



DIVISION OF  
MARKET REGULATION

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

August 21, 2000

Mr. Richard B. Nesson  
Executive Vice President &  
General Counsel  
The Depository Trust Company  
55 Water Street  
New York, NY 10041

Re: Net Capital Treatment of Class A Preferred Stock Issued by the  
Depository Trust Company

Dear Mr. Nesson:

This responds to the letter of Mr. Leopold S. Rassnick dated February 2, 2000, on behalf of the Depository Trust Company ("DTC") and its broker-dealer participants, in which DTC requests that the Division of Market Regulation ("Division") not recommend enforcement action to the Securities and Exchange Commission ("Commission") if broker-dealer participants treat their investments in DTC Series "A" Preferred Stock as allowable assets when calculating net capital pursuant to Rule 15c3-1<sup>1</sup> (the "net capital rule" or "Rule 15c3-1") under the Securities Exchange Act of 1934, as amended.

Based on Mr. Rassnick's letter and discussions with the staff of the Division, I understand the following facts to be pertinent to DTC's request. DTC is a limited purpose trust company under New York Banking Law, which operates as a securities depository and clearinghouse for the settlement of securities trading activity. As such, it is registered with the Commission as a clearing agency, and also is regulated by the Board of Governors of the Federal Reserve System.

DTC makes its custodial and processing services available to banks, broker-dealers, clearing agencies, securities exchanges, and other financial institutions, which are known as "participants" under DTC's rules. In order to obtain these services, a prospective participant must apply to, and be approved by, DTC. During the approval

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<sup>1</sup> 17 CFR 240.15c3-1.

process, the applicant must demonstrate that it has the financial resources to meet all obligations to DTC, and that it has the personnel and operational facilities to fulfill its anticipated commitments to DTC and other participants. After being approved, a participant must deposit cash into a clearing fund maintained by DTC. DTC uses the clearing fund as a risk management device to protect against losses incident to its custodial and trade processing operations. The amount of each participant's clearing fund deposit is calculated monthly using a formula that takes into account the participant's activity in the depository. Under DTC's current rules and clearing fund formula, the clearing fund is maintained at a level of \$400 million.

DTC intends to issue a new variable rate non-cumulative nonvoting Series "A" Preferred Stock ("Preferred Stock") with a par value of \$100 per share that will function in coordination with the participants' mandatory cash deposits into the clearing fund. Specifically, DTC is amending its rules and clearing fund formula such that the aggregate cash deposits in the clearing fund of all participants will be reduced by \$75 million, and replaced with \$75 million worth of the Preferred Stock. The participants will collectively purchase all of the \$75 million worth of Preferred Stock in amounts equal to twenty-five percent (25%) of each participant's clearing fund deposit requirement. In this way, one quarter of a participant's required clearing fund deposit will be made up of an investment in the Preferred Stock.<sup>2</sup>

You have represented that, under DTC's new rules, the Preferred Stock will be treated similarly to the cash portion of the clearing fund deposit. For example, when an entity ceases to be a participant, the remaining participants will be required to purchase pro rata its Preferred Stock position. The proceeds from these purchases will be credited to the withdrawing participant's cash deposit, which will be returned in accordance with DTC's rules governing the return of clearing deposits. In addition, DTC may pay dividends on the Preferred Stock on a quarterly basis in an amount that will approximate the interest that DTC is paying on the cash portion of the participants' clearing fund deposits. Specifically, the dividends will be paid on the 20<sup>th</sup> business day of the first month of each quarter, and they will be paid without the need of a corporate declaration by DTC. Any such dividend payments will be credited to the participants' settlement accounts.

Generally, under paragraph (c)(2)(iv) of the net capital rule, broker-dealers are required to deduct all assets not readily convertible into cash when calculating their net capital. However, subparagraph (c)(2)(iv)(E) provides that "clearing deposits shall not

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<sup>2</sup> DTC intends to maintain the amount of Preferred Stock issued at \$75 million. However, it may, from time to time, increase the cash portion of the clearing fund in which case the percentage of the total deposit made up of Preferred Stock would decrease.

Mr. Richard B. Nesson

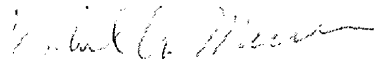
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be so deducted." Pursuant to this provision, broker-dealer participants may treat their required cash deposits in DTC's clearing fund as allowable assets. You ask that this treatment be extended to the par value of the Preferred Stock they are required to purchase pursuant to DTC's clearing fund formula.

Based on the foregoing facts and representations in your letter, the Division will not recommend enforcement action to the Commission if a broker-dealer participant, when computing net capital under Rule 15c3-1, does not deduct from its net worth the par value of the Preferred Stock it is required to purchase under DTC's clearing fund formula. You should be aware that this is a staff position with respect to enforcement only and does not purport to express any legal conclusions. Factual variations could warrant a different response, and any material change in the facts must be brought to the Division's attention. This position may be withdrawn or modified, if staff determines that such action is necessary for the protection of investors, in the public interest, or otherwise in furtherance of the purposes of the securities laws.

Sincerely yours,



Michael A. Machiaroli  
Associate Director

cc: Mr. Raymond J. Hennessy, NYSE  
Ms. Susan DeMando, NASD