

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.

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

Under DTC's current procedures for the processing of MPs, early on the maturity date (generally around 2:00 a.m.) DTC initiates deliveries of the maturing paper from the accounts of participants having positions in the maturing paper to the MMI participant account of the IPA. Each MP is processed as the equivalent of a book-entry delivery-versus-payment transfer. As such, MPs may "recycle" just as any delivery would if the net debit cap or collateralization controls applicable to an IPA's account prevent the delivery from updating. Recycling MPs would update once additional funds (e.g., from intraday settlement progress payment ("SPPs") or from new issuances) are credited to the IPA's account. With the exception of a recent change enabling an IPA to target settlement credits from an SPP to a specific issuer's maturity presentments, MPs update on a random basis.³ There is no provision in DTC's current procedures enabling an IPA to assure that the recycling MPs of a specific issuer update by allocating to that issuer's MPs all or a specified portion of the IPA's net debit cap or by applying to that issuer's MPs settlement credits derived from the new issuance of its paper. By the same token, because of the random nature of MP processing, the IPA is unable to prevent a portion of its net debit cap as well as any "excess" or "residual" credits from being used to update the MPs of an issuer to which the IPA would prefer not to extend credit.⁴

The proposed rule change would provide for the application of new issuance settlement credits to the MPs of the same issuer on a best efforts basis and would give IPAs the option to prioritize the order and manner in which MPs are processed, including the option to designate an issuer as self-funding.⁵ Systemically, DTC would attempt to align activities within the MMI system so that monies from Issuer A's credits are generally applied to Issuer A's MPs, subject to existing collateral monitor and net debit controls.

Under the alignment approach, once an IPA has incurred a net debit up to its applicable net debit cap (or the IPA's collateral is fully used), subsequent MPs presented to the IPA's account will still recycle as they do today. When an IPA processes a new issuance of an MMI into the system and the issuance transaction updates into the receiving participant's account, the resulting credit then becomes available in the IPA's account to fund a recycling MP. At this time, the revised MMI system would inquire against the queue of recycling MPs to determine if there is an MP for the same issuer with the same base CUSIP that could be processed against the available credit. Once the appropriate MP is identified, that MP would be taken off the recycle queue and would be processed into the IPA's account. As further issuances for that issuer occur, additional MPs for the issuer would be processed so that MP processing would remain in rough alignment with the related issuance activity. If no offsetting MP is available on the recycle queue, the credit would be applied to an MP from another issuer, as is the case today, to make use of the available liquidity in the IPA's settlement account.

Although the current procedures have worked well, since the events of September 11, 2001, participants in DTC's MMI program have been working with DTC on changes that would reduce risk without introducing processing inefficiencies. The proposed IPA rule change would address concerns that

specific issuer's MPs, as well as any unallocated net debit cap. "Residual" credits refer to credit balances from new issuances and targeted SPPs that are not large enough to completely offset the same issuer's MPs.

⁵ Under the proposed rule change, IPAs would be able to prioritize between issuers by using new Participant Terminal System ("PTS") functions. IPAs logged into DTC's MMII PTS function would select "Issuer Priority Control" to access the main menu of IPA-issuer options. This new functionality would allow IPAs to select which issuers' MPs would recycle at the bottom of the ATP queue; perform an issuer control inquiry on selected issuers; maintain an audit trail for selected issuers; and inquire about MPs for selected issuers.

IPAs have raised about the random nature of DTC's process for updating maturity presentments by providing IPAs with the means to exercise greater control of their intra-day liquidity requirements and credit risk.

The proposed rule change is consistent with the requirements of Section 17A(b)(3)(A) of the Act⁶ and the rules and regulations thereunder because it will promote the prompt and accurate settlement of securities transactions and will be implemented in a manner that is consistent with DTC's risk management controls.

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

DTC perceives no impact on competition by reason of the proposed rule change.

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

The subject proposals were developed in consultation with participants in the MMI market and are included as recommendations in a Discussion Paper issued jointly by The Bond Market Association and The Depository Trust & Clearing Corporation on March 31, 2003. DTC advised participants of the proposed modifications in Important Notice 5336 (October 10, 2003).⁷

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 **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 DTC 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 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange

⁶ 15 U.S.C. 78q(b)(3)(A).

⁷ DTC advised participants of additional MMI system modifications in Important Notice 5311 on October 10, 2003. Those modifications are not within the scope of this rule filing.

³ Securities Exchange Act Release No. 48145 (July 9, 2003), 68 FR 42442 (July 17, 2003) [File No. SR-DTC-2003-03] (proposed rule change allowing DTC to modify its settlement progress payment procedures to allow DTC participants to direct proceeds from a specific SPP be used to fund a particular transaction).

⁴ "Excess" credits refer to credits resulting from an issuer's new issuances that exceed that issuer's offsetting MPs, SPPs that are not targeted to a