

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54120; File No. SR-DTC-2005-14)

July 10, 2006

Self-Regulatory Organizations; The Depository Trust Company; Order Approving a Proposed Rule Change Relating to Compliance with Regulations Administered by the Office of Foreign Assets Control

On September 9, 2005, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and on October 25, 2005, amended the proposed rule change. On November 30, 2005, DTC again amended the proposed rule change.² Notice of the proposal was published in the Federal Register on November 14, 2005.³ The Commission received one comment letter.⁴ For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

DTC will revise its Deposit Service, Custody Service, and Withdrawals-By-Transfer Service procedures. These changes are based upon guidance from the U.S. Department of the Treasury’s Office of Foreign Assets Control (“OFAC”) to DTC.

1. Deposit Service

¹ 15 U.S.C. 17s(b)(1).

² Republication of notice of proposed rule change is not required because the second amendment to the proposed rule change merely clarified an existing DTC practice and did not alter the rights or responsibilities of DTC’s participants.

³ Securities Exchange Act Release No. 52721 (Nov. 2, 2005), 70 FR 69179.

⁴ Letter from Alan E. Sorcher, Vice President and Associate General Counsel, Securities Industry Association (Dec. 8, 2005), available online at <<http://www.sec.gov/rules/sro/dtc/dtc200514.shtml>>.

In order for a participant to receive immediate credit in its securities account at DTC for a deposit of registered securities, the participant will be required to certify to DTC that it has compared certain parties identified on the deposited certificate (this could include parties such as the issuer, the party in whose name the deposited security is registered, and all assignees) against OFAC's list of Specially Designated Nationals and against OFAC's regulations (collectively referred to as the "OFAC list") and that there were no matches identified by such comparison.

In the case of a deposit of registered securities by a participant located outside the United States, including a deposit by or for the benefit of a participant accepted at a depository facility located outside the United States, a participant will not receive immediate credit in its securities account. DTC will give credit for the deposit only after DTC has screened the parties on the deposit against the OFAC list and has identified no valid matches.

2. Custody Service

With respect to securities and other financial instruments that are deposited pursuant to DTC's Custody Service procedures, DTC will act on the instructions of the depositing participant only after DTC has screened the parties on the deposit against the OFAC list and has identified no valid matches.⁵

3. Withdrawal-By-Transfer Service

For securities on deposit that are sought to be withdrawn pursuant to DTC's Withdrawal-By-Transfer Service, including Withdrawal-By-Transfer requests for securities in the Direct Registration System, DTC will act on the instructions of a withdrawing participant only after DTC has screened the investor in whose name the securities are to be registered against the

⁵ This is the clarification that was the subject of DTC's November 30, 2005, amendment to the proposed rule change. Supra note 2.

OFAC list and has identified no valid match.

For each service, in the event that DTC identifies a match against the OFAC list, DTC will first attempt to resolve false-positive matches. For valid matches, DTC will present the matches to participants that issued the instructions through a new Participant Terminal System function called “OFAP.” The participant will be required to review the registration of each certificate identified as a potential match and to respond to DTC for each such registration by providing information sufficient for DTC to conclude, in its sole discretion, that the registrant is or is not the person or entity listed on the OFAC list. Notwithstanding a participant’s efforts to resolve matches against the OFAC list, if DTC, in its sole discretion, continues to believe that the registrant is the person or entity on the OFAC list, it will refuse to process the requested transaction.

II. Comment Letters

The Commission received one comment letter on the proposed rule change from the Securities Industry Association (“SIA”). The SIA recommended that the Commission: 1) allow for a reasonable implementation period that recognizes the significant changes broker-dealers will likely have to make to their systems and procedures; 2) clarify a participant’s obligations to screen names that appear as prior owners on securities certificates; 3) clarify how introducing and clearing brokers are to implement certain provisions of the rule; and 4) provide guidance on the application of Regulation S-P,⁶ which governs the privacy of consumer financial information, to the process by which participants provide information to DTC. Furthermore, the SIA expressed concern that the rule change might negatively affect investors because of potential delays in processing their transactions due to duplicative OFAC checks.

⁶ 17 CFR 248.

In response to these comments, the Commission first observes that DTC provided its participants with the planned technical specifications of the processing systems for its deposit services in March 2006.⁷ On June 30, 2006, DTC further notified participants that the OFAC certification process would be implemented in two phases: Phase 1, which will be effective August 7, 2006, for deposits affecting a small category of deposits received by DTC and which should require no systems changes by participants; and Phase 2, which will be effective sometime in the fourth quarter of 2006, for the remaining deposits and that will require systems enhancements.⁸ The Commission believes that these implementation time frames should be sufficient for participants to make any needed systems changes and to make any needed operational changes required to implement DTC's revisions.

Second, the "property" and "property interests" subject to OFAC regulations⁹ relate to items where the property owner has a "present, future, or contingent" ownership interest.¹⁰ Since prior security owners whose names might appear on a securities certificate have no present, future, or contingent interest in that property, transacting in such certificates would not appear to be prohibited by OFAC regulations.

Third, in approving the proposed rule change, the Commission does not take a position on whether a DTC participant can evade OFAC liability if it relies on a certification of an

⁷ "Preparation for the Implementation of OFAC Certification of Deposits from Domestic Participants," DTC Important Notice B9382-06 (Mar. 31, 2006), available online at <http://www.dtc.org/impNtc/exe/exe_9382-06.pdf>.

⁸ "Implementation of OFAC Certification of Deposits from Domestic Participants," DTC Important Notice B9899-06 (June 30, 2006), available online at <http://www.dtc.org/impNtc/exe/exe_9899-06.pdf>.

⁹ See, e.g., 31 CFR 215.203.

¹⁰ 31 CFR 515.311(a).

introducing broker-dealer for which it acts that the introducing broker-dealer has screened the parties involved in the transaction against the OFAC list and that there were no matches identified by such screening.¹¹

Fourth, broker-dealers disclosing their customers' nonpublic personal information to comply with OFAC or DTC rules could rely on an exception from Regulation S-P's notice and opt out requirements for disclosures made to comply with federal, state, or local laws, rules and other applicable legal requirements.¹² Recipients of information disclosed under this exception would be subject to Regulation S-P's limitations on the redisclosure and reuse of such information.¹³

With respect to the SIA's concern that some investors might be negatively affected by potential delays in processing duplicative OFAC checks, the Commission notes that any such potential delays in processing should be minimal and well justified in light of the importance of the goals and purposes of doing such checks.

III. Discussion

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to assure the safeguarding of securities and funds that are in its custody or control.¹⁴ DTC, like all U.S. persons and entities, is subject to OFAC regulations.¹⁵ Pursuant to

¹¹ The Commission notes that further inquiries relating to this subject should be directed to OFAC.

¹² See 17 CFR 248.15(a)(7)(i).

¹³ See, e.g., 17 CFR 248.11(a).

¹⁴ 15 U.S.C. 78q-1(b)(3)(F).

¹⁵ The fines for violations can be substantial. Depending on the violation, criminal penalties can include fines ranging from \$50,000 to \$10,000,000 and imprisonment

recommendations made by OFAC, DTC is establishing formal procedures that will define and allocate responsibility for screening the names of persons and entities involved in furtherance of its obligation to refuse to transact directly or indirectly with restricted persons and entities. In so doing, DTC mitigates its regulatory risk of conducting business with such restricted individuals and entities, which could substantially imperil its or its participants assets, and therefore should help DTC assure the safeguarding of securities and funds that are in its custody or control or for which it is responsible.

The OFAC-related procedures of, among others, DTC and broker-dealers, are the subject of ongoing OFAC and Commission reviews to determine the effectiveness of these procedures in identifying and blocking transactions with restricted persons and entities. Accordingly, DTC has acknowledged that subject to the finding of these reviews it may need to revise its procedures in the future and has represented that it will continue to work with the Commission and OFAC to improve the effectiveness of its OFAC-related procedures.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act¹⁶ and the rules and regulations thereunder.

ranging from 10 to 30 years for willful violations. Civil penalties range from \$11,000 to \$1,000,000 for each violation.

¹⁶ 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-2005-14) be, and hereby is, approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Nancy M. Morris
Secretary

¹⁷ 17 CFR 200.30-3(a)(12).