SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-35649; File No. SR-DTC-94-19]

Self-Regulatory Organizations; The Depository Trust Company; Order Approving a Proposed Rule Change Regarding Implementation of New Guidelines Regarding Principal and Income Payments in a Same-Day Funds Environment

April 26, 1995.

On December 5, 1994, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-DTC-94-19) under Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").1 As filed, the proposal consisted of changes to the depositoryeligibility requirements for securities issues to require that principal and income distributions be made in sameday funds and provided for the use of a "Blanket Letter of Representations" in lieu of individual letters of representations for each securities issue.2 Notice of the proposal was published in the Federal Register on February 14, 1995.3 On April 3, 1995, DTC amended the proposed rule change by requesting that the Commission withdraw from consideration the portion of the proposed rule change that related to implementing the use of a Blanket Letter of Representations for making securities depository-eligible.4 The Commission received one comment letter opposing a part of DTC's proposal.5 For the reasons discussed

below, the Commission is approving the proposed rule change.

I. Description

A. Background

In 1988, the Group of Thirty 6 determined that international agreement on a set of practices and standards for clearance and settlement systems was desirable. Accordingly, a Working Committee appointed by the Group of Thirty issued a report in March 1989 containing nine recommendations to reduce risk, improve efficiency, and reduce costs in the world's clearance and settlement systems.7 One recommendation called for making payments associated with the settlement of securities transactions consistent across instruments and markets by adopting a same-day funds payment convention. The U.S. Working Committee of the Group of Thirty 8 concluded that payment for settlements among financial intermediaries and between financial intermediaries and their institutional customers should be made using same-day funds. In particular, the U.S. Working Committee concluded that payments for dividends, interest, redemptions, and reorganizations, commonly referred to as "principal and income payments," also should be made using same-day funds.

Thereafter, the U.S. Working Committee encouraged DTC and the **National Securities Clearing Corporation** ("NSCC") to focus on developing a same-day funds settlement system for U.S. trades in equity securities and corporate and municipal debt. Accordingly, in June 1992, DTC and NSCC published a memorandum entitled "A Same-Day Funds Settlement System Proposal for Industry Evaluation." In response to the memorandum, issues were raised regarding the appropriate handling of principal and income payments in a same-day funds settlement environment. Accordingly, a task force comprised of issuers, trustees, paying

agents, depositories, depository participants and their customers, and the respective representative organizations for these various groups was formed ("Same-Day Funds Task Force" or "Task Force") to explore ways that principal and income payments could be made to a depository for pass through to participants in same-day funds on payment date.9

The Task Force determined that converting to a same-day funds settlement system for principle and income payments would have a significant impact on industry participants, including a change in the timing of payments to depositories by paying agents. Paying agents will have to make payments to depositories earlier in the day so that depositories can settle with their participants before the Fedwire closes.

The Task Force recommended that several principles be adopted in order to convert to a same-day funds settlement system for principal and income payments. As discussed below, DTC proposes to incorporate the relevant provisions in its operational arrangements memorandum.

B. Proposed Rule Change

DTC's operational arrangements that are necessary for securities issues to be eligible for DTC services are designed to maximize the number of issues that can be made depository-eligible while ensuring orderly processing and timely payments to participants. DTC's experience demonstrates that when issuers, underwriters, and their counsel are aware of DTC's requirements those requirements can be met almost without exception. ¹⁰ The purpose of the rule change is to incorporate in DTC's operational arrangements memorandum

¹ 15 U.S.C. 78s(b)(1) (1988).

² Same-day funds, which are also known as "Fed funds," are immediately available for redelivery on the day of receipt.

 $^{^3}$ Securities Exchange Act Release No. 35342 (February 8, 1995), 60 FR 8434.

⁴Letter from Piku Thakkar, Assistant Counsel, DTC, to Peter Geraghty, Senior Counsel, Division of Market Regulation, Commission (April 3, 1995).

⁵ Letter from Terrence Hassett, President, North East Securities Transfer Association, Inc ("NESTA"), to Jonathan Katz, Secretary Commission (March 16, 1995). NESTA opposes the part of DTC's proposal that would deny depository eligibility to issues brought to market by agents who fail to make principal and income payments in same-day funds. In response, DTC stated that agents will not be penalized for isolated incidents of a failure to pay DTC in same-day funds on payment date and that the sanction of denying depository eligibility to an issue would be a last resort mechanism used in very limited circumstances. Furthermore, DTC indicated that it will make efforts to accommodate the needs of issuers and agents and will work closely with them in converting to a same-day funds payment standard for principal and income payments. Telephone conversation between Piku Thakkar, Assistant Counsel, DTC and Katherine Horan, Attorney, Commission (April 11,

⁶ The Group of Thirty, established in 1978, is an international, nonprofit organization charged with broadening the understanding of international economic and financial issues, exploring the international repercussions of decisions taken in public and private sectors, and examining the choices available to policymakers.

⁷ Group of Thirty, Clearance and Settlement Systems in the World's Securities Markets, New York and London, March 1989.

⁸ The U.S. Working Committee of the Group of Thirty is an organization made up of representatives from broker-dealers, banks, and financial intermediaries charged with analyzing the existing clearance and settlement systems in the U.S. in light of the Group of Thirty's nine recommendations.

⁹In the current next-day funds settlement ("'NDFS") system, paying agents make payments in same-day funds to depositories for corporate income payments (*e.g.*, interest and dividends) and reorganization actions (*e.g.*, tenders and exchanges) for the majority of issues. Although corporate and municipal redemption payments and municipal income payments may be paid in next-day funds, generally paying agents make these payments in same-day funds on payment date to ensure their timely arrival at the depositories. DTC invests these funds overnight and rebates to the paying agents interest on the deposits as compensation for holding the funds overnight.

¹⁰ During 1993, a total of 392,000 new issues were made eligible for DTC's services. This was 99.94% of all new issues submitted to DTC's Underwriting Department for eligibility determinations. These figures include equity, corporate debt, municipal debt, and U.S. Government and Agency securities. In the unusual circumstance where the processing characteristics of a new issue that is being structured would not meet DTC's operational arrangements, if contacted early enough in the planning process DTC staff often is able to assist in suggesting restructuring alternatives that would permit the issue to be made depository eligible.