

DTC's business, assets, securities inventory, and membership to another legal entity with such transfer being effected in connection with proceedings under Chapter 11 of the U.S. Bankruptcy Code.<sup>64</sup> After effectuating this transfer, DTC would liquidate any remaining assets in an orderly manner in bankruptcy proceedings.

Although the Commission is not opining on the Wind-down Plan's consistency with the U.S. Bankruptcy Code, in reviewing the proposed changes, the Commission believes that DTC's intent to use bankruptcy proceedings to achieve an orderly liquidation of assets after any transfer of DTC's business appears reasonable, in light of the provisions of the Bankruptcy Code that address the liquidation and distribution of a debtor's property among creditors and interest holders.<sup>65</sup> Under many circumstances, Section 363 of the Bankruptcy Code provides for the sale of property "free and clear of any interest in such property of an entity other than the estate[.]"<sup>66</sup> The Commission believes that DTC's analysis regarding the applicability of these provisions, while not free from doubt, presents a reasonable approach to liquidation in light of the circumstances and the available alternatives.<sup>67</sup> Therefore, the Commission believes that the R&W Plan's Wind-down Plan helps DTC establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by DTC, which includes a wind-down plan necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses.

Therefore, the Commission believes that the R&W Plan is consistent with Rule 17Ad-22(e)(3)(ii) under the Act.<sup>68</sup>

#### *D. Consistency With Rules 17Ad-22(e)(15)(i)-(ii) Under the Act*

Rule 17Ad-22(e)(15)(i) under the Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures

reasonably designed to identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if those losses materialize, including by determining the amount of liquid net assets funded by equity based upon its general business risk profile and the length of time required to achieve a recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken.<sup>69</sup> Rule 17Ad-22(e)(15)(ii) under the Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if those losses materialize, including by holding liquid net assets funded by equity equal to the greater of either (x) six months of the covered clearing agency's current operating expenses, or (y) the amount determined by the board of directors to be sufficient to ensure a recovery or orderly wind-down of critical operations and services of the covered clearing agency, as contemplated by the plans established under Rule 17Ad-22(e)(3)(ii) under the Act,<sup>70</sup> discussed above.<sup>71</sup>

As discussed above, DTC's Capital Policy is designed to address how DTC holds LNA in compliance with these requirements,<sup>72</sup> while the Wind-down Plan would include an analysis to estimate the amount of time and cost to achieve a recovery or orderly wind-down of DTC's critical operations and services, and would provide that the Board review and approve this analysis and estimation annually. The Wind-down Plan also would provide that the estimate would be the Recovery/Wind-down Capital Requirement under the Capital Policy. Under that policy, the General Business Risk Capital Requirement, which is the amount of LNA that DTC plans to hold to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialize, is calculated as the greatest of three estimated amounts, one of

which is this Recovery/Wind-down Capital Requirement. Therefore, the Commission believes that the R&W Plan is consistent with Rules 17Ad-22(e)(15)(i) and (ii) under the Act.<sup>73</sup>

### III. Conclusion

*It is therefore noticed*, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,<sup>74</sup> that the Commission *does not object* to advance notice SR-DTC-2017-803, as modified by Amendment No. 1, and that DTC is *authorized* to implement the proposal as of the date of this notice or the date of an order by the Commission approving proposed rule change SR-DTC-2017-021, as modified by Amendment No. 1, whichever is later.

By the Commission.

**Eduardo A. Aleman,**  
*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-83950; File No. SR-DTC-2017-804]

### Self-Regulatory Organizations; The Depository Trust Company; Notice of No Objection to an Advance Notice, as Modified by Amendment No. 1, To Amend the Loss Allocation Rules and Make Other Changes

August 27, 2018.

On December 18, 2017, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-DTC-2017-804 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> to amend DTC's application of the Participants Fund, loss allocation rules, voluntary retirement process for Participants, the return of certain deposits to former Participants, and make other conforming and technical changes.<sup>3</sup> The

<sup>73</sup> 17 CFR 240.17Ad-22(e)(15)(i) and (ii).

<sup>74</sup> 12 U.S.C. 5465(e)(1)(I).

<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 18, 2017, DTC filed the advance notice as proposed rule change SR-DTC-2017-022 with the Commission pursuant to Section 19(b)(1) of the Act and Rule 19b-4 thereunder ("Proposed Rule Change"). 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. The Proposed Rule Change

Continued

<sup>64</sup> 11 U.S.C. 101 *et seq.*

<sup>65</sup> *See, e.g.*, 11 U.S.C. 363, 726, and 1129(a)(7).

<sup>66</sup> *See* 11 U.S.C. 363(f).

<sup>67</sup> The Wind-down Plan would identify certain factors the Board may consider in evaluating alternatives, which would include, for example, whether DTC could safely stabilize the business and protect its value without seeking bankruptcy protection, and DTC's ability to continue to meet its regulatory requirements.

<sup>68</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>69</sup> 17 CFR 240.17Ad-22(e)(15)(i).

<sup>70</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>71</sup> 17 CFR 240.17Ad-22(e)(15)(ii).

<sup>72</sup> *Supra* note 13.

advance notice was published for comment in the **Federal Register** on January 30, 2018.<sup>4</sup> In that publication, the Commission also extended the review period of the advance notice for an additional 60 days, pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act.<sup>5</sup> On April 10, 2018, the Commission required additional information from DTC pursuant to Section 806(e)(1)(D) of the Clearing Supervision Act,<sup>6</sup> which tolled the Commission's period of review of the advance notice until 60 days from the date the information required by the Commission was received by the Commission.<sup>7</sup> On June 28, 2018, DTC filed Amendment No. 1 to the advance

was published in the **Federal Register** on January 8, 2018. Securities Exchange Act Release No. 82426 (January 2, 2018), 83 FR 913 (January 8, 2018) (SR-DTC-2017-022). On February 8, 2018, the Commission designated a longer period within which to approve, disapprove, or institute proceedings to determine whether to approve or disapprove the Proposed Rule Change. Securities Exchange Act Release No. 82670 (February 8, 2018), 83 FR 6626 (February 14, 2018) (SR-DTC-2017-022, SR-FICC-2017-022, SR-NSCC-2017-018). On March 20, 2018, the Commission instituted proceedings to determine whether to approve or disapprove the Proposed Rule Change. Securities Exchange Act Release No. 82914 (March 20, 2018), 83 FR 12978 (March 26, 2018) (SR-DTC-2017-022). On June 25, 2018, the Commission designated a longer period for Commission action on the proceedings to determine whether to approve or disapprove the Proposed Rule Change. Securities Exchange Act Release No. 83510 (June 25, 2018), 83 FR 30791 (June 29, 2018) (SR-DTC-2017-022, SR-FICC-2017-022, SR-NSCC-2017-018). On June 28, 2018, DTC filed Amendment No. 1 to the Proposed Rule Change, which was published in the **Federal Register** on July 19, 2018. Securities Exchange Act Release No. 83629 (July 13, 2018), 83 FR 34246 (July 19, 2018) (SR-DTC-2017-022). DTC submitted a courtesy copy of Amendment No. 1 to the Proposed Rule Change through the Commission's electronic public comment letter mechanism. Accordingly, Amendment No. 1 to the Proposed Rule Change has been publicly available on the Commission's website at <https://www.sec.gov/rules/sro/dtc.htm> since June 29, 2018. The Commission did not receive any comments. The proposal, as set forth in both the advance notice and the Proposed Rule Change, each as modified by Amendments No. 1, shall not take effect until all required regulatory actions are completed.

<sup>4</sup> Securities Exchange Act Release No. 82582 (January 24, 2018), 83 FR 4297 (January 30, 2018) (SR-DTC-2017-804) ("Notice").

<sup>5</sup> Pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act, the Commission may extend the review period of an advance notice for an additional 60 days, if the changes proposed in the advance notice raise novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. 12 U.S.C. 5465(e)(1)(H). The Commission found that the advance notice raised complex issues and, accordingly, extended the review period of the advance notice for an additional 60 days until April 17, 2018. See Notice, *supra* note 4.

<sup>6</sup> 12 U.S.C. 5465(e)(1)(D).

<sup>7</sup> See 12 U.S.C. 5465(e)(1)(E)(ii) and (G)(ii); see Memorandum from the Office of Clearance and Settlement Supervision, Division of Trading and Markets, titled "Commission's Request for Additional Information," available at <http://www.sec.gov/rules/sro/dtc-an.shtml>.

notice to amend and replace in its entirety the advance notice as originally filed on December 18, 2017.<sup>8</sup> On July 6, 2018, the Commission received a response to its request for additional information in consideration of the advance notice, which, in turn, added a further 60 days to the review period pursuant to Section 806(e)(1)(E) and (G) of the Clearing Supervision Act.<sup>9</sup> The Commission did not receive any comments. This publication serves as notice that the Commission does not object to the proposed changes set forth in the advance notice, as modified by Amendment No. 1 (hereinafter, "Advance Notice").

### I. Description of the Advance Notice

The Advance Notice consists of proposed changes to DTC's Rules, By-Laws and Organization Certificate of DTC ("Rules")<sup>10</sup> in order to (1) modify the application of the Participants Fund; (2) modify the loss allocation process; (3) align DTC's loss allocation rule with the three clearing agencies of The Depository Trust & Clearing Corporation ("DTCC")—Fixed Income Clearing Corporation ("FICC") (including the Government Securities Division ("FICC/GSD") and the Mortgage-Backed Securities Division ("FICC/MBSD")), National Securities Clearing Corporation ("NSCC"), and DTC (collectively, the "DTCC Clearing Agencies");<sup>11</sup> (4) modify the voluntary retirement process; (5) reduce the time within which DTC is required to return a former Participant's Actual Participants Fund Deposit; and (6) make conforming and technical changes. Each of these proposed changes is described below. A detailed description of the specific rule

<sup>8</sup> Securities Exchange Act Release No. 83746 (July 31, 2018), 83 FR 38357 (August 6, 2018) (SR-DTC-2017-804) ("Notice of Amendment No. 1"). DTC submitted a courtesy copy of Amendment No. 1 to the advance notice through the Commission's electronic public comment letter mechanism. Accordingly, Amendment No. 1 to the advance notice has been publicly available on the Commission's website at <http://www.sec.gov/rules/sro/dtc-an.shtml> since June 29, 2018.

<sup>9</sup> 12 U.S.C. 5465(e)(1)(E) and (G); see Memorandum from the Office of Clearance and Settlement Supervision, Division of Trading and Markets, titled "Response to the Commission's Request for Additional Information," available at <http://www.sec.gov/rules/sro/dtc-an.shtml>.

<sup>10</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>11</sup> DTCC is a user-owned and user-governed holding company and is the parent company of DTC, FICC, and NSCC. DTCC operates on a shared services model with respect to the DTCC Clearing Agencies. Most corporate functions are established and managed on an enterprise-wide basis pursuant to intercompany agreements under which it is generally DTCC that provides a relevant service to a DTCC Clearing Agency.

text changes proposed in this Advance Notice can be found in the Notice of Amendment No. 1.<sup>12</sup>

#### A. Application of the Participants Fund

Under current Section 3 of 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: (1) Apply some or all of the Actual Participants Fund Deposit of such Participant to such obligation; (2) 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>13</sup> and/or (3) 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.

Current Rule 4 provides a single set of tools and a common process for the use of the Participants Fund for both (1) liquidity purposes to complete settlement among non-defaulting Participants, if one or more Participants fails to settle, and (2) the satisfaction of losses and liabilities due to Participant defaults<sup>14</sup> or non-default losses that are incident to the business of DTC.<sup>15</sup> For both liquidity<sup>16</sup> and loss scenarios, current Section 4 of 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

<sup>12</sup> See Notice of Amendment No. 1, *supra* note 8.

<sup>13</sup> DTC states that it maintains a 364-day committed revolving line of credit with a syndicate of commercial lenders, renewed every year. DTC further states that 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>14</sup> DTC states that the failure of a Participant to satisfy its settlement obligation constitutes a liability to DTC. Insofar as DTC undertakes to complete settlement among Participants other than the Participant that failed to settle, that liability may give rise to losses as well.

<sup>15</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 10.

<sup>16</sup> DTC states that, in contrast to NSCC and FICC, DTC is not a central counterparty and does not guarantee obligations of its membership. DTC states that the Participants Fund is a mutualized pre-funded liquidity and loss resource. Therefore, in contrast to NSCC and FICC, DTC does not have an obligation to "repay" the Participants Fund, and the application of the Participants Fund does not convert to a loss.

that a Participant was required to Deposit to the Participants Fund pursuant to Section 2 of Rule 9(A).<sup>17</sup> Current Section 4 of Rule 4 provides that if DTC incurs a loss or liability which is not satisfied by charging the Participant responsible for causing the 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 current Rules, after the Participants Fund is applied pursuant to 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 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 (1) the amount of its Aggregate Required Deposit and Investment, as fixed immediately prior to the time of the first pro rata charge, plus 100 percent of the amount thereof, or (2) 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.

Proposed Section 3 of Rule 4 would provide that a Participant Default occurs when a Participant becomes a Defaulting Participant pursuant to Rule 9(B) or is otherwise obligated to DTC pursuant to the Rules and Procedures, and fails to satisfy any such obligation. The proposal would clarify that DTC would apply some or all of the Actual Participants Fund Deposit of a Defaulting Participant to its obligation to satisfy the Participant Default, to the

extent necessary to eliminate such obligation. If such application would be insufficient to satisfy such obligation, DTC may, in its sole discretion, to the extent necessary to satisfy such obligation (1) 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 (2) 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.

The proposed change would also 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. DTC states that the proposed changes reinforce the distinction between the mechanisms to complete settlement on a Business Day, and to mutualize losses that may result from a failure to settle or other loss-generating events. DTC also states that the change would more closely align the loss allocation provisions of proposed Section 5 of Rule 4 to similar provisions of the NSCC and FICC rules, to the extent appropriate.

Proposed Section 4 would address the situation of a Defaulting Participant failure to settle if the application of the Actual Participants Fund Deposit of that Defaulting Participant, pursuant to proposed Section 3, is not sufficient to complete settlement among Participants other than the Defaulting Participant (each, a “non-defaulting Participant”).<sup>18</sup>

Proposed Section 4 would expressly state that the Participants Fund shall constitute a liquidity resource which 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 Defaulting 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. 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,” 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 pro rata settlement charge for each 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 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 it would not include the current distinction for common members of another clearing agency pursuant to a Clearing Agency Agreement.<sup>19</sup> DTC states that 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>20</sup> The proposed change would require 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 change would provide each non-defaulting Participant an opportunity to elect to terminate its business with DTC and thereby cap its exposure to further pro rata settlement

<sup>17</sup> Section 2 of Rule 9(A) provides, in part, “[a]t 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 . . .” *Supra* note 10. Pursuant to the proposed 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.”

<sup>18</sup> As described above, proposed Rule 4 splits the liquidity and loss provisions to more closely align to similar loss allocation provisions in NSCC and FICC rules. Pursuant to the proposed change, DTC would also align, where appropriate, the liquidity and loss provisions within proposed Rule 4. DTC would retain the existing Rule 4 concepts of calculating the ratable share of a Participant, charging each non-defaulting Participant a pro rata share of an application of the Participants Fund to complete settlement, providing notice to Participants of such charge, and providing each Participant the option to cap its liability for such charges by electing to terminate its business with DTC. However, pursuant to the proposed change, DTC would modify these concepts and certain associated processes to more closely align with the analogous proposed loss allocation provisions in proposed Rule 4 (e.g., Loss Allocation Notice, Loss Allocation Termination Notification Period, and Loss Allocation Cap).

<sup>19</sup> Rule 4, Section 4(a)(1), *supra* note 10. DTC states that it 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>20</sup> DTC states 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.

charges. As proposed, Participants would have five Business Days<sup>21</sup> 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 Settlement Charge Cap. In addition, the proposal would 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>22</sup> A Participant that elects to terminate its business with DTC would, subject to its cap, remain responsible for (1) its pro rata settlement charge that was the subject of the Settlement Charge Notice, and (2) all other pro rata settlement charges until the Participant Termination Date. 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 percent of the amount thereof (“Settlement Charge Cap”). The proposed Settlement Charge Cap would be no greater than the current cap.<sup>23</sup>

DTC states that 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. The proposed loss allocation concepts described below would not apply to pro rata settlement charges.<sup>24</sup>

<sup>21</sup> DTC states a five Business Day 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 Business Day pro rata settlement charge notification period would conform to the proposed loss allocation notification period in this proposed change and in the proposed changes for NSCC and FICC. See *infra* note 34.

<sup>22</sup> DTC states 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>23</sup> Current Section 8 of 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 percent 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 10. The alternative limit in clause (b) would be eliminated in proposed Section 8(a) in favor of a single defined standard.

<sup>24</sup> DTC states that 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 designed to be the basic provision of remedies if a Participant fails to satisfy an obligation to DTC. Proposed Section 4 is

### *B. Changes to the Loss Allocation Process*

DTC’s current loss allocation rules address the use of the Participants Fund for both liquidity purposes to complete settlement among non-defaulting Participants, and for the satisfaction of losses and liabilities due to Participant defaults or certain other losses or liabilities incident to the business of DTC, together. For both liquidity and loss scenarios, current Section 4 of Rule 4 provides that DTC may apply some or all of the Actual Participants Fund Deposits of all other Participants, and/or charge the existing retained earnings and undivided profits of DTC. Currently, if DTC applies the Actual Participants Fund Deposits, any loss or liability will 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). Current Section 4 of Rule 4 provides that if there is an unsatisfied loss or liability, DTC may, in its sole discretion, charge the existing retained earnings and undivided profits of DTC.

DTC proposes to change the manner in which each of the aspects of the loss allocation process described above would be employed. The proposal would clarify or adjust certain elements, and introduce certain new loss allocation concepts, as further discussed below. In addition, the proposal would address 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, also as described below.

DTC proposes five key changes to enhance DTC’s loss allocation process. Specifically, DTC proposes to make changes regarding (1) the Corporate Contribution, (2) the Event Period, (3) the loss allocation round and notice, (4) the loss allocation termination notice and cap, and (5) the governance around non-default losses, each of which is discussed below.

designed to be a specific remedy for a failure to settle by a Defaulting Participant (*i.e.*, a specific type of Participant Default). Proposed Section 5 is designed to be a remedial provision for a Participant Default when, additionally, DTC ceases to act for the Participant and there are remaining losses or liabilities. DTC states that if a Participant Default occurs, the application of proposed Section 3 would be required, while the application of proposed Section 4 would be at the discretion of 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 Participant, proposed Section 5 would apply.

### (1) Corporate Contribution

Current Section 4 of 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 change, DTC would replace the discretionary application of an unspecified amount of retained earnings and undivided profits with a mandatory, defined Corporate Contribution. The proposed Corporate Contribution would apply to losses and liabilities that are incurred by DTC with respect to an Event Period, whether arising from a Default Loss Event or Declared Non-Default Loss Event, before the allocation of losses to Participants.<sup>25</sup>

The proposed Corporate Contribution would be defined to be an amount equal to 50 percent of DTC’s General Business Risk Capital Requirement.<sup>26</sup> DTC’s General Business Risk Capital Requirement, as defined in DTC’s Clearing Agency Policy on Capital Requirements,<sup>27</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>28</sup> The proposed Corporate Contribution would be held in addition to DTC’s General Business Risk Capital Requirement. Proposed Rule 4 also would 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. As proposed, if the 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 250

<sup>25</sup> The proposed change would not apply the Corporate Contribution if the Participants Fund is used with respect to a pro rata settlement charge. However, if, after a Participant Default, the proceeds of the sale of the Collateral of the Participant are insufficient to 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, the Corporate Contribution would be applied.

<sup>26</sup> DTC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (1) an amount determined based on its general business profile, (2) an amount determined based on the time estimated to execute a recovery or orderly wind-down of DTC’s critical operations, and (3) an amount determined based on an analysis of DTC’s estimated operating expenses for a six month period.

<sup>27</sup> See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR–DTC–2017–003, SR–NSCC–2017–004, SR–FICC–2017–007).

<sup>28</sup> 17 CFR 240.17Ad–22(e)(15).

Business Days in order to permit DTC to replenish the Corporate Contribution.<sup>29</sup> Under the proposal, Participants would receive notice of any such reduction to the Corporate Contribution.

## (2) Event Period

DTC states that in order to clearly define the obligations of DTC and its Participants regarding loss allocation and to balance the need to manage the risk of sequential loss events against Participants' need for certainty concerning their maximum loss allocation exposures, DTC proposes to introduce the concept of an Event Period to the Rules 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 within a period of 10 Business Days ("Event Period") for purposes of allocating losses to Participants in one or more rounds, subject to the limits of loss allocation as explained below.<sup>30</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, an Event Period would begin on the day that DTC notifies Participants of the Declared Non-Default Loss Event (or the next Business Day, if such day is not a Business Day). 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. 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

<sup>29</sup> DTC states that 250 Business Days would be a reasonable estimate of the time frame that DTC would be required 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.

<sup>30</sup> DTC states that having a 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.

Declared Non-Default Loss Events occurring during overlapping 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 would apply for any Participant that elects to terminate its business with DTC in respect of a loss allocation round, 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.<sup>31</sup>

DTC states that in order to enhance clarity, the proposed change would define "Default Loss Event" as the determination by DTC to cease to act for a Participant ("CTA Participant") pursuant to Rule 10, Rule 11, or Rule 12. The proposed change also would define "Declared Non-Default Loss Event" as the determination by the Board of Directors that a loss or liability incident to the clearance and settlement 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 its services in an orderly manner.

## (3) Loss Allocation Round and Loss Allocation Notice

Under the proposal, 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.

<sup>31</sup> Each Participant that is a Participant on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Default Loss Event (other than a Default Loss Event with respect to which it is the CTA Participant) and each Declared Non-Default Loss Event occurring during the Event Period.

Each loss allocation would be communicated to Participants by the issuance of a notice that advises each Participant of the amount being allocated to it ("Loss Allocation Notice"). 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 it would not include the current distinction for common members of another clearing agency pursuant to a Clearing Agency Agreement.<sup>32</sup> In addition, 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>33</sup>

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. 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 Business Days<sup>34</sup> from the issuance 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 (such notification, whether with respect to a Settlement Charge Notice or Loss Allocation Notice, a "Termination Notice") pursuant to proposed Section 8(b) of Rule 4, and thereby benefit from its Loss Allocation Cap. In other words, the proposed 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. After a first round of loss allocations with respect to an Event Period, only Participants that have not

<sup>32</sup> See *supra* note 19.

<sup>33</sup> DTC states 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>34</sup> Current Section 8 of 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 10 Business Days after receiving notice of a pro rata charge. DTC states that it is appropriate to shorten such time period from 10 Business Days to five 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 states that five Business Days would provide Participants with sufficient time to decide whether to cap their loss allocation obligations by terminating their business with DTC.

submitted a Termination Notice, in accordance with proposed Section 8(b) of Rule 4, would be subject to further loss allocation with respect to that Event Period.

DTC's current loss allocation provisions provide that if a charge is made against a Participant's Actual Participants Fund Deposits, and as result thereof the Participant's deposit is less than its Required Participants Fund Deposit, the Participant will, upon demand by DTC, be required to replenish its deposit to eliminate the deficiency within such time as DTC shall require. Under the proposal, Participants would receive two Business Days' notice of a loss allocation, and be required to pay the requisite amount no later than the second Business Day following the issuance of such notice.<sup>35</sup>

#### (4) Termination Notice and Loss Allocation Cap

DTC's current Rules provide that a Participant may terminate its business with DTC by notifying DTC. DTC proposes to enhance the termination procedure to clarify and align with the rules of NSCC and FICC, where appropriate. As proposed, Participants would have five 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>36</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. In addition, DTC would also change the beginning date of such notification period from the receipt of the notice to the date of the issuance of the first Loss Allocation Notice for any round. Pursuant to the proposed change, a Participant would be able to elect to terminate its membership by following the requirements in proposed Section 8(b) of Rule 4: (1) Specify in its Termination Notice an effective date of termination ("Participant Termination Date"), which date shall be no later than 10 Business Days following the last day of the applicable Loss Allocation Termination Notification Period; (2) cease all activities and use of DTC's services other than activities and services necessary to terminate the

business of the Participant with DTC; and (3) ensure that all activities and use of DTC services by such Participant cease on or prior to the Participant Termination Date.

Under the current Rules, the exposure of the terminating Participant for pro rata charges would be capped at the greater of (1) the amount of its Aggregate Required Deposit and Investment, as fixed immediately prior to the time of the first pro rata charge, plus 100 percent of the amount thereof, or (2) 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. Under the proposal, if a Participant timely 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 percent of the amount thereof ("Loss Allocation Cap").<sup>37</sup> 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, the Participant would still be required to pay for the excess amount.

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; however, 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.

#### (5) Declared Non-Default Loss Event

The Rules currently permit DTC to apply the Participants Fund to non-

default losses,<sup>38</sup> provided that such loss or liability is incident to the business of DTC. DTC proposes to enhance 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 would 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 change would provide that DTC would then be required to promptly notify Participants of this determination, which would be referred to as a "Declared Non-Default Loss Event." In addition, DTC proposes to specify that (1) the Corporate Contribution would apply to losses or liabilities arising from a Default Loss Event or a Declared Non-Default Loss Event, and (2) the loss allocation process 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.

#### C. Voluntary Retirement Process

Section 1 of Rule 2 provides that a Participant may terminate its business with DTC by notifying DTC in the appropriate manner.<sup>39</sup> To provide additional transparency to Participants with respect to the voluntary retirement of a Participant, and to align, where appropriate, with the proposed rule changes of NSCC and FICC with respect to voluntary termination, DTC is proposing to add proposed Section 6(a) to Rule 4, which would be titled, "Upon Any Voluntary Retirement." Proposed

<sup>38</sup> Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

<sup>39</sup> Section 1 of Rule 2 provides, in relevant part, that "[a] Participant may terminate its business with the Corporation by notifying the Corporation as provided in Sections 7 or 8 of Rule 4 or, if for a reason other than those specified in said Sections 7 and 8, by notifying the Corporation thereof; the Participant shall, upon receipt of such notice by the Corporation, cease to be a Participant. In the event that a Participant shall cease to be a Participant, the Corporation shall thereupon cease to make its services available to the Participant, except that the Corporation may perform services on behalf of the Participant or its successor in interest necessary to terminate the business of the Participant or its successor with the Corporation, and the Participant or its successor shall pay to the Corporation the fees and charges provided by these Rules with respect to services performed by the Corporation subsequent to the time when the Participant ceases to be a Participant." *Supra* note 10. DTC is proposing to modify the provision to clarify that the termination would be subject to proposed Section 6 of Rule 4.

<sup>35</sup> DTC states that allowing Participants two 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>36</sup> Under the proposal, a Participant would 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.

<sup>37</sup> The alternative limit in clause (b) would be eliminated in proposed Section 8(b) in favor of a single defined standard. *See supra* note 23.

Section 6(a) of Rule 4 would (1) clarify the requirements for a Participant that wants to voluntarily terminate its business with DTC, and (2) address the situation where a Participant submits a Voluntary Retirement Notice and subsequently receives a Settlement Charge Notice or the first Loss Allocation Notice in a round on or prior to the Voluntary Retirement Date.

Specifically, DTC is proposing that if a Participant elects to terminate its business with DTC pursuant to Section 1 of Rule 2 for reasons other than those specified in proposed Section 8 (a “Voluntary Retirement”), the Participant would be required to: (1) Provide a written notice of such termination to DTC (“Voluntary Retirement Notice”), as provided for in Section 1 of Rule 2; (2) specify in the Voluntary Retirement Notice a desired date for the termination of its business with DTC (“Voluntary Retirement Date”); (3) cease all activities and use of DTC services other than activities and services necessary to terminate the business of the Participant with DTC; and (4) ensure that all activities and use of DTC services by the Participant cease on or prior to the Voluntary Retirement Date.<sup>40</sup> Proposed Section 6(a) of Rule 4 would provide that if the Participant fails to comply with the requirements of proposed Section 6(a), its Voluntary Retirement Notice would be deemed void.

Further, proposed Section 6(a) of Rule 4 would provide that if a Participant submits a Voluntary Retirement Notice and subsequently receives a Settlement Charge Notice or the first Loss Allocation Notice in a round on or prior to the Voluntary Retirement Date, such Participant must timely submit a Termination Notice in order to benefit from its Settlement Charge Cap or Loss Allocation Cap, as the case may be. In such a case, the Termination Notice would supersede and void the pending Voluntary Retirement Notice submitted by the Participant.

#### *D. Accelerated Return of Former Participant's Clearing Fund Deposit*

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 proposes 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 change, the time period would be reduced from four years to two years. All other requirements relating to the return of the Actual Participants Fund Deposit would remain the same.

DTC states that the four 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 states that the change to two years is appropriate because, currently, as DTC and the industry continue to move toward automation and dematerialization, claims typically surface more quickly. Therefore, DTC states that a shorter retention period of two 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.

#### *E. Conforming and Technical Changes*

DTC proposes to make various conforming and technical changes necessary to harmonize the remaining current Rules with the proposed changes. Such changes include, but are not limited to, (1) inserting, deleting, or changing various terms, sentences, or

headings for clarity and consistency; (2) consolidating certain sections of the Rules for clarity; and (3) amending Rule 1 (Definitions; Governing Law) to add cross-references to proposed terms that would be defined in Rule 4.

## **II. Discussion and Commission Findings**

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, its stated purpose is instructive: To mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.<sup>41</sup>

Section 805(a)(2) of the Clearing Supervision Act<sup>42</sup> authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act<sup>43</sup> provides the following objectives and principles for the Commission's risk management standards prescribed under Section 805(a):

- To promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act<sup>44</sup> and Section 17A of the Act<sup>45</sup> (“Rule 17Ad-22”).<sup>46</sup> Rule 17Ad-22 requires registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.<sup>47</sup> Therefore, it is appropriate for the Commission to review proposed changes in advance notices against the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing

<sup>41</sup> See 12 U.S.C. 5461(b).

<sup>42</sup> 12 U.S.C. 5464(a)(2).

<sup>43</sup> 12 U.S.C. 5464(b).

<sup>44</sup> 12 U.S.C. 5464(a)(2).

<sup>45</sup> 15 U.S.C. 78q-1.

<sup>46</sup> 17 CFR 240.17Ad-22.

<sup>47</sup> *Id.*

<sup>40</sup> Typically, a Participant would ultimately submit a notice after having ceased its transactions and transferred all securities out of its Account.

Supervision Act<sup>48</sup> and against Rule 17Ad-22.<sup>49</sup>

*A. Consistency With Section 805(b) of the Clearing Supervision Act*

The Commission believes that the proposed changes in the Advance Notice are designed to help DTC promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system as discussed below.

The proposal would clarify that if a Participant fails to satisfy its obligations, such Participant's Actual Participants Fund Deposit would be used to eliminate any unpaid obligations of that Participant to DTC, as described above. Further, the proposal would modify the application of the Participants Fund, and clarify that the Participants Fund may be used (1) as a liquidity resource for DTC to fund settlement among non-defaulting Participants, and (2) to satisfy losses and liabilities of DTC in the loss allocation process. In addition, the proposal would add the term "Participant Default" to current Section 3 to clarify that proposed Section 3 would apply when there is a failure of a Participant to satisfy any obligation to DTC. The proposal would expressly provide for the application of the Actual Participants Fund Deposit of the defaulting Participant to satisfy its unpaid obligations. The proposal would explicitly state that the Participants Fund shall constitute a liquidity resource which may be applied by DTC to fund settlement among non-defaulting Participants in the event of the failure of a Defaulting Participant to satisfy its settlement obligation. In addition, the proposal would provide two separate procedures to charge the Participants Fund: One to use it as a liquidity resource and another to pay for allocated losses.

The proposal is designed to give authority explicitly to DTC to use the Participants Fund as a liquidity resource to fund settlement among non-defaulting Participants. With such clear authority to use the Participants Fund as a liquidity resource, DTC would have additional liquidity during a stress event, and thus be better able to manage its liquidity risks stemming from a Defaulting Participant. This access to liquidity during a stress event would help mitigate any risk to settlement finality due to DTC having insufficient funds to meet all its payment obligations to its Participants. As such, access to this liquidity would help to

strengthen liquidity of DTC, which is designated as systemically important,<sup>50</sup> and thereby support the stability of the broader financial system. Moreover, the Commission believes that these changes provide clarity to the application of the Participants Fund and would enable DTC and Participants to better anticipate and prepare for their potential exposures, which, in turn, would allow them to better manage their risk, thereby promoting robust risk management as well as safety and soundness.

In addition to the changes to the Participant Fund application, DTC proposes to make the following changes to its loss allocation process. First, DTC would establish a mandatory Corporate Contribution to be applied to DTC's losses and liabilities. The proposed Corporate Contribution would be defined to be an amount equal to 50 percent of DTC's General Business Risk Capital Requirement. The proposed changes also would clarify that the proposed Corporate Contribution would apply to both Default Loss Events and Declared Non-Default Loss Events. Moreover, the proposal specifies that if the Corporate Contribution is applied to a loss or liability relating to an Event Period, then for any subsequent Event Periods that occur during the 250 business days thereafter, the Corporate Contribution would be reduced to the remaining, unused portion of the Corporate Contribution. The Commission believes that these changes set clear expectations about how and when DTC's Corporate Contribution would be applied to help address a loss, and allow DTC to better anticipate and prepare for potential exposures that may arise during an Event Period.

Second, as described above, DTC proposes to introduce the concept of an Event Period, which would group Default Loss Events and Declared Non-Default Loss Events occurring within a period of 10 Business Days for purposes of allocating losses to Participants in one or more rounds. Under the current Rules, every time DTC incurs a loss or liability, DTC will initiate its current loss allocation process by applying its retained earnings and allocating losses. The current Rules do not contemplate a situation where loss events occur in quick succession. Accordingly, even if multiple losses occur within a short period, the current Rules dictate that DTC start the loss allocation process separately for each loss event. Having multiple loss allocation calculations and notices from DTC and Termination Notices from Participants after multiple

sequential loss events could cause operational risk to DTC, since multiple notices may cause confusion at a time of significant stress.

The Commission believes that the proposed change to introduce an Event Period would improve upon the current loss allocation process described immediately above. Specifically, the introduction of an Event Period would provide a more defined and transparent structure than the current loss allocation process. Such an improved structure should enable both DTC and each Participant to more effectively manage the risks and potential financial obligations presented by sequential Default Loss Events and/or Declared Non-Default Loss Events that are likely to arise in quick succession, and could be closely linked to an initial event and/or market dislocation episode. In other words, the proposed Event Period structure should help clarify and define for both DTC and Participants how DTC would initiate a single defined loss allocation process to cover all loss events within 10 Business Days. As a result, all loss allocation calculation and notices from DTC and potential Termination Notices from Participants would be tied back to one Event Period instead of each individual loss event.

Third, as described above, the proposal would improve upon the approach laid out in DTC's current Rules by providing for a loss allocation round, a Loss Allocation Notice process, a Termination Notice process, and a Loss Allocation Cap. A loss allocation round would be a series of loss allocations relating to an Event Period, the aggregate amount of which would be limited by the round cap. When the losses allocated in a round equals the round cap, any additional losses relating to the Event Period would be allocated in subsequent rounds until all losses from the Event Period are allocated among Participants. Each loss allocation would be communicated to Participants by the issuance of a Loss Allocation Notice. Each Participant in a loss allocation round would have five Business Days from the issuance of such first Loss Allocation Notice for the round to notify DTC of its election to terminate its business with DTC, and thereby benefit from its Loss Allocation Cap. The Loss Allocation Cap of a Participant would be the amount of its Aggregate Required Deposit and Investment, as fixed on the first day of the Event Period, plus 100 percent of the amount thereof. Participants would have two Business Days after DTC issues a first round Loss Allocation Notice to pay the amount specified in such notice.

<sup>48</sup> 12 U.S.C. 5464(b).

<sup>49</sup> 17 CFR 240.17Ad-22.

<sup>50</sup> See *infra* note 52.



The Commission believes that the changes to (1) establish a specific Event Period, (2) continue the loss allocation process in successive rounds, (3) clearly communicate with its Participants regarding their loss allocation obligations, and (4) effectively identify continuing Participants for the purpose of calculating loss allocation obligations in successive rounds, are designed to make DTC's loss allocation process more certain. In addition, the changes are designed to provide Participants with a clear set of procedures that operate within the proposed loss allocation structure, and provide increased predictability and certainty regarding Participants' exposures and obligations. Furthermore, by grouping all loss events within 10 Business Days, the loss allocation process relating to multiple loss events can be streamlined. With enhanced certainty, predictability, and efficiency, DTC would then be able to better manage its risks from loss events occurring in quick succession, and Participants would be able to better manage their risks by deciding whether and when to withdraw from membership and limit their exposures to DTC. Furthermore, the proposed changes are designed to reduce liquidity risk to Participants by providing a two-day window to arrange funding to pay for loss allocation, while still allowing DTC to address losses in a timely manner.

Fourth, as described above, DTC proposes to clarify the governance around Declared Non-Default Loss Events by providing 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 its services in an orderly manner. DTC also proposes to provide that DTC would then be required to promptly notify Participants of this determination and start the loss allocation process concerning the loss stemming from a Declared Non-Default Loss Event.

The Commission believes that the immediately above described changes should provide an orderly and transparent procedure to allocate a non-default loss by requiring the Board of Directors to make a definitive decision to announce an occurrence of a Declared Non-Default Loss Event, and requiring DTC to provide a notice to Participants of such decision. The Commission further believes that an orderly and transparent procedure should result in a risk management process at DTC that is more robust as a result of enhanced governance around DTC's response to

non-default losses, thereby promoting safety and soundness.

Collectively, the Commission believes that the proposed changes to DTC's loss allocation process would provide greater transparency, certainty, and efficiency to both DTC and Participants regarding the amount of resources and the instances in which DTC would apply such resources to address risks arising from Default Loss Events and Declared Non-Default Loss Events, which could occur in quick succession. The Commission believes that such transparency, certainty, and efficiency would allow better predictability to DTC and its Participants regarding their exposures, and in turn, would allow a risk management process at DTC and its Participants that is more robust in response to such events and would improve their ability to continue to operate and recover in a safe and sound manner during such events. Therefore, the Commission believes that the proposal promotes robust risk management as well as safety and soundness.

In addition to the key changes discussed above, DTC proposes to provide additional transparency to Participants with respect to voluntary retirement. In particular, the proposal provides that if a Participant submits a Voluntary Retirement Notice and subsequently receives a Settlement Charge Notice of the first Loss Allocation Notice in a round on or prior to the Voluntary Retirement Date, such Participant must timely submit a Termination Notice in order to benefit from its Settlement Charge Cap or Loss Allocation Cap, as the case may be. This proposed change helps to eliminate uncertainty as to the obligations of a Participant that submits a termination notice to DTC pursuant to the current Rules, and later receives a Settlement Charge Notice or a Loss Allocation Notice pursuant to the proposed Rules. Accordingly, the Commission believes that the proposal is designed to promote robust risk management by eliminating such uncertainty by providing a clear termination process, which, in turn should promote safety and soundness by enabling better management obligations to DTC.

Furthermore, the proposed changes would align the loss allocation rules of the DTCC Clearing Agencies to the extent practicable and appropriate. The alignment is designed to help provide consistent treatment for firms that are participants of multiple DTCC Clearing Agencies. The Commission believes that providing consistent treatment through consistent procedures among the DTCC Clearing Agencies would help firms that

participate in multiple DTCC Clearing Agencies from encountering unnecessary complexities and confusion stemming from differences in procedures regarding loss allocation processes, particularly at times of significant stress. Accordingly, the Commission believes that the change is designed to reduce systemic risk and support the stability of the broader financial system.

Also, DTC proposes to reduce the time within which DTC is required to return the Actual Participants Fund Deposit of a former Participant from four years to two years. The Commission believes that this reduction in time would enable firms that have exited DTC to have access to their funds sooner than under the current Rules. While acknowledging that the reduction in time could lessen DTC's flexibility in liquidity management for the period between two years and four years, the Commission believes that DTC's procedures would continue to protect DTC and its clearance and settlement services because the rule would maintain the provisions that DTC (1) 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, and (2) could retain the funds for up to two years. Therefore, DTC could maintain a necessary level of coverage for possible claims arising in connection with the DTC activities of a former Participant. Accordingly, the Commission believes that the proposed changes to accelerate the return of a former Participant's Actual Participants Fund Deposit are designed to reduce the systemic risks by reducing financial risks for participants of multiple DTCC Clearing Agencies, and in turn, support the stability of the broader financial system.

Finally, DTC proposes to make conforming and technical changes necessary to harmonize the current Rules with the proposed changes. The Commission believes that these changes are designed to provide clear and coherent Rules concerning loss allocation process to DTC and its Participants. The Commission further believes that clear and coherent Rules should help enhance the ability of DTC and Participants to more effectively plan for, manage, and address the risks and financial obligations that loss events present to DTC and its Participants. Accordingly, the Commission believes that the conforming and technical changes are designed to promote robust risk management.

Therefore, for all of the reasons stated above, the Commission believes that the

changes proposed in the Advance Notice are consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act.<sup>51</sup>

*B. Consistency With Rule 17Ad-22(e)(4)(viii)*

Rule 17Ad-22(e)(4)(viii) under the Act requires, in part, that a covered clearing agency<sup>52</sup> establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by addressing allocation of credit losses the covered clearing agency may face if its collateral and other resources are insufficient to fully cover its credit exposures.<sup>53</sup>

As described above, the proposal would revise the loss allocation process to address how DTC would manage loss events, including Defaulting Loss Events. Under the proposal, if losses arise out of or relate to a Defaulting Loss Event, DTC would first apply its Corporate Contribution. If such funds prove insufficient, the proposal provides for allocating the remaining losses to the remaining Participants through the proposed process.

Accordingly, the Commission believes that the proposal is reasonably designed to manage DTC's credit exposures to its Participants, by addressing allocation of credit losses.

Therefore, the Commission believes that DTC's proposal is consistent with Rule 17Ad-22(e)(4)(viii) under the Act.<sup>54</sup>

*C. Consistency With Rule 17Ad-22(e)(7)(i)*

Rule 17Ad-22(e)(7)(i) under the Act requires, in part, that a covered clearing agency 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 the covered clearing

agency, 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>55</sup>

As described above, the proposal would clarify that the Participants Fund may be used as a liquidity resource which may be applied by DTC to fund settlement among non-defaulting Participants. In addition, the proposal would provide a separate procedure to charge the Participants Fund to use it as a liquidity resource. The proposed change is designed to help DTC manage its settlement and funding flows on a more timely basis and better effect same day settlement of payment obligations in certain foreseeable stress scenarios.

Therefore, the Commission believes that the proposal is reasonably designed to help DTC effectively manage liquidity risk in a timely manner to complete settlement, and accordingly is consistent with Rule 17Ad-22(e)(7)(i).<sup>56</sup>

*D. Consistency With Rule 17Ad-22(e)(13)*

Rule 17Ad-22(e)(13) under the Act requires, in part, that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure the covered clearing agency has the authority to take timely action to contain losses and liquidity demands and continue to meet its obligations.<sup>57</sup>

As described above, the proposal would establish a more detailed and structured loss allocation process by (1) applying a defined and mandatory Corporate Contribution to a loss; (2) introducing an Event Period; (3) introducing a loss allocation round and notice process; (4) modifying the termination process and the cap of terminating Participant's loss allocation exposure; and (5) providing the governance around a non-default loss. The Commission believes that each of these proposed changes helps establish a more transparent and clear loss allocation process and authority of DTC to take certain actions, such as announcing a Declared Non-Default Loss Event, within the loss allocation process. Further, having a more transparent and clear loss allocation process as proposed would provide clear authority to DTC to allocate losses

from Default Loss Events and Declared Non-Default Loss Events and take timely actions to contain losses, and continue to meet its clearance and settlement obligations.

Therefore, the Commission believes that DTC's proposal is consistent with Rule 17Ad-22(e)(13) under the Act.<sup>58</sup>

*E. Consistency With Rule 17Ad-22(e)(23)(i) and (ii)*

Rule 17Ad-22(e)(23)(i) under the Act requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures.<sup>59</sup> Rule 17Ad-22(e)(23)(ii) under the Act requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency.<sup>60</sup>

As described above, the proposal would publicly disclose how DTC's Corporate Contribution would be calculated and applied. In addition, the proposal would establish and publicly disclose a detailed procedure in the Rules for loss allocation. More specifically, the proposed changes would establish an Event Period, loss allocation rounds, a termination process followed by a settlement charge process or loss allocation process, and a Loss Allocation Cap that would apply to Participants after termination. Additionally, the proposal would align the loss allocation rules across the DTCC Clearing Agencies, to help provide consistent treatment, and clarify that non-default losses would trigger loss allocation to Participants. The proposal would also provide for and make known to members the procedures to trigger a loss allocation procedure, contribute DTC's Corporate Contribution, allocate losses, and withdraw and limit Participant's loss exposure. Accordingly, the Commission believes that the proposal is reasonably designed to (1) publicly disclose all relevant rules and material procedures concerning key aspects of DTC's default rules and procedures, and (2) provide sufficient information to enable Participants to identify and evaluate the risks by participating in DTC.

<sup>51</sup> 12 U.S.C. 5464(b).

<sup>52</sup> A "covered clearing agency" means, among other things, a clearing agency registered with the Commission under Section 17A of the Exchange Act (15 U.S.C. 78q-1 *et seq.*) that is designated systemically important by the Financial Stability Oversight Counsel ("FSOC") pursuant to the Clearing Supervision Act (12 U.S.C. 5461 *et seq.*). See 17 CFR 240.17Ad-22(a)(5) and (6). On July 18, 2012, FSOC designated DTC as systemically important. U.S. Department of the Treasury, "FSOC Makes First Designations in Effort to Protect Against Future Financial Crises," available at <https://www.treasury.gov/press-center/press-releases/Pages/ig1645.aspx>. Therefore, DTC is a covered clearing agency.

<sup>53</sup> 17 CFR 240.17Ad-22(e)(4)(viii).

<sup>54</sup> *Id.*

<sup>55</sup> 240.17Ad-22(e)(7)(i).

<sup>56</sup> *Id.*

<sup>57</sup> 240.17Ad-22(e)(13).

<sup>58</sup> *Id.*

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

<sup>60</sup> 17 CFR 240.17Ad-22(e)(23)(ii).

Therefore, the Commission believes that DTC's proposal is consistent with Rules 17Ad-22(e)(23)(i) and (ii) under the Act.<sup>61</sup>

### III. Conclusion

It is therefore noticed, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,<sup>62</sup> that the Commission does not object to advance notice SR-DTC-2017-804, as modified by Amendment No. 1, and that DTC is authorized to implement the proposal as of the date of this notice or the date of an order by the Commission approving proposed rule change SR-DTC-2017-022, as modified by Amendment No. 1, whichever is later.

By the Commission.

**Eduardo A. Aleman,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-83938; File No. SR-CboeBZX-2018-047]

### Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Notice of Designation of a Longer Period for Commission Action on a Proposed Rule Change To Amend BZX Rule 14.8, General Listings Requirements—Tier I, To Adopt Listing Standards for Closed-End Funds

August 24, 2018.

On June 21, 2018, Cboe BZX Exchange, Inc. ("BZX") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend BZX Rule 14.8, titled "General Listings Requirements—Tier I," in order to adopt listing standards for closed-end funds. The proposed rule change was published for comment in the **Federal Register** on July 11, 2018.<sup>3</sup> The Commission has received no comment letters on the proposed rule change.

Section 19(b)(2) of the Act<sup>4</sup> provides that, within 45 days of the publication of notice of the filing of a proposed rule change, or within such longer period up to 90 days as the Commission may designate if it finds such longer period

to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission shall either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether the proposed rule change should be disapproved. The 45th day after publication of the notice for this proposed rule change is August 25, 2018. The Commission is extending this 45-day time period.

The Commission finds that it is appropriate to designate a longer period within which to take action on the proposed rule change so that it has sufficient time to consider the proposed rule change. Accordingly, the Commission, pursuant to Section 19(b)(2) of the Act,<sup>5</sup> designates October 9, 2018, as the date by which the Commission shall either approve or disapprove or institute proceedings to determine whether to disapprove the proposed rule change (File Number SR-CboeBZX-2018-047).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>6</sup>

**Eduardo A. Aleman,**  
Assistant Secretary.

[FR Doc. 2018-18783 Filed 8-29-18; 8:45 am]

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## DEPARTMENT OF STATE

[Public Notice 10508]

### 60-Day Notice of Proposed Information Collection: Special Immigrant Visa Supervisor Locator

**ACTION:** Notice of request for public comment.

**SUMMARY:** The Department of State is seeking Office of Management and Budget (OMB) approval for the information collection described below. In accordance with the Paperwork Reduction Act of 1995, we are requesting comments on this collection from all interested individuals and organizations. The purpose of this notice is to allow 60 days for public comment preceding submission of the collection to OMB.

**DATES:** The Department will accept comments from the public up to October 29, 2018.

**ADDRESSES:** You may submit comments by any of the following methods:

- **Web:** Persons with access to the internet may comment on this notice by

<sup>5</sup> *Id.*

<sup>6</sup> 17 CFR 200.30-3(a)(31).

going to [www.Regulations.gov](http://www.Regulations.gov). You can search for the document by entering "Docket Number: DOS-2018-0033" in the Search field. Then click the "Comment Now" button and complete the comment form.

- **Email:** [PRA\\_BurdenComments@state.gov](mailto:PRA_BurdenComments@state.gov).

You must include the DS form number (if applicable), information collection title, and the OMB control number in any correspondence.

#### SUPPLEMENTARY INFORMATION:

- **Title of Information Collection:** Special Immigrant Visa Supervisor Locator.
- **OMB Control Number:** 1405-0144.
- **Type of Request:** Revision of a Currently Approved Collection.
- **Originating Office:** CA/VO/L/R.
- **Form Number:** DS-158.
- **Respondents:** Special Immigrant Visa Applicants.
- **Estimated Number of Respondents:** 150.
- **Estimated Number of Responses:** 150.
- **Average Time per Response:** 1 hour.
- **Total Estimated Burden Time:** 150 hours.
- **Frequency:** Once per application.
- **Obligation to Respond:** Required to Obtain or Retain a Benefit.

We are soliciting public comments to permit the Department to:

- Evaluate whether the proposed information collection is necessary for the proper functions of the Department.
- Evaluate the accuracy of our estimate of the time and cost burden for this proposed collection, including the validity of the methodology and assumptions used.
- Enhance the quality, utility, and clarity of the information to be collected.

• Minimize the reporting burden on those who are to respond, including the use of automated collection techniques or other forms of information technology.

Please note that comments submitted in response to this Notice are public record. Before including any detailed personal information, you should be aware that your comments as submitted, including your personal information, will be available for public review.

#### Abstract of Proposed Collection

Department of State uses Form DS-158 (Special Immigrant Visa Supervisor Locator) in order to assist applicants for special immigrant visa (SIV) applicants under section 602(b) of the Afghan Allies Protection Act of 2009 (Pub. L. 111-8), in attempting to locate an applicant's prior Department of Defense (DoD) supervisor. The information

<sup>61</sup> 17 CFR 240.17Ad-22(e)(23)(i) and (ii).

<sup>62</sup> 12 U.S.C. 5465(e)(1)(I).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 83596 (July 5, 2018), 83 FR 32162.

<sup>4</sup> 15 U.S.C. 78s(b)(2).