Rule 9(A). Any such additional amount shall be part of the Required Participants Fund Deposit of such Participant.” from Section 1(a) to a new proposed Section 1(b). In addition to the relocation, DTC would add a defined term for such additional amount, as “Additional Participants Fund Deposit,” for drafting convenience and transparency throughout proposed Rule 4. Further, DTC proposes to

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<sup>55</sup> On December 18, 2017, DTC submitted a proposed rule change and advance notice to adopt the Recovery & Wind-down Plan of DTC, and amend the Rules in order to adopt Rule 32(A) (Wind-down of the Corporation) and Rule 38 (Market Disruption and Force Majeure). See SR-DTC-2017-021 and SR-DTC-2017-803, which were filed with the Commission and the Board of Governors of the Federal Reserve System, respectively, available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

add the headings “Required Participants Fund Deposits” and “Additional Participants Fund Deposits” to Section 1(a) and proposed Section 1(b), respectively.

Section 1(c). For enhanced readability, DTC is proposing to add the heading “Voluntary Participants Fund Deposits” to Section 1(c) of Rule 4, and to replace the word “as” with “in the manner.”

Section 1(d). For enhanced clarity, DTC is proposing to modify Section 1(d) to make it clear that any Additional Participants Fund Deposit is required to be in cash. DTC is also proposing to delete the extraneous phrase “pursuant to this Section” and to replace language regarding Section 2 of Rule 9(A) with the proposed defined term “Additional Participants Fund Deposit.” Further, DTC proposes to add the heading “Cash Participants Fund” to Section 1(d) of Rule 4.

Section 1(e). For enhanced clarity, DTC is proposing to add the language “among Account Families” to clarify the scope of the allocation described in Section 1(e). In addition, DTC proposes to add the heading “Allocation of Participants Fund Deposits Among Account Families” to Section 1(e) of Rule 4.

Section 1(f). Section 1(f) addresses, among other things, the permitted use of the Participants Fund. For consistency with the balance of Section 1(f), the first paragraph would be amended to state that the Actual Participants Fund Deposits of Participants “may be used or invested” instead of stating “shall be applied.” Section 1(f) provides, in part, that the Participants Fund is limited to the satisfaction of losses or liabilities of DTC incident to the business of DTC. Section 1(f) currently defines “business” with respect to DTC as “the doing of all things in connection with or relating to [DTC’s] performance of the services specified in the first and second paragraphs of Rule 6 or the cessation of such

services.” For enhanced transparency of the permitted uses of the Participants Fund, proposed Section 1(f) would be amended to explicitly state that the Actual Participants Fund Deposits of Participants may be used (i) to satisfy the obligations of Participants to DTC, as provided in proposed Section 3, (ii) to fund settlement among non-defaulting Participants, as provided in proposed Section 4 and (iii) to satisfy losses and liabilities of DTC incident to the business of DTC, as provided in proposed Section 5. Section 1(f) would also be amended to make the definition of “business” applicable to the entirety of Rule 4, instead of just Section 1(f), as the term would appear elsewhere in the rule pursuant to the proposed rule change. In addition, DTC proposes to add the heading “Maintenance, Permitted Use and Investment of Participants Fund” to Section 1(f) of Rule 4.

Section 1(g) (consolidated into proposed Section 1(f)). Pursuant to the proposed rule change, DTC would consolidate current Section 1(g) into proposed Section 1(f), and modify language to make it clear that DTC may invest cash in the Participants Fund in accordance with the Clearing Agency Investment Policy adopted by DTC.<sup>56</sup> Further, language would be streamlined by replacing “securities, repurchase agreements or deposits” with “financial assets,” and “securities and repurchase agreements in which such cash is invested” with “its investment of such cash.”

### Section 2

Pursuant to the proposed rule change, Section 2 of Rule 4 would be titled “Participants Investment.”

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<sup>56</sup> See Securities Exchange Act Release No. 79528 (December 12, 2016), 81 FR 91232 (December 16, 2016) (SR-DTC-2016-007).

Section 2(a)-2(d) (Proposed Section 2(a)). For clarity, DTC is proposing to consolidate Sections 2(b)-2(d) into proposed Section 2(a) and would add the heading “Required Preferred Stock Investments” to proposed Section 2(a). In addition, DTC proposes to modify certain language to update references and cross-references to specific subsections to reflect the proposed changes to the numbering of the subsections in proposed Section 2 of Rule 4.

Section 2(e) (Proposed Section 2(b)). For enhanced clarity, DTC is proposing to add the language “among Account Families” to clarify the scope of the allocation described in proposed Section 2(b). In addition, DTC proposes to add the heading “Allocation of Preferred Stock Investments Among Account Families” to proposed Section 2(b) of Rule 4.

Section 2(f) (Proposed Section 2(c)). DTC is proposing to add language to clarify that when any Pledge of a Preferred Stock Security Interest pursuant to proposed Section 2(c) of Rule 4 is made by appropriate entries on the books of DTC, the Rules, in addition to such entries, shall be deemed to be a security agreement for purposes of the New York Uniform Commercial Code. In addition, DTC proposes to update a cross-reference to proposed Section 2(c). In addition, DTC proposes to add the heading “Security Interest in Preferred Stock Investments of Participants” to proposed Section 2(c).

Sections 2(g) – 2(i) (Proposed Sections 2(d) – 2(f)). DTC proposes to add the headings “Dividends on Preferred Stock Investments of Participants,” “Sale of Preferred Stock Investments of Participants,” and “Permitted Transfers of Preferred Stock Investments of Participants” to proposed Sections 2(d), 2(e), and 2(f), respectively. Proposed Sections 2(e) and 2(f) would be modified to update cross-references to certain

subsections. In addition, proposed Section 2(f) would be modified to renumber paragraphs and internal lists for consistency with the numbering schemes in Rule 4.

Section 7. For clarity, DTC is proposing to amend Section 7 of Rule 4 to (i) replace language referencing Additional Participants Fund Deposits with the proposed defined term, (ii) update cross-references to reflect proposed renumbering, and (iii) add the headings “Increased Participants Fund Deposits and Preferred Stock Investments,” “Required Participants Fund Deposits,” and “Required Preferred Stock Investments” to proposed Sections 7, 7(a) and 7(b) of Rule 4, respectively.

#### D. Proposed Changes to Rule 1

DTC is proposing to amend Rule 1 (Definitions; Governing Law) to add cross-references to proposed terms that would be defined in Rule 4, and to delete one defined term. The defined terms to be added are: “Additional Participants Fund Deposit,” “Corporate Contribution,” “Declared Non-Default Loss Event,” “Default Loss Event,” “Event Period,” “Loss Allocation Cap,” “Loss Allocation Notice,” “Loss Allocation Termination Notification Period,” “Participant Default,” “Participant Termination Date,” “Settlement Charge Cap,” “Settlement Charge Notice,” “Settlement Charge Termination Notification Period,” and “Termination Notice”. The term “Section 8 Pro Rata Charge” would be deleted from Rule 1, because it would be deleted from proposed Rule 4 as no longer necessary.

#### Participant Outreach

Beginning in August 2017, DTC has conducted outreach to Participants in order to provide them with advance notice of the proposed changes. As of the date of this filing, no written comments relating to the proposed changes have been received in



response to this outreach. The Commission will be notified of any written comments received.

Implementation Timeframe

Pending Commission approval, DTC expects to implement this proposal promptly. Participants would be advised of the implementation date of this proposal through issuance of a DTC Important Notice.

*Expected Effect on Risks to the Clearing Agency, its Participants and the Market*

DTC believes that the proposed rule changes to clarify the remedies available to DTC with respect to a Participant Default, including the application of the Participants Fund as a liquidity resource, and by clarifying and providing the related processes, would provide clarity as to the application of the Participants Fund to fund settlement and would mitigate any risk to settlement finality due to Participant Default.

DTC believes that the proposed rule change to enhance the resiliency of DTC's loss allocation process and to shorten the time within which DTC is required to return the Actual Participants Fund Deposit of a former Participant would reduce the risk of uncertainty to DTC, its Participants and the market overall.

By replacing the discretionary application of DTC retained earnings to losses and liabilities with a mandatory and defined amount of the Corporate Contribution, the proposed rule change is designed to provide enhanced transparency and accessibility to Participants as to how much DTC would contribute in the event of a loss or liability. The proposed rule change also clarifies that the Corporate Contribution applies to both Default Loss Events and Declared Non-Default Loss Events. The proposed rule change would provide greater transparency as to the proposed replenishment period for the

Corporate Contribution, which would allow Participants to better assess the adequacy of DTC's loss allocation process. Taken together, the proposed rule changes with respect to the Corporate Contribution would enhance the overall resiliency of DTC's loss allocation process by specifying the calculation and application of DTC's Corporate Contribution, including the proposed replenishment period, and would allow Participants to better assess the adequacy of DTC's loss allocation process.

By introducing the concept of an Event Period, DTC would be able to group Default Loss Events and Declared Non-Default Loss Events occurring within a period of ten (10) Business Days for purposes of allocating losses to Participants. DTC believes that the Event Period would provide a defined structure for the loss allocation process to encompass potential sequential Default Loss Events or Declared Non-Default Loss Events that may or may not be closely linked to an initial event and/or a market dislocation episode. Having this structure would enhance the overall resiliency of DTC's loss allocation process because the proposed rule would expressly address losses that may arise from multiple Default Loss Events and/or Declared Non-Default Loss Events that arise in quick succession. Moreover, the proposed Event Period structure would provide certainty for Participants concerning their maximum exposure to mutualized loss allocation with respect to such events.

By introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Participant termination process in connection with the loss allocation process, DTC would (i) set forth a defined amount that it would allocate to Participants during each round (i.e., the round cap), (ii) advise Participants of loss allocation obligation

information as well as round information through the issuance of Loss Allocation Notices, and (iii) provide Participants with the option to limit their loss allocation exposure after the issuance of the first Loss Allocation Notice in each round. These proposed rule changes would enhance the overall resiliency of DTC's loss allocation process because they would expressly permit DTC to continue the loss allocation process in successive rounds until all of DTC's losses are allocated and enable DTC to identify continuing Participants for purposes of calculating subsequent loss allocation obligations in successive rounds. Moreover, the proposed rule changes would define for Participants a clear manner and process in which they could cap their loss allocation exposure to DTC.

By reducing the time within which DTC is required to return the Actual Participants Fund Deposit of a former Participant, DTC would enable firms that have exited DTC to have access to their funds sooner than under current Rule 4 while maintaining the protection of DTC and its provision of clearance and settlement services. DTC would continue to be protected under the proposed rule change, which will maintain the provision that DTC may offset the return of funds against the amount of any loss or liability of DTC arising out of or relating to the obligations of the former Participant to DTC, and would provide that DTC could retain the funds for up to two (2) years. As such, DTC would maintain a necessary level of coverage for possible claims arising in connection with the DTC activities of a former Participant.

*Management of Identified Risks*

DTC is proposing the rule changes as described in detail above in order to (i) provide clarity as to the application of the Participants Fund to fund settlement when a

Participant fails to settle, (ii) enhance the resiliency of DTC's loss allocation process, and (iii) provide clarity and certainty to Participants regarding DTC's loss allocation process.

*Consistency with the Clearing Supervision Act*

The proposed rule change would be consistent with Section 805(b) of the Clearing Supervision Act.<sup>57</sup> The objectives and principles of Section 805(b) of the Clearing Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.<sup>58</sup>

The proposed rule change would provide clarity and certainty around the use of the Participants Fund in connection with a Participant Default by expressly providing for the application of the Actual Participants Fund Deposit of the defaulting Participant to its unpaid obligations, and by providing a defined process for pro rata settlement charges to non-defaulting Participants that is separate from the loss allocation process. Together, these proposed rule changes more clearly specify the rights and obligations of DTC and its Participants in respect of the application of the Participants Fund. Reducing the risk of uncertainty to DTC, its Participants, and the market overall would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, DTC believes that the proposed rule changes to provide clarity and certainty around the use of the Participants Fund in connection with a Participant Default, and to provide a defined process for pro rata settlement charges to the Actual Participants Fund Deposits of non-defaulting

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<sup>57</sup> 12 U.S.C. 5464(b).

<sup>58</sup> Id.

Participants, are consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

The proposed rule change would enhance the resiliency of DTC's loss allocation process by (1) requiring a defined contribution of DTC corporate funds to a loss, (2) introducing an Event Period, and (3) introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Participant termination process in connection with the loss allocation process. Together, these proposed rule changes would (i) create greater certainty for Participants regarding DTC's obligation towards a loss, (ii) more clearly specify DTC's and Participants' obligations toward a loss and balance the need to manage the risk of sequential defaults and other potential loss events against Participants' need for certainty concerning their maximum exposures, and (iii) provide Participants the opportunity to limit their exposure to DTC by capping their exposure to loss allocation. Reducing the risk of uncertainty to DTC, its Participants and the market overall would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, DTC believes that the proposed rule change to enhance the resiliency of DTC's loss allocation process is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

The proposed rule change is also consistent with Rules 17Ad-22(e)(7)(i), 17Ad-22(e)(13) and (e)(23)(i), promulgated under the Act.<sup>59</sup>

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<sup>59</sup> 17 CFR 240.17Ad-22(e)(7)(i), (e)(13) and (e)(23)(i).

Rule 17Ad-22(e)(7)(i) under the Act requires, in part, that DTC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by DTC, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity, by maintaining sufficient liquid resources to effect same-day settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios.<sup>60</sup> By clarifying the remedies available to DTC with respect to a Participant Default, including the application of the Participants Fund as a liquidity resource, and by clarifying and providing the related processes, the proposed rule change is designed so that DTC may manage its settlement and funding flows on a timely basis and apply the Participants Fund as a liquid resource in order to effect same day settlement of payment obligations with a high degree of confidence. Therefore, DTC believes that the proposed rule changes with respect to the application of the Actual Participants Fund Deposits of non-defaulting Participants to complete settlement are consistent with Rule 17Ad-22(e)(7)(i) under the Act.

Rule 17Ad-22(e)(13) under the Act requires, in part, that DTC establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure DTC has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations.<sup>61</sup> The proposed rule changes to (1) require a defined Corporate Contribution to a loss, (2) introduce an Event Period, (3) introduce the concept of “rounds” (and accompanying Loss Allocation

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<sup>60</sup> Id. at 240.17Ad-22(e)(7)(i).

<sup>61</sup> Id. at 240.17Ad-22(e)(13).

Notices) and apply this concept to the timing of loss allocation payments and the Participant termination process in connection with the loss allocation process, taken together, are designed to enhance the resiliency of DTC's loss allocation process. Having a resilient loss allocation process would help ensure that DTC can effectively and timely address losses relating to or arising out of Default Loss Events and/or Declared Non-Default Loss Events, which in turn would help DTC contain losses and continue to conduct its clearance and settlement business. In addition, by providing clarity as to the application of the Participants Fund to fund settlement in the event of a Participant Default, the proposed rule change is designed to clarify that DTC is authorized to use the Participants Fund to fund settlement. Therefore, DTC believes that the proposed rule changes to enhance the resiliency of DTC's loss allocation process, and to provide clarity as to the application of the Participants Fund to fund settlement, are consistent with Rule 17Ad-22(e)(13) under the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires DTC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of DTC's default rules and procedures.<sup>62</sup> The proposed rule changes to (i) separate the provisions for the use of the Participants Fund for settlement and for loss allocation, (ii) make clarifying changes to the provisions regarding the application of the Participants Fund to complete settlement and for the allocation of losses, (iii) further align the loss allocation rules of the DTCC Clearing Agencies, (iv) improve the overall transparency and accessibility of the provisions in the Rules governing loss allocation, and (v) make

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<sup>62</sup> Id. at 240.17Ad-22(e)(23)(i).

technical and conforming changes, would not only ensure that DTC's loss allocation rules are, to the extent practicable and appropriate, consistent with the loss allocation rules of the other DTCC Clearing Agencies, but also would help to ensure that DTC's loss allocation rules are transparent and clear to Participants. Aligning the loss allocation rules of the DTCC Clearing Agencies would provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and clear loss allocation rules would enable Participants to better understand the key aspects of DTC's Rules and Procedures relating to Participant Default, as well as non-default events, and provide Participants with increased predictability and certainty regarding their exposures and obligations. As such, DTC believes that the proposed rule changes with respect to pro rata settlement charges, and to align the loss allocation rules across the DTCC Clearing Agencies and to improve the overall transparency and accessibility of DTC's loss allocation rules are consistent with Rule 17Ad-22(e)(23)(i) under the Act.

III. Date of Effectiveness of the Advance Notice, and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be



implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The clearing agency shall post notice on its website of proposed changes that are implemented.

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 Advance Notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-DTC-2017-804 on the subject line.

##### Paper Comments:

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

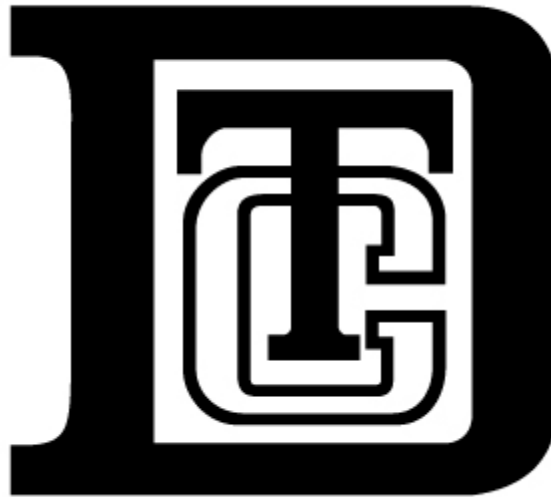
All submissions should refer to File Number SR-DTC-2017-804. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the Advance Notice that are filed with the Commission, and all written communications relating to the Advance Notice 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-2017-804 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary

**Bolded, underlined text** indicates added language.

**~~Bolded, strikethrough text~~** indicates deleted language.



**RULES**

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**BY-LAWS**

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**ORGANIZATION CERTIFICATE**

**THE DEPOSITORY TRUST COMPANY**

**RULE 1**  
**DEFINITIONS; GOVERNING LAW**

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*Section 2.* Set forth below are certain other terms defined in these Rules, and the place in these Rules where such other terms are defined and used:

<u>Defined Term</u>	<u>Rule</u>	<u>Section</u>
<b><u>Additional Participants Fund Deposit</u></b>	<b>Rule 4</b>	<b>Section 1</b>
Cash	Rule 4(A)	Section 1
Contra Party	Rule 9(B)	Section 1
<b><u>Corporate Contribution</u></b>	<b>Rule 4</b>	<b>Section 5</b>
Custodian	Rule 2	Section 1
<b><u>Declared Non-Default Loss Event</u></b>	<b>Rule 4</b>	<b>Section 5</b>
Deemed Net Additions	Rule 9(B)	Section 2
Defaulting Participant	Rule 9(B)	Section 2
<b><u>Default Loss Event</u></b>	<b>Rule 4</b>	<b>Section 5</b>
End-of-Day Credit Facility	Rule 4	Section 2
<b><u>Event Period</u></b>	<b>Rule 4</b>	<b>Section 5</b>
FATCA	Rule 2	Section 9
FATCA Certification	Rule 2	Section 9
FATCA Compliance Date	Rule 2	Section 9
FATCA Compliant	Rule 2	Section 9
FFI Participant	Rule 2	Section 9
Interested Person	Rule 22	Section 1
<b><u>Loss Allocation Cap</u></b>	<b>Rule 4</b>	<b>Section 5</b>
<b><u>Loss Allocation Notice</u></b>	<b>Rule 4</b>	<b>Section 5</b>
<b><u>Loss Allocation Termination Notification Period</u></b>	<b>Rule 4</b>	<b>Section 5</b>
MMI Funding Acknowledgment	Rule 9(C)	Section 1
MMI Optimization	Rule 9(C)	Section 1
Net-Net Credit Balance	Rule 9(D)	
Net-Net Debit Balance	Rule 9(D)	
Panel	Rule 22	Section 3
<b><u>Participant Default</u></b>	<b>Rule 4</b>	<b>Section 3</b>
Participant Representative	Rule 7	Section 1
<b><u>Participant Termination Date</u></b>	<b>Rule 4</b>	<b>Section 6</b>
P&I Cash Advance	Rule 4(A)	Section 3
P&I Credit Facility	Rule 4(A)	Section 3
P&I Finance Cost	Rule 4(A)	Section 3
P&I Finance Period	Rule 4(A)	Section 3
P&I Payment Date	Rule 4(A)	Section 3
P&I Receipt Date	Rule 4(A)	Section 3
P&I Reversal Date	Rule 4(A)	Section 3

P&I Scheduled Payment	Rule 4(A)	Section 3
P&I Security Interest	Rule 4(A)	Section 3
Pool	Rule 22	Section 3
Preferred Stock Security Interest	Rule 4	Section 2
<del>Section 8 Pro Rata Charge</del>	<del>Rule 4</del>	<del>Section 6</del>
<b><u>Settlement Charge Cap</u></b>	<b>Rule 4</b>	<b>Section 4</b>
<b><u>Settlement Charge Notice</u></b>	<b>Rule 4</b>	<b>Section 4</b>
<b><u>Settlement Charge Termination Notification</u></b>	<b>Rule 4</b>	<b>Section 4</b>
<b><u>Period</u></b>		
Settling Bank Refusal	Rule 9(D)	
Short Charge	Rule 9(B)	Section 2
Special Representative	Rule 6	
<b><u>Termination Notice</u></b>	<b>Rule 4</b>	<b>Section 6</b>
Time of Insolvency	Rule 12	Section 4
Transaction	Rule 6	
Voting Rights	Rule 6	

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## RULE 4

### PARTICIPANTS FUND AND PARTICIPANTS INVESTMENT

#### *Section 1.*     **Participants Fund**

The Participants Fund shall comprise the Actual Participants Fund Deposits of all Participants, as provided in these Rules and as specified in the Procedures.

##### (a)     **Required Participants Fund Deposits**

Each Participant shall be required to make a Required Participants Fund Deposit in accordance with one or more formulas based upon the Participant's use of the facilities of the Corporation; provided, however, that (i) each Participant other than a Limited Participant shall be required to make at least a minimum Required Participants Fund Deposit and (ii) depending upon the services it utilizes, a Limited Participant may or may not be required to make a Required Participants Fund Deposit. The formulas for determining the Required Participants Fund Deposits of Participants and the amount of the minimum Required Participants Fund Deposit shall be fixed by the Corporation and specified in the Procedures so as to assure that the aggregate amount of Required Participants Fund Deposits of Participants will be increased to provide for costs and expenses incurred by it incidental to the voluntary liquidation **or wind-down** of the Corporation, ~~if any~~.

The Corporation may from time to time change the formulas for determining the Required Participants Fund Deposits of Participants and the amount of the minimum Required Participants Fund Deposit; provided, however, that notice of such change shall

be given to each Participant at least ten Business Days in advance of the effective date thereof. ~~The Corporation may require a Participant to Deposit an additional amount to the Participants Fund pursuant to Section 2 of Rule 9(A). Any such additional amount shall be part of the Required Participants Fund Deposit of such Participant.~~

(b) —The Corporation shall determine on a daily basis for each Participant the amount of its Required Participants Fund Deposit, and the Corporation shall notify each Participant of any change in the amount of its Required Participants Fund Deposit. If the Actual Participants Fund Deposit of a Participant is less than the amount of its Required Participants Fund Deposit, the Participant shall Deposit to the Participants Fund, in the manner specified in the Procedures, the amount needed to eliminate the deficiency. If the Actual Participants Fund Deposit of a Participant is more than the amount of its Required Participants Fund Deposit, the Corporation shall pay to the Participant from the Participants Fund, in the manner specified in the Procedures, the amount of the excess, or such lesser amount as the Participant may request; provided, however, that the Corporation may determine, in its sole discretion, not to return such excess deposit (i) if the Collateral Monitor with respect to any Account Family of the Participant is negative or will be negative as a consequence thereof, (ii) if any Account Family of the Participant will, immediately after the return of such excess deposit, have a negative balance which exceeds the Net Debit Cap for that Account Family, (iii) until any amount which is required to be charged or levied against the Participant or its Required Participants Fund Deposit is paid by the Participant to the Corporation, (iv) if the Corporation determines that the recent use of any service of the Corporation by the Participant is materially different from its prior use of such service and that a higher Required Participants Fund Deposit is thereby justified and (v) until after the amounts, if any, to be charged or levied against the Participant or its Required Participants Fund Deposit on account of transactions which occurred previously have been satisfied. Notwithstanding the foregoing, the Corporation may withhold all or part of any excess deposit of a Participant if the Corporation determines, in its sole discretion, that such action is necessary for the protection of the Corporation, other Participants or Pledges.

**(b) Additional Participants Fund Deposits**

**The Corporation may require a Participant to Deposit, on demand, an additional amount to the Participants Fund pursuant to Section 2 of Rule 9(A) (an “Additional Participants Fund Deposit”). Any such Additional Participants Fund Deposit shall be part of the Required Participants Fund Deposit of such Participant.**

**(c) Voluntary Participants Fund Deposits**

A Participant may make a Voluntary Participants Fund Deposit to the Participants Fund, **as in the manner** specified in the Procedures. A Voluntary Participants Fund Deposit shall not be part of the Required Participants Fund Deposit of the Participant but shall be part of its Actual Participants Fund Deposit.

**(d) Cash Participants Fund**

The Required Participants Fund Deposit, any Additional Participants Fund Deposit and any Voluntary Participants Fund Deposit of a Participant shall be in cash. All amounts due to or from a Participant in connection with increases and decreases in its Required Participants Fund Deposit, ~~(pursuant to this Section or Section 2 of Rule 9(A))~~ and any Additional Participants Fund Deposit, any Voluntary Participants Fund Deposit, and any charge pursuant to Section 5 of this Rule, may be credited to or debited from its Settlement Account.

(e) Allocation of Participants Fund Deposits Among Account Families

A Participant with more than one Account Family may, in the manner specified in the Procedures, designate the portion of its Actual Participants Fund Deposit to be allocated to each Account Family at the opening of business each Business Day. The Corporation shall not be obligated to make any allocations in accordance with such instructions if the Corporation determines, in its sole discretion, that such action might result in financial loss to the Corporation, other Participants or Pledges. The Corporation may allocate among Account Families, in the manner specified in the Procedures, any portion of the Actual Participants Fund Deposit of a Participant which is not allocated by the Participant.

(f) Maintenance, Permitted Use and Investment of Participants Fund

The Actual Participants Fund Deposits of Participants to the Participants Fund shall be held by the Corporation and ~~shall~~ may be ~~applied~~ used or invested as provided in these Rules and as specified in the Procedures.

The Actual Participants Fund ~~shall be limited to the satisfaction of losses or Deposits of Participants may be used (i) to satisfy the obligations of Participants to the Corporation, as provided in Section 3 of this Rule, (ii) to fund settlement among non-defaulting Participants, as provided in Section 4 of this Rule and (iii) to satisfy losses and~~ liabilities of the Corporation incident to the business of the Corporation, as provided in Section 5 of this Rule. For purposes of this ~~Section~~ Rule, the term “business” with respect to the Corporation shall mean the doing of all things in connection with or relating to the Corporation's performance of the services specified in the first and second paragraphs of Rule 6 or the cessation of such services. Notwithstanding anything to the contrary in this Rule, the Participants Fund may be used as provided in any Clearing Agency Agreement.

~~(g) — The cash in the Participants Fund may be partially or wholly invested by the Corporation, in its sole discretion, for its account in securities issued or guaranteed as to principal and interest by the United States or agencies or instrumentalities of the United States or repurchase agreements relating to securities issued or guaranteed as to principal and interest by the United States or agencies or instrumentalities of the United States and to the extent not so invested shall be deposited by the Corporation in its name in a depository or depositories selected by the Corporation. Any securities, repurchase agreements or deposits in accordance with the Clearing Agency Investment Policy adopted by the~~

**Corporation. Any financial assets** in which cash in the Participants Fund is invested may be sold by the Corporation or Pledged as security for loans made to the Corporation, as provided in Rule 4(A). The Corporation shall pay interest to a Participant on the cash such Participant has Deposited to the Participants Fund at the rate the Corporation earns on ~~securities and repurchase agreement in which~~ **hits investment of** such cash ~~is invested~~ or as specified in the Procedures.

**(g) Return of Participants Fund Deposits to Participants**

~~(h)~~—After three months from when a Person has ceased to be a Participant, the Corporation shall return to such Person (or its successor in interest or legal representative) the amount of the Actual Participants Fund Deposit of the former Participant plus accrued and unpaid interest to the date of such payment (including any amount added to the Actual Participants Fund Deposit of the former Participant pursuant to Section 2(~~he~~) of this Rule), provided that the Corporation receives such indemnities and guarantees as the Corporation deems satisfactory with respect to the matured and contingent obligations of the former Participant to the Corporation. Otherwise, within ~~four~~**two** years after a Person has ceased to be a Participant, the Corporation shall return to such Person (or its successor in interest or legal representative) the amount of the Actual Participants Fund Deposit of the former Participant plus accrued and unpaid interest to the date of such payment, except that the Corporation may offset against such payment the amount of any known loss or liability ~~to~~**of** the Corporation arising out of ~~an~~**or** related to the obligations of the former Participant to the Corporation.

*Section 2.* **Participants Investment**

The Participants Investment shall comprise the Required Preferred Stock Investments of all Participants, as provided in these Rules and as specified in the Procedures.

**(a) Required Preferred Stock Investments**

Each Participant shall be required to make a Required Preferred Stock Investment in accordance with one or more formulas based upon the Participant's use of the facilities of the Corporation; provided, however, that (i) each Participant other than a Limited Participant shall be required to make at least a minimum Required Preferred Stock Investment and (ii) depending upon the services it utilizes, a Limited Participant may or may not be required to make a Required Preferred Stock Investment. The formulas for determining the Required Preferred Stock Investments of Participants and the amount of the minimum Required Preferred Stock Investment shall be fixed by the Corporation and specified in the Procedures. The Corporation may from time to time change the formulas for determining the Required Preferred Stock Investments of Participants and the amount of the minimum Required Preferred Stock Investment; provided, however, that notice of such change shall be given to each Participant at least ten Business Days in advance of the effective date thereof.

~~(b)~~—The Corporation shall determine on a quarterly basis for each Participant the amount of its Required Preferred Stock Investment, and the Corporation shall notify



each Participant of any change in the amount of its Required Preferred Stock Investment. If the Actual Preferred Stock Investment of a Participant is less than the amount of its Required Preferred Stock Investment, such Participant shall purchase, in the manner specified in the Procedures, the number of outstanding shares of Preferred Stock needed to eliminate the deficiency. If the Actual Preferred Stock Investment of a Participant is more than the amount of its Required Preferred Stock Investment, such Participant shall sell, in the manner specified in the Procedures, the number of its shares of Preferred Stock needed to eliminate the excess. The Corporation, acting as agent and attorney-in-fact for its Participants, shall effect the foregoing purchases and sales of shares of Preferred Stock on their behalf, so that each Participant shall own the amount of its Required Preferred Stock Investment, as adjusted from time to time in accordance with the provisions of ~~Paragraph (a) of this Section 2 and~~ this Paragraph ~~(b)~~.

~~(e)~~—A Participant may not purchase from the Corporation or any other Participant any shares of Preferred Stock in excess of the amount of its Required Preferred Stock Investment.

~~(d)~~—Except as otherwise provided in ~~this Paragraph or~~ Paragraph ~~(if)~~ of this Section, all purchases and sales of Preferred Stock pursuant to these Rules shall be made in cash at a price equal to the aggregate Preferred Stock Par Value of the shares plus accrued and unpaid dividends thereon to the date of such purchase or sale; provided, however, that (i) the portion of the price equal to the aggregate Preferred Stock Par Value of the shares shall be paid on the date of such purchase and sale and (ii) the portion of the price equal to the accrued and unpaid dividends thereon shall be paid on the first Preferred Stock Dividend Date following the date of such purchase and sale if dividends are paid on the Preferred Stock on such Preferred Stock Dividend Date.

All amounts due to or from Participants in connection with purchases and sales of Preferred Stock shall be credited to or debited from their Settlement Accounts, except that any amounts due to a Person which has ceased to be a Participant shall be paid to such account as the former Participant shall designate for this purpose. The Corporation, acting as agent and attorney-in-fact for its Participants, shall effect all payments on their behalf, at the times and in the amounts provided in these Rules and as specified in the Procedures, without any further action or consent required on the part of such Participants, and, without limiting the generality of the foregoing, the Corporation may apply all dividends paid on the Preferred Stock to the payments required to be made to all past and present holders of Preferred Stock pursuant to this Section.

Any determination by the Corporation of a number of shares of Preferred Stock to be purchased or sold pursuant to these Rules shall be made by converting any fraction into a decimal rounded to the nearest one-hundred-thousandth and by rounding to the nearest one-hundred-thousandth the product of any such decimal and any number of shares of Preferred Stock. In order to make the products of all such determinations by the Corporation pursuant to any one provision of these Rules consistent with the total number of shares of Preferred Stock being purchased and sold, the Corporation shall randomly assign to ~~nor~~ deduct from the number of shares of Preferred Stock being purchased from

or sold to any Participant the difference between such total number of shares of Preferred Stock and the sum of such products.

**(b) Allocation of Preferred Stock Investments Among Account Families**

~~(e)~~—A Participant with more than one Account Family may, in the manner specified in the Procedures, designate the portion of its Actual Preferred Stock Investment to be allocated to each Account Family at the opening of business each Business Day. The Corporation shall not be obligated to make any allocations in accordance with such instructions if the Corporation determines, in its sole discretion, that such action might result in financial loss to the Corporation, other Participants or Pledges. The Corporation may allocate among Account Families, in the manner specified in the Procedures, any portion of the Actual Preferred Stock Investment of a Participant which is not allocated by the Participant.

**(c) Security Interest in Preferred Stock Investments of Participants**

~~(f)~~—To secure the obligations of Participants to the Corporation, the Corporation, acting as agent and attorney-in-fact for its Participants, may (i) Pledge the entire right, title and interest of any Participant in and to some or all of its shares of Preferred Stock, together with all distributions thereon, proceeds thereof and replacements or substitutions therefor (a “Preferred Stock Security Interest”), as collateral security for the obligations of the Corporation to its Lenders under any credit facility maintained by the Corporation for the purpose of funding the end-of-day settlement of transactions processed through the facilities of the Corporation (an “End-of-Day Credit Facility”) or (ii) sell some or all of the shares of Preferred Stock of any Participant to other Participants (who shall be obligated to purchase such shares pro rata their Required Preferred Stock Investments at the time of such purchase), and apply the proceeds of such sale to the obligations of such Participant to the Corporation. Any such Pledge of a Preferred Stock Security Interest pursuant to this Paragraph~~(f)~~, shall be made by appropriate entries on the books of the Corporation (and such entries, together with these Rules, shall be deemed to be a security agreement for purposes of the NYUCC) or by any other means provided in the NYUCC, and each Participant hereby grants to the Corporation an irrevocable power of attorney (coupled with an interest) to execute and deliver, in the name and on behalf of such Participant, any and all additional documents, instruments, agreements and financing statements necessary or desirable as determined by the Corporation, in its sole discretion, to create and perfect the Pledge of the Preferred Stock Security Interest by the Corporation to its Lenders under the End-of-Day Credit Facility. Any such sale of shares of Preferred Stock pursuant to this Paragraph~~(f)~~, and any application of the proceeds thereof as provided herein, shall be effected by the Corporation without any further action or consent required on the part of the Participant whose shares of Preferred Stock are sold, and the Settlement Account of such Participant shall be credited with the full amount of such proceeds.

**(d) Dividends on Preferred Stock Investments of Participants**

~~(g)~~—The Corporation shall pay dividends on the Preferred Stock at a rate fixed by the Board of Directors in accordance with the Organization Certificate of the Corporation.

**(e) Sale of Preferred Stock Investments of Participants**

~~(h)~~—Promptly after a Person has ceased to be a Participant, the Corporation, acting as agent and attorney-in-fact for such Person (or its successor in interest or legal representative), shall sell all of the shares of Preferred Stock of the former Participant to current Participants (who shall be required to purchase such shares pro rata their Required Preferred Stock Investments at the time of such purchase), and add the proceeds thereof to the Actual Participants Fund Deposit of the former Participant for disposition in accordance with Section 1(~~hg~~) of this Rule.

**(f) Permitted Transfers of Preferred Stock Investments of Participants**

~~(i)~~—Shares of Preferred Stock may be transferred from a Participant to another Person, subject to the provisions of this Paragraph ~~(f) of this Section 2~~:

**(1)** ~~(A)~~—if ~~(1A)~~ such Participant gives the Corporation at least twenty Business Days prior written notice of the proposed transfer and ~~(2B)~~ such transfer is effected in the course of or pursuant to ~~(xi)~~ a merger or consolidation of such Participant into or with such Person or ~~(yii)~~ a sale of all or substantially all of the business and assets of such Participant to such Person and ~~(3C)~~ such Person is also a Participant; or

**(2)** ~~(B)~~—if ~~(1A)~~ such Participant ~~(xi)~~ gives the Corporation and all other Participants at least twenty Business Days prior written notice of the proposed transfer and ~~(yii)~~ offers to sell the shares to such other Participants (pro rata their Required Preferred Stock Investments at the time of such offer) at the lower of ~~(Ix)~~ the aggregate purchase price that such Person has agreed to pay for the shares or ~~(Hy)~~ the aggregate Preferred Stock Par Value of the shares and ~~(2B)~~ the Corporation, acting as agent and attorney-in-fact for such other Participants, declines on their behalf to purchase the shares on such terms.

No shares of Preferred Stock may be purchased, sold or transferred except in accordance with this Paragraph ~~(i)~~—or in connection with the quarterly reallocation of shares of Preferred Stock pursuant to Paragraph ~~(ba)~~ of this Section.

*Section 3.* **Application of Participants Fund Deposits and Preferred Stock Investments to Participant Default**

If a Participant is obligated to the Corporation, ~~other than for a pro rata charge~~ pursuant to ~~Section 5 of this Rule~~ **these Rules and the Procedures**, and fails to satisfy such obligation **(a “Participant Default”)**, including, without limitation, the obligation of the

Participant to reimburse the Corporation for the amount of any payment with respect to such Participant paid by or owing from the Corporation to any other clearing agency pursuant to a Clearing Agency Agreement, the Corporation shall, **to the extent necessary to eliminate such obligation, apply some or all of the Actual Participants Fund Deposit of such Participant to such obligation to satisfy the Participant Default.**

**If any such application of the Actual Participants Fund Deposit of a Participant is insufficient to satisfy such obligation, the Corporation may,** in such order and ~~in~~ such amounts as the Corporation shall determine, in its sole discretion, to the extent necessary to ~~eliminate~~ **satisfy** such obligation:

~~(a) — apply some or all of the Actual Participants Fund Deposit of such Participant to such obligation;~~

~~(b)~~ Pledge some or all of the shares of Preferred Stock of such Participant to its Lenders as collateral security for a loan under the End-of-Day **Credit** Facility, **and apply the proceeds of such loan to satisfy such obligation;** and/or

~~(c)~~ sell some or all of the shares of Preferred Stock of such Participant to other Participants (who shall be required to purchase such shares pro rata their Required Preferred Stock Investments at the time of such purchase), and apply the proceeds of such sale to such obligation.

If the Corporation takes any of the foregoing actions, the Participant shall, upon the demand of the Corporation, within such time as the Corporation shall require:

(a) Deposit to the Participants Fund the amount in cash needed to eliminate any resulting deficiency in its Required Participants Fund Deposit;

(b) wire to the Corporation an amount in cash sufficient to discharge any loan secured by its shares of Preferred Stock; and/or

(c) repurchase any of its shares of Preferred Stock sold to other Participants.

If the Participant shall fail to take any action demanded by the Corporation, the Corporation may take disciplinary action against the Participant pursuant to these Rules. Any disciplinary action which the Corporation takes pursuant to these Rules, or the voluntary or involuntary cessation of participation by the Participant, shall not affect the obligation of the Participant to the Corporation or any remedy to which the Corporation may be entitled under applicable law.

*Section 4.* **Application of Participants Fund Deposits of Non-Defaulting Participants**

~~If the Corporation incurs a loss or liability which is not satisfied by charging the Participant or Participants responsible for causing the loss or liability pursuant to Section 3 of this Rule, the Corporation shall, in such order and in such amounts as the Corporation shall determine, in its sole discretion, to the extent necessary to satisfy such loss or liability:~~

~~(a) — apply some or all of the Actual Participants Fund Deposits of all other Participants to such loss or liability, in which case:~~

~~(1) — with respect to any loss or liability incurred by the Corporation in connection with any payment required to be made by the Corporation to any other clearing agency pursuant to a Clearing Agency Agreement, the Actual Participants Fund Deposit of each Participant that is concurrently a member of such other clearing agency, excluding the Participant or Participants responsible for causing the loss or liability, shall be applied pro rata (A) its Required Participants Fund Deposit (as such Required Participants Fund Deposit was fixed at the time the loss or liability was discovered) less (B) any portion of such Required Participants Fund Deposit attributable to any additional amount that such Participant was required to Deposit to the Participants Fund pursuant to Section 2 of Rule 9(A); or~~

~~(2) — with respect to any other loss or liability incurred by the Corporation, the Actual Participants Fund Deposit of each Participant, excluding the Participant or Participants responsible for causing the loss or liability, shall be applied pro rata (A) its Required Participants Fund Deposit (as such Required Participants Fund Deposit was fixed at the time the loss or liability was discovered) less (B) any portion of such Required Participants Fund Deposit attributable to any additional amount that such Participant was required to Deposit to the Participants Fund pursuant to Section 2 of Rule 9(A); and/or~~

~~(b) — charge the existing retained earnings and undivided profits of the Corporation.~~

The Participants Fund shall constitute a liquidity resource which may be applied by the Corporation in such amounts as the Corporation shall determine, in its sole discretion, to fund settlement among non-defaulting Participants in the event of the failure of a Participant to satisfy its settlement obligation on any Business Day. If the amount charged to the Actual Participants Fund Deposit of a Participant pursuant to Section 3 of this Rule is not sufficient to complete settlement among non-defaulting Participants on that Business Day, the Corporation may apply the Actual Participants Fund Deposits of non-defaulting Participants as provided in this Section and/or apply such other liquidity resources as may be available to the Corporation from time to time, including the End-of-Day Credit Facility.

If the Participants Fund is applied to ~~a loss or liability~~complete settlement, the Corporation shall promptly after the event notify each Participant and the SEC of the amount applied and the reasons therefor (“Settlement Charge Notice”).

Each non-defaulting Participant's pro rata share of such application of the Participants Fund shall be equal to (i) its Required Participants Fund Deposit, as such Required Participants Fund Deposit was fixed on the Business Day of such application less its Additional Participants Fund Deposit, if any, on that day, divided by (ii) the sum of the Required Participants Fund Deposits of all non-defaulting Participants, as such Required Participants Fund Deposits were fixed on that day, less the sum of the Additional Participants Fund Deposits, if any, of such non-defaulting Participants on that day.

A Participant's maximum obligation with respect to its pro rata share of such application of the Participants Fund (each a "pro rata settlement charge") shall be equal to the amount set forth in Section 8(a) of this Rule ("Settlement Charge Cap"). A Participant shall have a period of five Business Days following issuance of a Settlement Charge Notice (such period, a "Settlement Charge Termination Notification Period") to notify the Corporation of its election to terminate its business with the Corporation pursuant to Section 8(a) of this Rule and thereby benefit from its Settlement Charge Cap.

If a Participant notifies the Corporation of its election to terminate its business with the Corporation pursuant to Section 8(a) of this Rule, it shall comply with the provisions of Section 6 of this Rule. If, after notifying the Corporation of its election to terminate its business with the Corporation pursuant to Section 6 of this Rule, the Participant fails to comply with the provisions of Section 6 of this Rule, its election to terminate its business with the Corporation shall be deemed void and it will remain subject to further pro rata settlement charges as may be charged against it as if it had not given such notice.

Notwithstanding Section 1(a) of this Rule, the Corporation may retain the entire amount of the Actual Participants Fund Deposit of a Participant subject to a pro rata settlement charge, up to the amount of the Participant's Settlement Charge Cap in accordance with Section 8(a) of this Rule.

~~Section 5. — Except as provided in~~ Subject to Section 8 of this Rule, if ~~a pro rata charge is made pursuant to Section 4 of this Rule against the Required~~ the Actual Participants Fund Deposit of a Participant, is applied as provided in this Section and, as a consequence, the Actual Participants Fund Deposit of such Participant is less than its Required Participants Fund Deposit, the Participant shall, upon the demand of the Corporation, within such time as the Corporation shall require, Deposit to the Participants Fund the amount in cash needed to eliminate any resulting deficiency in its Required Participants Fund Deposit. If the Participant shall fail to make such ~~d~~Deposit to the Participants Fund, the Corporation may take disciplinary action against the Participant pursuant to these Rules. Any disciplinary action which the Corporation takes pursuant to these Rules, or the voluntary or involuntary cessation of participation by the Participant, shall not affect the obligations of the Participant to the Corporation or any remedy to which the Corporation may be entitled under applicable law.

#### Section 5. Loss Allocation Waterfall

If the Corporation incurs a loss or liability (i) relating to or arising out of a Participant Default which is not satisfied pursuant to Section 3 of this Rule and the Corporation has ceased to act for such Participant (a "Default Loss Event") or (ii)

otherwise incident to the business of the Corporation, as determined below (a “Declared Non-Default Loss Event”), the Corporation shall address the loss or liability as follows:

Default Loss Events and/or Declared Non-Default Loss Events that occur within a period of ten Business Days (an “Event Period”) shall be grouped together for purposes of applying the limits on loss allocations set forth in Section 8 of this Rule. In the case of a Default Loss Event, an Event Period begins on the day that the Corporation notifies Participants that it has ceased to act for a Participant (or the next Business Day, if such day is not a Business Day).

In the case of a Declared Non-Default Loss Event, an Event Period begins on the day that the Corporation notifies Participants of the determination by the Board of Directors that the applicable loss or liability incident to the business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Participants in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner, which notification shall be issued promptly following any such determination.

If a subsequent Default Loss Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities relating to or arising out of any such subsequent event shall be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

The Corporation shall apply the Corporate Contribution (as defined below) to losses and liabilities that arise out of or relate to one or more Default Loss Events and/or Declared Non-Default Loss Events that occur within an Event Period. If losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, the Corporation shall allocate such losses and liabilities to Participants, subject to the requirements and limitations below.

In the case of losses and liabilities relating to or arising out of a Declared Non-Default Loss Event, all Participants shall be subject to loss allocation. In the case of losses and liabilities relating to or arising out of a Default Loss Event, only non-defaulting Participants shall be subject to loss allocation. After a first round of loss allocations with respect to an Event Period, only Participants that have not submitted a Termination Notice (as defined below) in accordance with Section 6(b) of this Rule shall be subject to further loss allocation with respect to that Event Period. The Corporation shall notify Participants subject to loss allocation of the amounts being allocated to them (“Loss Allocation Notice”) in successive rounds of loss allocations. Notwithstanding Section 1(a) of this Rule, the Corporation may retain the entire Actual Participants Fund Deposit of a Participant subject to loss allocation, up to the Participant’s Loss Allocation Cap (as defined below) in accordance with Section 8(b) of this Rule.

A loss allocation “round” means a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Participants (a “round cap”). When the aggregate amount of losses allocated in a

round equals the round cap, any additional losses relating to the applicable Event Period shall be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. The Corporation may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Participants that have not submitted a Termination Notice in accordance with Section 6(b) of this Rule.

Each loss allocation shall be communicated to Participants by the issuance of a Loss Allocation Notice. Each Loss Allocation Notice shall specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round shall expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Participant in such round has five Business Days from the issuance of such first Loss Allocation Notice for the round (such period, a “Loss Allocation Termination Notification Period”) to notify the Corporation of its election to terminate its business with the Corporation pursuant to Section 8(b) of this Rule, and thereby benefit from its Loss Allocation Cap. Participants shall pay to the Corporation the amount specified in any first round Loss Allocation Notice on the second Business Day after the Corporation issues any such notice. Participants shall pay to the Corporation the amount specified in any subsequent round Loss Allocation Notice on the second Business Day after the Corporation issues such notice, unless the Participant has timely notified (or will timely notify) the Corporation of its election to terminate its business with the Corporation with respect to a prior loss allocation round pursuant to Section 8(b) of this Rule. Each Participant’s maximum payment obligation with respect to any loss allocation round shall be equal to the amount set forth in Section 8(b) of this Rule (“Loss Allocation Cap”), subject to Section 8(c) of this Rule.

Each Participant’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) its Required Participants Fund Deposit, as such Required Participants Fund Deposit was fixed on the first day of the applicable Event Period, less its Additional Participants Fund Deposit, if any, on such day, divided by (ii) the sum of the Required Participants Fund Deposits of all Participants subject to loss allocation in such round, as such Required Participants Fund Deposits were fixed on such day, less the sum of any Additional Participants Fund Deposits, if any, of all Participants subject to loss allocation in such round on such day.

If a Participant fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Participant as a Participant that has failed to satisfy an obligation in accordance with Section 3 of this Rule.

If a Participant notifies the Corporation of its election to terminate its business with the Corporation pursuant to Section 8(b) of this Rule, the Participant shall comply with the provisions of Section 6 of this Rule. If, after notifying the Corporation of its election to terminate its business with the Corporation pursuant to Section 8(b) of this Rule, the Participant fails to comply with the provisions of Section 6 of this Rule, its election to terminate its business with the Corporation shall be deemed void and any further losses



resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

For any loss allocation pursuant to this Section 5, whether arising out of or relating to a Default Loss Event or a Declared Non-Default Loss Event, the Corporation's corporate contribution to losses or liabilities that are incurred by the Corporation with respect to an Event Period ("Corporate Contribution") shall be an amount that is equal to fifty percent (50%) of the amount calculated by the Corporation in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period. The Corporation's General Business Risk Capital Requirement, as defined in its Clearing Agency Policy on Capital Requirements, is, at a minimum, equal to the regulatory capital that the Corporation is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Exchange Act. If the Corporate Contribution is applied by the Corporation against a loss or liability relating to an Event Period, the Corporate Contribution for any subsequent Event Periods occurring during the two hundred fifty (250) Business Days thereafter shall be reduced to the remaining unused portion of the Corporate Contribution amount that applied for the first Event Period. The Corporation shall notify Participants of any such reduction to the Corporate Contribution.

Nothing in these Rules shall prevent the Corporation from voluntarily applying amounts greater than the Corporate Contribution against any loss or liability of the Corporation, whether a Default Loss Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

*Section 6.*     Obligations of Participant Upon Termination

~~Whenever a Participant ceases to be such, it shall continue to be obligated (a) to satisfy any deficiency in the amount of its Required Participants Fund Deposit and/or Required Preferred Stock Investment that it did not satisfy prior to such time, including (i) any deficiency resulting from a pro rata charge with respect to which the Participant has given notice to the Corporation of its election to terminate its business with the Corporation pursuant to Section 8 of this Rule (a "Section 8 Pro Rata Charge") and (ii) any deficiency the Participant is required to satisfy pursuant to Section 3 or 5 of this Rule (other than any deficiency referred to in the preceding clause (i) or, subject to Section 8 of this Rule, any pro rata charge under Section 5 of this Rule arising after the Section 8 Pro Rata Charge) and (b) to discharge any liability of the Participant to the Corporation resulting from the transactions of the Participant open at the time it ceases to be a Participant or on account of transactions occurring while it was a Participant; provided, however, that, subject to Section 8 of this Rule, the aggregate liability of the Participant for any Section 8 Pro Rata Charge shall not exceed the amount of its Aggregate Required Deposit and Investment, as fixed immediately prior to the time of such charge, plus 100% of the amount thereof.~~

(a) Upon Any Termination

Subject to Section 8 of this Rule, whenever a Participant ceases to be such, it shall continue to be obligated (i) to satisfy any deficiency in the amounts of its

**Required Participants Fund Deposit and/or Required Preferred Stock Investment that it did not satisfy prior to such time, including any deficiency the Participant is required to satisfy pursuant to Sections 3 or 4 of this Rule, and (ii) to discharge any liability of the Participant to the Corporation resulting from the transactions of the Participant open at the time it ceases to be a Participant or on account of transactions occurring while it was a Participant.**

**(b) Upon Termination Following Settlement Charge or Loss Allocation**

**If a Participant timely notifies the Corporation of its election to terminate its business with the Corporation in respect of a settlement charge as set forth in Section 4 of this Rule or a loss allocation as set forth in Section 5 of this Rule (“Termination Notice”), the Participant shall:**

- (1) specify in the Termination Notice an effective date of termination (“Participant Termination Date”), which date shall be no later than ten Business Days following the last day of the applicable Settlement Charge Termination Notification Period or Loss Allocation Termination Notification Period;**
- (2) cease all activity that would result in transactions being submitted to the Corporation for clearance and settlement after the Participant Termination Date; and**
- (3) ensure that all activities and use of Corporation services for which such Participant may have any obligation to the Corporation cease prior to the Participant Termination Date.**

**If the Participant fails to comply with the requirements of this Paragraph (b), its Termination Notice will be deemed void, and the Participant will remain subject to further pro rata settlement charges pursuant to Section 4 of this Rule or loss allocations pursuant to Section 5 of this Rule as if it had not given such Termination Notice.**

*Section 7.* **Increased Participants Fund Deposits and Preferred Stock Investments**

Except for any ~~increase in the amount of the Required~~**Additional** Participants Fund Deposits ~~of a Participant pursuant to Section 2, which shall be Deposited on demand as provided in Section 1(b) of this Rule~~**9(A)**, the Corporation shall give a Participant at least ten Business Days prior notice of any proposed increase in its Required Participants Fund Deposit or Required Preferred Stock Investment.

**(a) Required Participants Fund Deposits**

If a Participant does not, within the time allowed, give the Corporation notice (in the manner specified in Section 4 of Rule 2) of its election to terminate its business with the Corporation, the Participant shall be required to Deposit the amount needed to satisfy any such increase in its Required Participants Fund Deposit, and the obligation of the

Participant to make such deposit shall not be affected by any subsequent voluntary or involuntary cessation of participation of the Participant. From and after the time such increase becomes effective, the obligations of the Participant to the Corporation shall be determined in accordance with such increased Required Participants Fund Deposit of the Participant whether or not the appropriate amount has been Deposited in the Participants Fund. For purposes of this Section, an increase in the Required Participants Fund Deposit of a Participant shall include an increase resulting from the application of the formulas provided for in Section 1(a) of this Rule and shall also include an increase resulting from a change in such formulas.

(b) **Required Preferred Stock Investments**

If a Participant does not, within the time allowed, give the Corporation notice (in the manner specified in Section 4 of Rule 2) of its election to terminate its business with the Corporation, the Participant shall be required to purchase the number of shares of Preferred Stock needed to satisfy any such increase in its Required Preferred Stock Investment, and the obligation of the Participant to make such purchase shall not be affected by any subsequent voluntary or involuntary cessation of participation of the Participant. From and after the time such increase becomes effective, the obligations of the Participant to the Corporation shall be determined in accordance with such increased Required Preferred Stock Investment of the Participant whether or not the appropriate number of shares of Preferred Stock have been purchased. For purposes of this Section, an increase in the Required Preferred Stock Investment of a Participant shall include an increase resulting from the application of the formulas provided for in Section 2(a) of this Rule and shall also include any increase resulting from a change in such formulas.

*Section 8.* **Termination; Obligation for Pro Rata Settlement Charges and Loss Allocations**

(a) **Settlement Charges**

If a Participant, within ~~ten~~**five** Business Days after ~~receipt~~**the issuance** of ~~notice of a pro rata charge for a loss or liability incurred by the Corporation~~**Settlement Charge Notice** pursuant to Section 4 of this Rule, gives notice to the Corporation of its election to terminate its business with the Corporation, the Participant shall nevertheless remain obligated for ~~such pro rata charge. The Corporation may also make additional pro rata charges~~**(i) its pro rata settlement charge related to such Settlement Charge Notice and (ii) all other pro rata settlement charges until the Participant Termination Date. attributable to the same loss or liability. In that event, notwithstanding the limitation set forth in Section 6 of this Rule, t**~~The obligation of a Participant which elects to terminate its business with the Corporation pursuant to this Section~~**Paragraph** shall be limited to the ~~greater of (a) the~~ amount of its Aggregate Required Deposit and Investment, as fixed ~~immediately prior to~~**on** the ~~timed~~**day** of the ~~first~~**pro rata settlement** charge ~~that was the subject of the Settlement Charge Notice, plus 100% of the amount thereof, or (b) the amount of all prior pro rata charges attributable to the same loss or liability with respect to which the~~

~~Participant has not timely exercised its right to limit its obligation as provided above.~~

**(b) Loss Allocations**

**If a Participant, within five Business Days after the issuance of a first Loss Allocation Notice for any round pursuant to Section 5 of this Rule gives notice to the Corporation of its election to terminate its business with the Corporation, the Participant shall nevertheless remain liable for (i) the loss allocation that was the subject of such Loss Allocation Notice and (ii) all other loss allocations made by the Corporation with respect to the same Event Period. The obligation of a Participant which elects to terminate its business with the Corporation pursuant to this Paragraph shall be limited to the amount of its Aggregate Required Deposit and Investment, as fixed on the first day of the Event Period, plus 100% of the amount thereof.**

**(c) Maximum Obligation**

**Notwithstanding anything to the contrary, under no circumstances shall the aggregate obligation of a Participant to the Corporation pursuant to both Paragraph (a) and Paragraph (b) of this Section 8 exceed the amount of its Aggregate Required Deposit and Investment, as fixed on the earlier of the day specified in the last sentence of Paragraph (a) or the day specified in the last sentence of Paragraph (b), plus 100% of the amount thereof.**

**(d) Obligation to Replenish Deposit**

If the amount of the Actual Participants Fund Deposit of a Participant is insufficient to satisfy a pro rata settlement charge, ~~as limited by pursuant to~~ **Section 64 of this Rule and Paragraph (a) of this Section or a loss allocation pursuant to Section 5 of this Rule and Paragraph (b) of this Section**, the Participant shall be obligated to Deposit the amount of any such deficiency to the Participants Fund notwithstanding the fact that the Participant subsequently ceases to be a Participant.

*Section 9.*     **Recovery and Repayment**

If ~~a loss~~ **any amount is** charged ~~pro rata~~ **pursuant to Section 4 of this Rule or pursuant to Section 5 of this Rule and such amount** is afterward recovered by the Corporation, in whole or in part, the net amount of the recovery shall be ~~credited~~ **repaid ratably (on the same basis that it was originally charged or allocated)** to the Persons against ~~whom~~ **which** the ~~loss~~ **amount** was ~~originally~~ **originally** charged ~~in proportion to the amounts charged against them~~ by (a) crediting the appropriate amounts to the Actual Participants Fund Deposits of Persons which are still Participants and (b) paying the appropriate amounts in cash to Persons which are not still Participants.

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