

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87022; File No. SR-DTC-2019-005)

September 19, 2019

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing of Partial Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Partial Amendment No. 1, to Amend the Settlement Guide to Implement a New Algorithm for Transactions Processed in the Night Cycle

I. Introduction

On July 22, 2019, the Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-DTC-2019-005, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) and Rule 19b-4 thereunder.¹ The proposed rule change was published for comment in the Federal Register on August 8, 2019.² On September 16, 2019, DTC filed Partial Amendment No. 1 to the proposed rule change to postpone the implementation date of the proposed rule change.³ The Commission did not receive any comment letters on the proposed rule change. The Commission is publishing this notice to solicit comment on Partial Amendment No. 1 from interested persons and to approve the proposed rule change, as modified by Partial Amendment No. 1 (hereinafter, “Proposed Rule Change”), on an accelerated basis.

¹ 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4.

² Securities Exchange Act Release No. 86554 (August 2, 2019), 84 FR 39025 (August 8, 2019) (SR-DTC-2019-005) (“Notice”).

³ DTC submitted a courtesy copy of Partial Amendment No. 1 to the proposed rule change through the Commission’s electronic public comment letter mechanism. Accordingly, Partial Amendment No. 1 to the proposed rule change has been publicly available on the Commission’s website since September 16, 2019: <https://www.sec.gov/comments/sr-dtc-2019-005/srdtc2019005-6132114-192254.pdf>

II. Description of the Proposed Rule Change⁴

DTC proposes to amend the Settlement Guide to implement a new processing algorithm for book-entry Deliveries⁵ and Payment Orders⁶ processed in the DTC night cycle (“Night Cycle”)⁷. Specifically, DTC proposes to make enhancements to its processing of transactions in the Night Cycle.

Currently, other than a limited look-ahead process as described below, DTC does not employ a processing mechanism that is designed to proactively optimize the percentage of available transactions that are processed for settlement on settlement date.

⁴ Capitalized terms not defined herein are defined in the Rules, By-Laws and Organization Certificate of DTC (“Rules”), available at www.dtcc.com/~media/Files/Downloads/legal/rules/dtc_rules.pdf, and the DTC Settlement Service Guide (“Settlement Guide”), available at <http://www.dtcc.com/~media/Files/Downloads/legal/service-guides/Settlement.pdf>.

⁵ Pursuant to Rule 1, the term “Delivery” as used with respect to a Security held in the form of a Security Entitlement on the books of DTC, means debiting the Security from an Account of the Deliverer and crediting the Security to an Account of the Receiver. See Rules, supra note 4.

⁶ Pursuant to the Settlement Guide, “Payment Order” means a transaction in which a Participant charges another Participant for changes in value for outstanding stock loans or option contract premiums. See Settlement Guide, supra note 4, at 5.

⁷ The Night Cycle starts at approximately 8:30 p.m. ET on the Business Day prior to settlement date and runs until approximately 10:00 p.m. ET each Business Day. Transactions that cannot satisfy DTC’s controls at the time they are introduced to DTC will recycle throughout the day and be continuously reattempted until approximately 3:10 p.m. for valued transactions, and 6:35 p.m. for free transactions. See Notice, supra note 2, at 39026.

DTC proposes to implement a process that would facilitate a higher percentage of available transactions being processed for settlement during the Night Cycle.⁸

Specifically, pursuant to the Proposed Rule Change, DTC would introduce an algorithm that would test multiple scenarios that would incorporate all transactions available for processing at the start of the Night Cycle as a single batch (“Night Batch Process”), to determine the order of processing of those transactions that allows for the optimal percentage of the transactions to satisfy risk and position controls (i.e., the Collateral Monitor and Net Debit Cap controls),⁹ and therefore be processed for settlement in the Night Cycle. Consistent with DTC’s existing processing environment, the scenarios used would only involve processing of the transactions on a bilateral basis (i.e., no netting of Deliveries).¹⁰ Once the optimal order of processing has been identified, the results reflecting this optimal processing order would be incorporated into

⁸ DTC stated that 50 percent of transactions available for processing at the start of the Night Cycle are processed for settlement during the Night Cycle. DTC anticipates that the proposal would increase the percentage of transactions processed for settlement during the Night Cycle to approximately 65 percent. See Notice, supra note 2, at 39026.

⁹ In managing its credit risk, DTC uses the Collateral Monitor and Net Debit Cap. These two controls work together to protect the DTC settlement system in the event of Participant default. The Collateral Monitor requires net debit settlement obligations, as they accrue intraday, to be fully collateralized; the Net Debit Cap limits the amount of any Participant’s net debit settlement obligation to an amount that can be satisfied with DTC liquidity resources (the Participants Fund and the committed line of credit from a consortium of lenders). See Settlement Guide, supra note 4, at 64-67.

¹⁰ The Proposed Rule Change relates only to the processing order of Deliveries and does not impact DTC’s funds settlement process, by which associated funds debits and credits in the Participant’s settlement account are netted intraday to calculate, at any time, a net debit balance or net credit balance, resulting in an end-of-day settlement obligation or right to receive payment.

DTC's core processing environment on a transaction-by-transaction basis, and member output would be produced using existing DTC output facilities. Delivery instructions provided to DTC after the Night Batch Process has begun would be submitted for daytime processing. According to DTC, the Proposed Rule Change would facilitate more efficient processing of Deliveries and Payment Orders in the Night Cycle and increase the percentage of transactions that have been processed for settlement prior to the start of regular daytime processing.¹¹

Elimination of Obsolete Functions

Currently, Participants can use a profile in the Inventory Management System ("IMS") that allows them to define the order in which their transactions get submitted for processing during the Night Cycle.¹² The submission ordering allows Participants to control the order in which different transaction types are submitted into DTC's core processing system. The recycle ordering allows Participants to control how DTC attempts to process recycling, or pending, transactions. Similar to the submission ordering, Participants can also prioritize transactions by transaction types under recycle ordering. Additionally, Participants can instruct DTC to (i) attempt transactions in the defined order but complete any transaction that can be completed, (ii) only complete transactions in the defined order, or (iii) not complete any transactions until instructed to do so. Because the proposed Night Batch Process would attempt to maximize settlement

¹¹ See Notice, supra note 2, at 39026.

¹² See Securities Exchange Act Release No. 52450 (September 15, 2005), 70 FR 55641 (September 22, 2005) (File No. SR-DTC-2005-07) and Securities Exchange Act Release No. 50944 (December 29, 2004), 70 FR 1927 (January 11, 2005) (File No. SR-DTC-2004-10).

regardless of transaction type, the IMS profile would become obsolete with respect to transactions processed in the Night Cycle and would not be utilized for processing of transactions in the Night Batch Process.

DTC's look-ahead process ("Look-Ahead Process") runs throughout the processing day at fifteen-minute intervals and selects pairs of transactions that when processed simultaneously will not violate the involved Participants' Net Debit Cap, Collateral Monitor, and other risk management system controls.¹³

The Look-Ahead Process reduces transaction blockage for Securities by identifying a receive transaction pending due to a Net Debit Cap insufficiency, and determines whether the processing of an offsetting delivery transaction pending because of a quantity deficiency in the same Security would permit both transactions to be completed in compliance with DTC's risk management system controls.¹⁴ DTC's processing system calculates the net effect to the Collateral Monitor and Net Debit Cap controls for all three Participants involved, and if the net effect will not result in a deficit in the Collateral Monitor or Net Debit Cap for any of the three Participants, the system processes the transactions simultaneously.¹⁵ Because the Night Batch Process would provide an algorithm to maximize settlement for all transactions processed in the Night Cycle, the Look-Ahead Process would become obsolete for Night Cycle processing and would not be utilized for processing of transactions in the Night Batch Process.

Description of Partial Amendment No. 1

¹³ See Settlement Guide, supra note 4, at 43.

¹⁴ Id.

¹⁵ Id.

In Partial Amendment No. 1, DTC proposes to amend the implementation timeframe of the proposal.¹⁶ In its original filing with the Commission, DTC previously stated that the proposed rule change would be effective by September 26, 2019. Pursuant to Partial Amendment No. 1, the Proposed Rule Change would be effective by December 6, 2019.

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act¹⁷ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization. After carefully considering the Proposed Rule Change, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to DTC. In particular, the Commission finds that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act.¹⁸

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency be designed “to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.”¹⁹ The Proposed Rule Change would implement a new processing algorithm for book-entry Deliveries and Payment Orders processed in the Night Cycle. Specifically, DTC would test the entire

¹⁶ Partial Amendment No. 1, supra note 3.

¹⁷ 15 U.S.C. 78s(b)(2)(C).

¹⁸ 15 U.S.C. 78q-1(b)(3)(F)

¹⁹ Id.

batch of transactions available for processing at the start of the Night Batch Process to determine the optimal order to process transactions in the Night Cycle, such that they may satisfy risk and position controls, which would help maximize the number of transactions processed for settlement during the Night Cycle.

Helping to identify the optimal order to process transactions for settlement would help maximize the number of transactions processed for settlement during the Night Cycle. Therefore, the Commission believes that the Proposed Rule Change would promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

IV. Solicitation of Comments on Partial Amendment No. 1 to the Proposed Rule Change

Interested persons are invited to submit written data, views and arguments concerning whether Partial Amendment No. 1 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-DTC-2019-005 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-DTC-2019-005. This file number should be included on the subject line if e-mail is used. To help the Commission process

and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the Proposed Rule Change that are filed with the Commission, and all written communications relating to the Proposed Rule Change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of DTC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-DTC-2019-005 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of the Proposed Rule Change, as Modified as Partial Amendment No. 1

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,²⁰ to approve the proposed rule change prior to the 30th day after the date of publication of Partial Amendment No. 1 in the Federal Register. As noted above, Partial Amendment

²⁰ 15 U.S.C. §78s(b)(2).

No. 1 delays the implementation timeframe of the proposal from September 26, 2019 to December 6, 2019.²¹ The Commission believes that the Partial Amendment is consistent with the Act because it does not raise any regulatory issues and would provide more time before the proposal would go into effect.

For the reasons discussed above, the Commission finds that Partial Amendment No. 1 is reasonably designed to protect investors and the public interest, and consistent with the requirements of the Act. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,²² to approve the proposed rule change, as modified by Partial Amendment No. 1, on an accelerated basis.

VI. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change, as modified by Partial Amendment No. 1, is consistent with the requirements of the Act and, in particular, with the requirements of Section 17A of the Act²³ and the rules and regulations promulgated thereunder.

²¹ Partial Amendment No. 1, supra note 3.

²² 15 U.S.C. §78s(b)(2).

²³ 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act²⁴ that proposed rule change SR-DTC-2019-005, as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.²⁵

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁶

Jill M. Peterson
Assistant Secretary

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ In approving the proposed rule change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

²⁶ 17 CFR 200.30-3(a)(12).