

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>19</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-66186; File No. SR-DTC-2011-09]

### Self-Regulatory Organizations; The Depository Trust Company; Order Approving Proposed Rule Change To Modify a Practice in Order To Mitigate Systemic Risk, Specifically Liquidity Related, Associated With DTC End of Day Net Funds Settlement

January 19, 2012.

#### I. Introduction

On November 21, 2011, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change SR-DTC-2011-09 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder. The proposed rule change was published for comment in the **Federal Register** on December 8, 2011.<sup>3</sup> The Commission received no comment letters regarding the proposal. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

#### II. Description

Pursuant to the rule change, DTC will temporarily reduce each Participant's maximum net debit cap for night cycle processing of valued transactions over weekends and holidays and to restore such debit cap at the start of day cycle processing for the next settlement date (*i.e.*, the first business day following the weekend or holiday). Under the proposed change, DTC would temporarily reduce each Participant's maximum net debit cap for night cycle processing<sup>4</sup> of valued transactions over

weekends and holidays and would restore such debit cap at the start of day cycle processing for the next settlement date (*i.e.*, the first business day following the weekend or holiday). In doing so, DTC believes it would reduce the systemic risk associated with a liquidity shortfall and would enhance the safety and soundness of the U.S. settlement system.

#### *Background on DTC Settlement and the Net Debit Cap Control*

DTC's Settlement System is structured so that Participants may make intraday book-entry deliveries versus payment of securities held in their DTC accounts. These transfers generate debits to the settlement account of each receiving Participant and credits to the settlement account of each delivering Participant. As debits and credits of multiple transactions net over the course of the business day, a Participant will have either a net debit balance or net credit balance from time to time and at settlement will be in either a net debit or net credit balance position. Participants having a net debit balance for settlement owe payments of the amount of the net debit to DTC. In order that DTC has the resources to achieve end-of-day settlement among non-defaulting Participants, DTC maintains liquidity resources sufficient to complete settlement, notwithstanding the failure of its largest Participant to pay, by covering the net debit balance of a defaulting Participant. One of the key risk management controls in this process is the net debit cap, which limits the net debit balance of a Participant, intraday and at settlement, to DTC's available liquidity resources. (The net debit balance must also be fully collateralized by sufficient collateral measured by the collateral monitor risk control.) DTC assigns a net debit cap to each Participant based on the Participant's activity and currently limits the maximum net debit cap for a Participant to \$1.8 billion and for a family of related Participants to \$3 billion aggregate.<sup>5</sup> This settlement structure is designed to support the efficient recycling of intraday liquidity to facilitate the settlement of

approximately 3:30 p.m. For Monday settlement, the night cycle begins on the preceding Friday evening at 9 p.m. and ends at 11:30 p.m. Friday night; the day cycle does not begin until 3 a.m. on Monday.

<sup>5</sup> These net debit caps are supported by \$3.2 billion of liquidity resources at DTC in the form of a \$1.3 billion all-cash Participants Fund and a \$1.9 billion committed line of credit available for settlement in the event that a Participant fails to pay its net debit balance at settlement.

transactions while limiting systemic risk due to Participant failure.

With Friday night cycle processing over weekends and holidays, however, Participants may accrue net debit balances for end-of-day settlement on the next business day, which is two to three calendar days away. DTC has recognized that during such extended processing, external credit events may occur, including, in particular, the possibility of a weekend insolvency.

#### *Change in Night Cycle Processing*

To address the liquidity risk<sup>6</sup> over the extended periods of weekends and holidays, DTC is proposing to reduce the maximum net debit cap temporarily over the extended period for any Participant or any family of related Participants to \$1.5 billion at the opening of night cycle processing on any DTC business day for which the succeeding calendar day is not a business day. DTC would then restore the net debit cap for any affected Participant or family of related Participants to its full net debit cap at the open of day cycle processing for the next business day in the ordinary course of business.<sup>7</sup>

#### *Risk Reduction and Anticipated Minimal Settlement System and Participant Impact*

The purpose of this proposed change in processing practice is to minimize systemic risk to U.S. markets and to DTC Participants as well as to minimize direct liquidity risk to DTC by the management of net debit balances over extended processing periods such as weekends and holidays.

The highest net debit caps at DTC are established primarily to support the settlement of Money Market Instrument ("MMI") transactions. MMI transactions are high value, same day settling transactions that are processed principally in the afternoon on any settlement day. Because these transactions are processed during the

<sup>6</sup> "Liquidity risk" refers to the financial risk associated with access to liquidity to cover the failure of a Participant to fund its net settlement obligation to DTC.

<sup>7</sup> Today, DTC may reduce a Participant's net debit cap (*see, e.g.*, DTC Rule 1, definition of Net Debit Cap which permits DTC to set the Net Debit Cap of a Participant at "any other amount determined by [DTC], in its sole discretion."). Accordingly, after a temporary weekend or holiday reduction as proposed herein, DTC may elect not to restore the net debit cap of any affected Participant. By way of example only, and in line with the purpose of this proposed change in practice, DTC would not expect to restore the net debit cap of a Participant that had become insolvent in the intervening non-business days or as to which DTC is concerned with its credit status. (DTC would take the same approach to holidays, that is, whenever two business days are not successive.)

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 34-65871 (December 2, 2011), 76 FR 76790 (December 8, 2011). In its filing with the Commission, DTC included statements concerning the purpose of and basis for the proposed rule change. The text of these statements is incorporated into the discussion of the proposed rule change in Section II below.

<sup>4</sup> DTC processes settlement in two cycles each business day: (i) A night cycle that begins at approximately 9 p.m. and finishes at approximately 11:30 p.m. and (ii) a day cycle that begins at approximately 3 a.m. and completes at

day cycle only, they should not be affected by the proposed modification to processing in the night-cycle for weekends and holidays.

In order to determine the potential effects of lowering the net debit caps for certain night cycle processing as proposed in this rule filing, DTC conducted a simulation study in which the maximum net debit cap for a Participant and for a Participant family was set at \$1.5 billion. The study found that net debit cap related blockage increased by only 1.13% on average, which represents a gross value of approximately \$913 million out of approximately \$70 billion processed in each night cycle for settlement on the next business day. For Participants that might encounter transaction blockage, this blockage could be further minimized by the Participant by instructing deliveries versus payment that would generate credits to offset debits. Under the proposed revised practice, at the time net debit caps are restored for same-day settlement, any transactions that are pending due to the lower net debit cap would be reprocessed and would be completed at the start of the day cycle, assuming no other changes.<sup>8</sup> DTC recognizes that this change in practice may affect transaction management for certain Participants and has taken the initiative to discuss the proposal with all of those Participants and has received no objections. Certain Participants indicated that they would consider changes that could lessen the impact by implementing their own night cycle process improvements.

Accordingly, DTC believes that the proposed rule change would mitigate systemic risk due to the potential shortfall in liquidity associated with the net settlement failure of a Participant with only minimal impact on Participants and processing.

### III. Discussion

Section 19(b)(2)(B) of the Act 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 the rules and regulations thereunder applicable to such organization.<sup>9</sup> In particular, Section 17A(b)(3)(A)<sup>10</sup> of the

Act requires, among other things, that the clearing agency be so organized and have the capacity to safeguard the securities and funds which are in the custody or control of such clearing agency or for which it is responsible.

Because the proposed change would allow DTC to enhance the risk management controls by temporarily reducing each Participant's and family of Participant's maximum net debit cap for night cycle processing of valued transactions over weekends and holidays and to restore such debit cap at the start of day cycle processing for the next settlement date, the Commission believes that the proposed rule change is consistent with DTC's safeguarding obligations under the Act.

### 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 Act and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2)<sup>11</sup> of the Act, that the proposed rule change (File No. SR-DTC-2011-09) be, and hereby is, approved.<sup>12</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-66190; File No. SR-BATS-2012-001]

### Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Extend Pilot Program Related to Trading Pauses Due to Extraordinary Market Volatility

January 19, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 6, 2012, BATS Exchange, Inc. (the "Exchange" or "BATS") filed with the

Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange is filing with the Commission a proposal to extend a pilot program previously approved by the Commission related to Rule 11.18, entitled "Trading Halts Due to Extraordinary Market Volatility."

The text of the proposed rule change is available at the Exchange's Web site at <http://www.batstrading.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the Exchange 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. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

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

##### 1. Purpose

The purpose of this filing is to extend the effectiveness of the Exchange's rule related to individual stock circuit breakers, which is contained in Rule 11.18(d) and Interpretation and Policy .05 to Rule 11.18. The rule, explained in further detail below, is currently operating as a pilot program set to expire on January 31, 2012. The Exchange proposes to extend the pilot program to July 31, 2012.

On June 10, 2010, the Commission approved on a pilot basis changes to BATS Rule 11.18 to provide for uniform market-wide trading pause standards for individual securities in the S&P 500® Index that experience rapid price movement.<sup>3</sup> Later, the Exchange and

<sup>8</sup> The Participants with increased blockage in the simulation often have large net debits in the night cycle because they do not send in Night Deliver Orders ("NDOs") or they exempt or withhold from night cycle processing many or all of their Institutional Deliveries that would otherwise create credits.

<sup>9</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>10</sup> 15 U.S.C. 78q-1(b)(3)(A).

<sup>11</sup> 15 U.S.C. 78s(b)(2).

<sup>12</sup> 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).

<sup>13</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 62252 (June 10, 2010), 75 FR 34186 (June 16, 2010) (SR-BATS-2010-014).