

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58345; File No. SR-DTC-2007-16)

August 12, 2008

Self-Regulatory Organizations; The Depository Trust Company; Order Granting Approval of a Proposed Rule Change Relating to the Admission of Foreign Entities as Direct Depository Participants

I. Introduction

On November 16, 2007, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) and on February 5, 2008, amended proposed rule change SR-DTC-2007-13 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on March 7, 2008.² No comment letters were received. For the reasons discussed below, the Commission is granting approval of the proposed rule change as modified by Amendment No. 1.

II. Description

The proposed rule change amends DTC’s policy statement regarding the admission of participants to permit entities that are organized in a foreign country and are not subject to U.S. federal or state regulation (“foreign entities”) to become eligible to become direct DTC participants (“Foreign Entity Policy Statement”).³

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 57392 (February 27, 2008), 73 FR 12485.

³ The National Securities Clearing Corporation (“NSCC”) filed and the Commission has approved a similar proposed rule change that would permit NSCC to adopt a similar policy statement with respect to the admission of foreign entities as members. Securities Exchange Act Release No. 58344 (August 12, 2008) (File No. SR-NSCC-2007-15).

In 1990, DTC adopted a Policy Statement on the Admission of Participants ("1990 Policy Statement") to make clear that in determining whether to grant access to its services, DTC regards as a critical factor that an applicant is subject to comprehensive U.S. federal or state regulation relating to, among other things, capital adequacy, financial reporting and recordkeeping, operating performance, and business conduct.⁴ Generally under the 1990 Policy Statement, unless an applicant is subject to U.S. federal or state regulatory agency oversight, the applicant would not be eligible to become a DTC participant.⁵ Since 1990, DTC has admitted a small number of foreign entities where their obligations to DTC have been guaranteed by creditworthy DTC participants.

The purpose of the proposed Foreign Entity Policy Statement is to establish admissions criteria that will permit well-qualified foreign entities to become participants of DTC and to obtain direct access to DTC's services while assuring that the unique risks associated with the admission of foreign entities are adequately addressed.⁶

The admission of foreign entities as participants raises a number of unique risks and issues, including that (1) the entity is not subject to U.S. federal or state regulation, (2) that the operation of the laws of the entity's home country and time zone differences⁷

⁴ Securities Exchange Act Release No. 28754 (January 8, 1991), 56 FR 1548 (January 15, 1991) (File No. SR-DTC-90-01).

⁵ DTC recognized, however, that any person designated by the Commission pursuant to Section 17A(b)(3)(B)(vi) of the Act, even if not subject to such regulatory oversight, would be eligible for admission. The 1990 Policy Statement was approved by the Commission on January 8, 1991.

⁶ DTC's proposed "Policy Statement on the Admission of Non-U.S. Entities as Direct Depository Participants" is attached as Exhibit 5 to its filing, which can be found at http://www.dtcc.com/downloads/legal/rule_filings/2007/dtc/2007-16.pdf.

⁷ Time zone differences may complicate communications between a foreign participant and its U.S. Settling Bank with respect to the timely payment of the participant's net debit to DTC including intraday demands for payment. These

may impede the successful exercise of DTC's rights and remedies particularly in the event of the entity's failure to settle, and (3) financial information about the foreign entity made available to DTC for monitoring purposes may be less adequate than the financial information about U.S.-based entities.

The Foreign Entity Policy Statement requires that in addition to executing the standard DTC Participation Agreement the foreign entity enter into a series of undertakings and agreements that are designed to address jurisdictional concerns and to assure that DTC is provided with audited financial information that is acceptable to DTC.⁸ The proposed policy statement would also require that the foreign entity (1) be subject to regulation in its home country and (2) be in good standing with its home country regulator.

The Foreign Entity Policy Statement was previously approved by the Commission on a temporary basis in 1997.⁹ As currently proposed, the Foreign Entity Policy Statement would retain all the requirements of the previous version with the exception of the "special financial conditions" requirements, as explained below. It

differences may also delay DTC's receipt of information available in the foreign participant's home country to others including its other creditors about the foreign participant's financial condition on the basis of which DTC would have taken steps to protect the interests of DTC and its participants.

⁸ In the Foreign Entity Policy Statement, DTC has reserved the right to waive certain of these criteria where such criteria are inappropriate to a particular applicant or class of applicants (e.g., a foreign government or international or national central securities depositories).

⁹ Securities Exchange Act Release Nos. 38600 (May 9, 1997), 62 FR 27086 (May 16, 1997) (File No. SR-DTC-96-13); 40064 (June 3, 1998), 63 FR 31818 (June 10, 1998) (File No. SR-DTC-98-11); 41466 (May 28, 1999), 64 FR 30077 (June 4, 1999) (File No. SR-DTC-99-12); 42865 (May 30, 2000), 65 FR 36188 (June 7, 2000) (File No. SR-DTC-00-07); 44470 (June 22, 2001), 66 FR 34972 (July 2, 2001) (File No. SR-DTC-2001-10). Approval of the Foreign Entity Policy Statement as previously filed and temporarily approved by the Commission extended through May 31, 2002.

would also include new requirements with respect to non-U.S. GAAP financial statements and anti-money laundering (“AML”) risk.

The Foreign Entity Policy Statement previously included “special financial conditions” requirements applicable to participants that were foreign entities. The special financial conditions requirements mandated that a foreign entity have and maintain minimum net capital of 1000% of the minimum net capital for the admission of a U.S. entity. A foreign entity was also required to have additional “special collateral” in its account equal to fifty percent of its net debit cap. Any net debit of the foreign entity had to be supported by the value of other, non-special collateral including securities received by the participant valued in accordance with DTC's customary haircuts. Except for U.S. Treasury securities, which received a haircut of 2 percent, securities posted as special collateral received a haircut of 50% of their market value. The foreign entity did not receive credit for special collateral in DTC's collateral monitor. DTC now believes that its net debit cap, collateral monitor, and other risk management controls and procedures applicable to all participants together with the other requirements of the Foreign Entity Policy Statement would adequately limit DTC's exposure in the event of a failure to settle and insolvency of a foreign participant without the need for the special financial conditions requirement.¹⁰

The Foreign Entity Policy Statement also previously required foreign entities to provide to DTC for financial monitoring purposes audited financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) or other generally accepted accounting principles that were satisfactory to DTC. As proposed, the

¹⁰ Additionally, in the Foreign Entity Policy Statement, DTC has reserved the right to require a foreign entity to deposit additional amounts to DTC’s participants fund and the right to require a letter of credit as the form of participant fund collateral where DTC in its sole discretion believes the entity presents legal risk.

Foreign Entity Policy Statement will provide for the submission of audited financial statements other than U.S. GAAP, but to address the risk presented by accepting financial statements prepared in non-U.S. GAAP, DTC would increase the existing minimum financial requirements for any foreign entity submitting its financial statements in non-U.S. GAAP by a premium. The premiums would be as follows:

- (i) 1 ½ times the existing requirement for a foreign entity submitting financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”), the Companies Act of 1985 (“UK GAAP”), or Canadian GAAP;
- (ii) 5 times the existing requirement for a foreign entity submitting financial statements prepared in accordance with a European Union (“EU”) country GAAP other than UK GAAP; and
- (iii) 7 times the existing requirement for a foreign entity submitting financial statements prepared in accordance with any other type of GAAP.

Finally, DTC is proposing to add a new requirement to the Foreign Entity Policy Statement that a foreign entity must provide sufficient information to DTC so that DTC can evaluate AML risk.

III. Discussion

Section 17A(b)(3)(F) of the Act requires 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.¹¹ When the Commission previously approved DTC’s Foreign Entity Policy Statement it found that the policy statement was designed to address the jurisdiction differences in regulatory structure and

¹¹ 15 U.S.C. 78q-1(b)(3)(F).

in business operations of non-U.S. entities with respect to risk control and management. Additionally, the Commission found that the policy statement was designed to bind non-U.S. entities to DTC's rules and procedures in a manner similar to domestic participants and was designed to lessen or eliminate the negative effects that jurisdictional issues could have on DTC's exercise of its rights against non-U.S. entities. The proposed rule change adopts a Foreign Entity Policy Statement that is substantially similar to the one previously approved by the Commission. DTC has eliminated the special financial conditions that were included in the earlier policy statement and has added a new requirement to increase the minimum financial requirements if the foreign participant submits audited financial statements prepared using non-U.S. GAAP. The multiples used to calculate the premiums DTC will charge for non-U.S. GAAP are identical to those the Commission previously approved for the Government Securities Division and MBS Division of the Fixed Income Clearing Corporation.¹² Although DTC will collect less collateral than was required under the earlier policy statement, we are satisfied with DTC's explanation that its other financial controls, such as in its discretion requiring a letter of credit, are sufficiently designed to limit risk of loss to DTC or its participants as a result of a foreign participant's insolvency. In addition, recent changes in bankruptcy law have raised questions about whether DTC could enforce its rights to a participant's collateral in non-U.S. jurisdictions. The changes with respect to the participants' minimum financial requirements should help to ensure that all foreign participants have sufficient financial resources to be participants in and meet their settlement obligations to DTC. Accordingly, based on this and the earlier findings, we find that the Foreign Entity

¹² Securities Exchange Act Release No. 51385 (March 16, 2005), 70 FR 14736 (March 23, 2005) (File No. SR-FICC-2004-14).

Policy Statement is designed assure the safeguarding of securities and funds which are in which are in the custody or control of DTC or for which it is responsible.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.¹³

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-2007-16), as modified by Amendment No. 1, be and hereby is approved.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Florence E. Harmon
Acting Secretary

¹³ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

¹⁴ 17 CFR 200.30-3(a)(12).