

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53435; File No. SR-DTC-2006-03)

March 7, 2006

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing of Proposed Rule Change to Amend the Criteria Used to Place Participants on Surveillance Status

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> notice is hereby given that on February 3, 2006, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which items have been prepared by DTC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

DTC is seeking to amend the criteria it uses to place participants on surveillance status.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, DTC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. DTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>2</sup>

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

<sup>2</sup> The Commission has modified the text of the summaries prepared by DTC.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Overview

DTC has developed certain criteria for placing participants on surveillance. Specifically, all broker-dealers from which DTC requires the submission of FOCUS or FOGS reports and banks from which DTC requires the submission of CALL reports<sup>3</sup> are assigned a rating that is generated by entering financial data of the participant into a risk evaluation matrix ("Matrix") that was developed by credit risk staff.<sup>4</sup> Those participants with a "weak" rating (i.e., deemed to pose a relatively higher degree of risk to DTC) are placed on an internal "watch list" and are monitored more closely. All participants that do not fall into the categories of banks and broker-dealers mentioned above are not currently included in the Matrix process but are monitored by DTC's credit risk staff using financial criteria deemed relevant by DTC.<sup>5</sup>

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<sup>3</sup> A small number of DTC member banks which submit CALL reports are not assigned a rating. Because these banks do not make loans and do not take deposits as part of their business activities, their CALL reports do not contain information on asset quality and/or liquidity. Asset quality and liquidity are among the financial figures used in the Matrix. Since these figures would be zero in the Matrix for these banks, their Matrix results would not adequately portray their financial status. DTC has therefore concluded that these banks do not lend themselves to appropriate analysis using the Matrix.

<sup>4</sup> The Matrix is used by DTC and its affiliated clearing agencies, the Fixed Income Clearing Corporation ("FICC") and the National Securities Clearing Corporation ("NSCC"). In using the Matrix, credit risk staff uses the financial data of each applicable DTC participant and the financial data of each applicable member of FICC and NSCC. In this way, each applicable DTC participant, FICC member, and NSCC member are rated against each other.

<sup>5</sup> DTC will continually evaluate the matrix methodology and its effectiveness and make such changes as it deems prudent and practicable within such time frames

### Procedures

Credit risk staff approaches its analysis of participants in the following manner. First, the required information of designated broker-dealers and banks are entered into the Matrix and a rating for each participant is generated. Low-rated participants are placed on the watch list. At this point, credit risk staff may downgrade a particular participant's rating based on various qualitative factors. For example, one qualitative factor might be that the participant in question received a qualified audit opinion on its annual audit. In order for DTC to protect itself and its other participants, it is important that credit risk staff maintain the discretion to downgrade a participant's Matrix rating and thus subject the participant to closer monitoring. All rated participants, including those on the watch list, are monitored monthly or quarterly, depending upon the participant's financial filing frequency, against basic minimum financial requirements and other parameters.

All broker-dealer participants included on the watch list are monitored more closely than those not on the watch list. This means that they are also monitored for various parameter breaks which may include but are not limited to such things as a defined decline in excess net capital over a one month or three month period, a defined period loss, a defined aggregate indebtedness/net capital ratio, a defined net capital/aggregate debit items ratio, or a defined net capital/regulatory net capital ratio. All bank participants included on the watch list are also monitored more closely for watch list parameter breaks which may include but are not limited to

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as it determines to be appropriate. DTC will update the Commission staff periodically on its evaluations of the Matrix.

such things as a defined quarter loss, a defined decline in equity, a defined tier one leverage ratio, a defined tier one risk-based capital ratio, and a defined total risk-based capital ratio.

Credit risk staff also monitors those participants not included in the Matrix process using similar criteria.<sup>6</sup> These criteria include but are not limited to such things as failure to meet minimum financial requirements, experiencing a significant decrease in equity, or a significant loss. This class of participants may be placed on the watch list based on credit risk staff's analysis of this information. DTC reserves the right to place a participant on the Watch List for failure to comply with operational standards and requirements.<sup>7</sup>

DTC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act<sup>8</sup> and the rules and regulations thereunder applicable to DTC because it will facilitate the safeguarding of securities and funds which are in its custody or control or for which it is responsible and in general will protect investors and the public interest by improving DTC's member surveillance process.

(B) Self-Regulatory Organization's Statement on Burden on Competition

DTC does not believe that the proposed rule change will have any impact or impose any burden on competition.

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<sup>6</sup> Participants that are not included in the Matrix are: the banks discussed in footnote 3, United States ("U.S.") branches and agencies of non-U.S. banks, non-U.S. central securities depositories, and U.S. government sponsored enterprises.

<sup>7</sup> Participants are required to meet the standards of financial condition, operational capability, and character set forth in DTC Rule 2 (Participants and Pledges).

<sup>8</sup> 15 U.S.C. 78q-1.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, participants or Others

Written comments have not been solicited with respect to the proposed rule change, and none have been received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-DTC-2006-03 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-DTC-2006-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of DTC and on DTC's Web site at <https://login.dtcc.com/dtcorg/>. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-DTC-2006-03 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

Nancy M. Morris  
Secretary

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<sup>9</sup> 17 CFR 200.30-3(a)(12).

