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SECURITIES AND EXCHANGE COMMISSION

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Self-Regulatory Organizations; The Depository Trust Company; Order Approving a Proposed Rule Change to Allow for the Deposit of Electronic Certificates of Deposit and Technical Changes

January 11, 2021.

I. Introduction

On November 20, 2020, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² proposed rule change SR-DTC-2020-017. The proposed rule change was published for comment in the Federal Register on December 4, 2020.³ The Commission did not receive any comment letters on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description of the Proposed Rule Change

The proposed rule change⁴ will amend the OA and Underwriting Service Guide to implement a new application and secured electronic vault (“E-vault”) for requests for

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 90534 (November 30, 2020), 85 Fed. Reg. 78371 (December 4, 2020) (SR-DTC-2020-017) (“Notice”).

⁴ Capitalized terms not defined herein are defined in the Rules, By-Laws and Organization Certificate of DTC (the “Rules”), available at www.dtcc.com/~media/Files/Downloads/legal/rules/dtc_rules.pdf, the DTC Operational Arrangements (Necessary for Securities to Become and Remain Eligible for DTC Services) (“OA”), available at <http://www.dtcc.com/~media/Files/Downloads/legal/issue-eligibility/eligibility/operational-arrangements.pdf>, and the DTC Underwriting Service Guide (“Underwriting Service Guide”), available at <http://www.dtcc.com/~media/Files/Downloads/legal/service-guides/Underwriting-Service-Guide.pdf>.

eligibility, execution, delivery, and storage of certificates of deposit (“CDs”) that are issued by state and federal chartered banks. Issuers and underwriters that choose not to use this new electronic CD program may continue to use the existing process, including making Deposits using physical certificates. Through the proposal, DTC will also make technical changes in its procedures to spelling, punctuation and spacing of text that are unrelated to the E-CD program.

A. Background

DTC is the central securities depository (“CSD”) for substantially all corporate and municipal debt and equity securities available for trading in the United States. As a covered clearing agency that provides CSD services,⁵ DTC provides a central location in which securities may be immobilized, and interests in those securities are reflected in accounts maintained for DTC’s Participants, which are financial institutions such as brokers or banks.

As part of its CSD services, DTC (i) makes eligible for deposit, processes, and holds physical CDs issued by various U.S. banks and deposited by Participants, and (ii) credits interests in those CDs to Participants’ Securities Accounts.⁶ DTC states that the

⁵ A covered clearing agency is defined as a registered clearing agency that provides the services of a central counterparty (“CCP”) or CSD. See 17 CFR 240.17Ad-22(a)(5). CSD services means services of a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Exchange Act. See 17 CFR 240.17Ad-22(a)(3). Specifically, the definition of a clearing agency includes, in part, “any person, such as a securities depository that (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates.” 15 U.S.C. 78c(a)(23)(A).

⁶ See OA, supra note 4, at 9-10.

use of physical CDs presents operational concerns to Participants and to DTC.⁷ To address these operational concerns, DTC has developed a system that will eliminate the need for physical certificates for certain issue types of CDs by allowing them to be issued and held in electronic form, as described below.

Upon implementation, the proposed rule change will address operational concerns of Participants relating to the amount of time and manual effort currently required for the issuance and redemption of physical CDs by allowing for a fully electronic process for the execution and delivery of the affected CDs. As such, DTC states that the proposed rule change would also reduce the need for DTC to (i) perform manual processing relating to CD deposits and (ii) reserve space in its secure, physical vault, which is currently used for CDs, by allowing for the storage of CDs in electronic form in a secure E-vault.⁸

The proposed electronic process will also address concerns relating to potential disruptions in the physical transport of physical CDs to DTC currently made using courier and overnight delivery services. Such disruptions may be caused by weather-related issues, such as Superstorm Sandy in 2012, and other previously unforeseen circumstances, such as the onset of the COVID-19 pandemic in spring 2020, both of which impacted physical securities processing. DTC states that although it has maintained securities eligibility and processing operations during such circumstances, including by utilizing a letter of securities possession⁹ (“LOP”) process that enables DTC to accept virtual delivery of securities represented in physical form even if the circumstances prevent actual physical delivery at that time, such disruptions could delay

⁷ See Notice, supra note 3, 85 Fed. Reg. at 78372.

⁸ Id.

⁹ See Underwriting Service Guide, supra note 4 at 17.

the deposit of CDs and impact the timely closing of issuances and otherwise affect liquidity in the marketplace for CDs.¹⁰

B. Current DTC Eligibility Process for CDs

Currently, DTC processes CDs as book entry-only (“BEO”) securities¹¹ registered to DTC’s nominee, Cede & Co. BEO securities are DTC-eligible securities for which (i) physical certificates are not available to investors, and (ii) DTC, through its nominee, Cede & Co., would hold the entire balance of the offering, either at DTC (in physical form) or through a FAST Agent in DTC’s Fast Automated Securities Transfer (“FAST”) program.

Once DTC has determined to make a security eligible for deposit at DTC, a Participant may deposit the security at DTC for crediting to its Securities Account. For a CD issuance, the issuing bank and Depositing Participant must coordinate the execution and delivery of the physical certificate to DTC in order for the Participant to timely receive credit by the anticipated closing date.¹² Once DTC receives an acceptable deposit of an eligible CD from a Participant, DTC credits a Security Entitlement¹³ in the CD to

¹⁰ See Notice, supra note 3, 85 Fed. Reg. at 78372.

¹¹ Underwriting Service Guide, supra note 4 at 4.

¹² See DTC Deposits Service Guide (“Deposits Guide”), available at <http://www.dtcc.com/~media/Files/Downloads/legal/service-guides/Deposits.pdf>, at 8. The closing date is the date on which DTC’s Underwriting Department will distribute an issue to the underwriter’s Participant account at DTC for book-entry delivery and settlement upon notification by both the underwriter and the issuer that an issue has closed (i.e., the distribution date). See Underwriting Guide, supra note 4, at 6. On the closing date, when an issuer or its agent and the underwriter confirm with DTC that the issue has closed and verifies pertinent data, DTC releases the position from an internal DTC account and credits the underwriter’s Participant account, provided that DTC has received the certificates. See id. at 9.

¹³ Pursuant to Rule 1, the term “Security Entitlement” has the meaning given to the term “security entitlement” in Section 8-102 of the New York Uniform Commercial Code (“NYUCC”). See Rule 1, supra note 4; see also NYUCC 8-

the Participant's Securities Account,¹⁴ and DTC holds the original paper certificate in its secure vault for the duration of the term of the CD.

C. Proposed DTC Eligibility Process for CDs

As noted above, DTC is proposing to launch a new program to support deposit of electronic CDs that are issued by banks ("E-CDs"). The program will allow E-CDs to be electronically generated, signed, delivered to DTC and held in electronic form in a secure E-vault.

Upon implementation of the proposed rule change, CDs of state and federally chartered banks containing certain standard terms that conform to one of four proposed templates ("System E-CD Templates") will be eligible for the new program. The templates cover four basic types of CDs, specifically (i) Fixed Rate Non-Callable, (ii) Fixed Rate Callable, (iii) Step Rate Non-Callable and (iv) Step Rate Callable.¹⁵

After implementation of the proposed rule change, in order to facilitate needs of issuers and underwriters, DTC has the discretion to (i) edit the System E-CD Templates, and/or (ii) add additional templates for use in the E-CD program as System E-CD Templates that would be published via Important Notice. Any edits to the System E-CD Templates would not affect E-CDs that were previously issued into DTC.

DTC states that more complex CDs that do not conform to the System E-CD Templates would be excluded from the proposed new process, because they typically

102. The interest of a Participant or Pledgee in a Security credited to its Account is a Security Entitlement. See Rule 1, supra note 4.

¹⁴ See Deposits Guide, supra note 12, at 8.

¹⁵ A Fixed Rate CD pays a fixed interest rate over the entire term of the CD. A Step Rate CD allows for increases in the interest rate at specific, intervals that are pre-defined by the issuer. A Callable CD contains a call feature that gives the issuing bank the ability to redeem the CD prior to its stated maturity, usually within a given time frame and at a preset call price as set forth in the "call provision" in the master certificate. A certificate without such a provision cannot be called by the issuer prior to maturity date (Non-Callable).

contain terms that are not amenable to the creation of fixed templates in the format proposed herein.¹⁶

Pursuant to the proposed rule change, Participants will be able to request eligibility for E-CDs that conform to the System E-CD Templates through a new system referred to as Underwriting Central (“UWC”).¹⁷

In order to request eligibility of a CD to be issued in electronic form, the Underwriter will provide all required information relating to the CD through UWC, including, but not limited to, offering documentation and the terms to be populated in the electronic certificate. DTC would then populate the relevant data (e.g., interest rate(s) and maturity date) into the templates based upon the data entered by the underwriter into the UWC application. It will be the responsibility of the Underwriter to disseminate the electronic master certificate to the issuer for electronic signature via UWC. The issuer will be required to electronically sign and deliver the master certificate to DTC prior to closing.¹⁸

For CDs that do not conform to the System E-CD Templates, eligibility requests will continue to be entered by the Underwriter through UW SOURCE, with a physical certificate delivered to DTC prior to closing.

Pursuant to the proposed rule change, the OA will require each E-CD issuer to submit a new BLOR (“E-CD BLOR”) to DTC through UWC prior to its first issuance of E-CDs. In order to minimize the additional provisions in the Electronic Master

¹⁶ See Notice, supra note 3, 85 Fed. Reg. at 78373.

¹⁷ UW SOURCE, DTC’s existing system for processing eligibility requests, will continue to remain available for other types of issuances, including the issuances of CDs in physical form.

¹⁸ Whether issued in electronic or physical form, securities must be delivered to DTC by no later than noon Eastern Time on the business day prior to the Closing Date as currently specified in Exhibit B of the OA.

Certificate (as defined below), the E-CD BLOR will contain supplemental terms related to the E-CD program (in addition to the representations that are currently included in a BLOR). The new E-CD BLOR will provide that all E-CDs issued in connection therewith and under one of the base CUSIP numbers set forth on the face of the E-CD BLOR would be part of the same transaction in which the E-CD BLOR was executed.¹⁹

E-CDs will be issued on a new form of master electronic certificate (“Electronic Master Certificate”) that has been created specifically for the E-CD program. A separate electronic Master Certificate would be issued by the issuer for each broker that participates in an E-CD offering. DTC will only make eligible E-CDs that have been initiated by the related broker/dealer through UWC and then created, signed and submitted to DTC through an electronic signature system designed by DTC for this purpose. UWC will allow Participants to initiate a new E-CD issuance by creating a draft Electronic Master Certificate using the applicable System E-CD Template that would be sent to an issuer for verification and signature. The issuer will verify and affix its electronic signature to the Electronic Master Certificate created by the Participant in a manner that creates an executed Electronic Master Certificate.

Once an issuer verifies and affixes its electronic signature to an Electronic Master Certificate, the Electronic Master Certificate will be automatically stored in an E-vault repository, and the Electronic Master Certificate will immediately be deemed “delivered” to DTC. The E-vault will identify Cede & Co. as the entity to which the Electronic Master Certificate was issued. According to DTC, the E-vault would maintain an audit trail that would track all events that occur with respect to the Electronic Master Certificate, including any authorized changes, such as notations to reflect withdrawals,

¹⁹ Section 3-119 of the NYUCC provides that a negotiable instrument may be “modified or affected by any other written agreement executed as part of the same transaction.”

which would be noted in the audit trail instead of on the body of the Electronic Master Certificate.²⁰ The audit trail will be incorporated as part of the Electronic Master Certificate in accordance with the BLOR.

Pursuant to the proposed rule change, the parties must also select New York law as the governing law for all E-CDs, in order to better allow DTC to structure a single E-CD program that it believes would be valid for issuers in all U.S. jurisdictions.²¹

D. Technical Changes

DTC will also make technical changes with respect to spelling, punctuation and spacing of text that are unrelated to the E-CD program.

Proposed Changes to the Underwriting Service Guide

- a. A glossary description provided for BLOR in the Underwriting Guide currently describes a BLOR as an agreement between DTC and an issuer of municipal securities. As described above, a BLOR or LOR is required to be submitted with respect to any issue of BEO Securities that also includes corporate securities. Pursuant to the proposed rule change, the text will be clarified so that the description of the term BLOR is not described as limited to applying only to municipal securities. DTC states that the proposed change to this glossary description would provide enhanced clarity for Participants and Issuers with respect to Procedures relating to eligibility documentation required for BEO Securities.²²
- b. Pursuant to the proposed rule change, DTC will eliminate references to the Participant Terminal System (“PTS”) functions ART and PUND as these

²⁰ Notice, supra note 3, 85 Fed. Reg. at 78375.

²¹ Notice, supra note 3, 85 Fed. Reg. at 78376.

²² See Notice, supra note 3, 85 Fed. Reg. at 78378.

functions have become obsolete. ART related to inquiries about transactions of a Participant processed by DTC, and PUND related to inquiries relating to issues and certificates for issues held by a Participant. Such Participant inquiries may now be directed to the Client Center available on dtcc.com.²³ The proposed rule change will update the Underwriting Service Guide to provide clarity for Participants on how to submit inquiries relating to DTC's services.²⁴

- c. Pursuant to the proposed rule change, a reference to the IMPP function in PTS will be deleted. The IMPP function allowed Participants to view Important Notices about underwriting, transfer agents, and money market instruments ("MMI"). DTC states that this function is not being widely used by Participants.²⁵ All DTC Important Notices are accessible on dtcc.com.²⁶

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act²⁷ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization. After carefully considering the proposed rule change, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to DTC. In particular, the

²³ See Securities Exchange Act Release No. 88050 (January 27, 2020), 85 FR 5728 (January 31, 2020) (File No. SR-DTC-2020-002).

²⁴ Id.

²⁵ See Notice, supra note 3, 85 Fed. Reg. at 78378.

²⁶ See <https://www.dtcc.com/legal/important-notices>.

²⁷ 15 U.S.C. 78s(b)(2)(C).

Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act and Rules 17Ad-22(e)(1), (e)(10), and (e)(11) promulgated under the Act,²⁸ for the reasons described below.

A. Consistency with Section 17A(b)(3)(F)

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency, such as DTC, assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible and promote the prompt and accurate clearance and settlement of securities transactions.²⁹

As described above, the proposed rule change will provide for the issuance of Electronic Master Certificates for E-CDs which will be stored in a secure E-Vault. First, the Commission believes that by providing for the storage of E-CDs in a secure electronic vault, the proposal should help safeguard CDs from potential disruptions caused by issues involving the use of a physical vault, such as weather-related or other operational issues. As such, the Commission believes that the proposal is 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. Second, the Commission believes that by eliminating the need for DTC to receive original paper master certificates in advance of CD issuances, the proposal should help reduce closing delays caused by disruptions to physical delivery of certificates. As a result, the Commission believes that the proposal is designed to promote the prompt and accurate clearance and settlement of securities transactions.

In addition, the proposed rule change will make technical changes to provide enhanced clarity for Participants and Issuers with respect to procedures relating to

²⁸ 15 U.S.C. 78q-1(b)(3)(F); 17 CFR 240.17Ad-22(e)(1), (e)(10), and (e)(11).

²⁹ Id.

eligibility processing and the deposit of CDs. By providing Participants and Issuers with enhanced clarity with regard to the procedures relating to, and therefore facilitating, eligibility processing and the deposit of CDs, the Commission believes that the technical changes are designed to promote the prompt and accurate clearance and settlement of securities transactions.

B. Consistency with Rule 17Ad-22(e)(1)

Rule 17Ad-22(e)(1) under the Act requires that DTC establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.³⁰

As described above, DTC will require E-CDs at DTC to be negotiable instruments governed by New York law. As described in the Notice, DTC believes that the proposed rules change would provide for a well-founded, clear, transparent, and enforceable legal basis for the valid issuance of E-CDs into DTC from issuers domiciled in any relevant jurisdiction.³¹ Specifically, DTC conducted analysis of the legal basis for E-CDs under the Uniform Commercial Code, the New York Electronic Signatures and Records Act,³² the Uniform Electronic Transactions Act,³³ and the federal Electronic Signatures in Global and National Commerce Act.³⁴ DTC believes that it has structured the E-CDs to meet the requirements of each law.³⁵ By conducting this analysis of applicable laws, the

³⁰ 17 CFR 240.17Ad-22(e)(1).

³¹ See Notice, supra note 3, 85 Fed. Reg. at 78373–75.

³² N.Y. State Tech. Law §30 (McKinney 2012).

³³ Unif. Electronic Transactions Act (Unif. L. Comm’n 1999).

³⁴ Electronic Signatures in Global and National Commerce 15 U.S.C. §70.

³⁵ See Notice, supra note 3, 85 Fed. Reg. at 78373–75.

Commission believes that DTC designed the proposal to help ensure that E-CDs are well-founded, transparent, and legally enforceable in all relevant jurisdictions, consistent with Rule 17Ad-22(e)(1) under the Act.³⁶

C. Consistency with Rule 17Ad-22(e)(10)

Rule 17Ad-22(e)(10) under the Act requires that DTC establish, implement, maintain and enforce written policies and procedures reasonably designed to establish and maintain operational practices that manage the risks associated with physical deliveries.³⁷

The proposed rule change will provide for the issuance of Electronic Master Certificates for E-CDs. As such, the proposal should help reduce risks of loss related to the physical CDs that would otherwise be physically transported to DTC for deposit and later returned to issuers or their agents for redemption upon maturity of the CD. By reducing the risk of loss of physical master certificates by allowing their replacement with Electronic Master Certificates, the Commission believes the proposal is designed to manage the risks associated with physical deliveries.³⁸

D. Consistency with Rule 17Ad-22(e)(11)

Rule 17Ad-22(e)(11) under the Act requires that DTC establish, implement, maintain and enforce written policies and procedures reasonably designed to (i) maintain securities in an immobilized or dematerialized form for their transfer by book entry; (ii) prevent the unauthorized creation or deletion of securities; and (iii) protect assets against

³⁶ 17 CFR 240.17Ad-22(e)(1).

³⁷ 17 CFR 240.17Ad-22(e)(10).

³⁸ Id.

custody risk through appropriate rules and procedures consistent with relevant laws, rules and regulations in jurisdictions where it operates.³⁹

The proposed rule change will provide for the issuance of Electronic Master Certificates for E-CDs. First, by providing for the deposit of securities in the name of Cede & Co. to be deposited in electronic form and stored in an electronic vault, the proposed rule change will provide for the immobilization and dematerialization of these master certificates for the transfer of CDs by book entry. Thus, the Commission believes the proposal is designed to maintain securities in an immobilized or dematerialized form for their transfer by book entry. Second, by the use of this centralized process for issuance and processing of CDs, the proposed rule change should facilitate the prevention of the unauthorized creation or deletion of securities processed through the E-CD program. Therefore, the Commission believes the proposal is designed to prevent the unauthorized creation or deletion of securities. Third, by the utilization of Electronic Master Certificates in the forms of System E-CD Templates issued under the applicable E-CD BLOR to account for relevant laws, the Commission believes the proposal is designed to protect assets against custody risk through appropriate rules and procedures consistent with relevant laws, rules, and regulations in jurisdictions where it operates.

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, with the requirements of Section 17A of the Act⁴⁰ and the rules and regulations promulgated thereunder.

³⁹ 17 CFR 240.17Ad-22(e)(11).

⁴⁰ 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act⁴¹ that proposed rule change SR-DTC-2020-017, be, and hereby is, APPROVED.⁴²

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴³

J. Matthew DeLesDernier,
Assistant Secretary.

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⁴¹ 15 U.S.C. 78s(b)(2).

⁴² In approving the proposed rule change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴³ 17 CFR 200.30-3(a)(12).