

The Depository Trust Company

# IMPORTANT

## EXECUTIVE IMPORTANT NOTICE

**B#:** 0444-06

**DATE:** October 20, 2006

**TO:** DTC PARTICIPANTS AND PLEDGEE BANKS

**CATEGORY:** Executive Notices

**FROM:** Ellen Fine Levine, CFO & Managing Director

**ATTENTION:** Operations Manager/Managing Partner/Officer

**SUBJECT:** Increase in Participants Investment in DTC  
Series A Preferred Stock

In 1999, DTC's Certificate of Organization was amended to provide for up to \$150 million of Preferred Stock as thereafter authorized by the Board of Directors. In February 2000, the Board determined to increase the capital of DTC by \$75 million by issuing 750,000 shares of variable rate, noncumulative, nonvoting Series A Preferred Stock, at the par value of \$100 per share, and to reduce the mandatory deposits to the DTC Participants Fund by a corresponding amount. DTC Participants are required to purchase and own shares of the Series A Preferred Stock in proportion to their use of DTC services.

DTC's Board of Directors recently approved the conversion of an additional \$50 million of mandatory Participants Fund deposits to 500,000 shares Series A Preferred Stock. As a result, total outstanding Series A Preferred Stock will be increased to 1,250,000 shares, for an aggregate of \$125 million, raising DTC's capital (including common stock, paid in capital and retained earnings) to \$175 million. The actions necessary to implement this conversion are underway, including filing for Securities and Exchange Commission ("SEC" or the "Commission") approval,<sup>1</sup> and completion is planned for December 2006.

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<sup>1</sup> DTC, in a letter to the Commission dated September 20, 2006, sought no-action relief from the SEC on behalf of DTC's broker-dealer Participants respecting the treatment of their investments in Series A Preferred Stock as allowable assets when calculating net capital pursuant to Rule 15c3-1. The SEC granted such relief in a letter dated September 29, 2006. A copy of the letter is attached to this Important Notice.

Pursuant to its Rules, DTC treats the mandatory Series A Preferred Stock investment by Participants substantially the same as the mandatory cash deposits made by Participants to the Participants Fund.

DTC Participants will not be required to take any action with respect to the conversion of the mandatory Participants Fund deposits to Series A Preferred Stock. Allocation of the shares to participants will be on a pro-rata basis, with each Participant receiving approximately .667 shares of additional Series A Preferred Stock for each share they already own. Further information will be distributed to Participants prior to the conversion.

Questions regarding this notice may be directed to Joseph C. Trentacoste, Vice President & Assistant Treasurer at (212) 855-3509, or Gary LaCara, Vice President & Comptroller at (212) 855-3430.



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

DIVISION OF  
MARKET REGULATION

September 29, 2006

Mr. Richard Nesson  
Executive Managing Director,  
Legal, Regulatory and Compliance  
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 is in response to your letter dated September 20, 2006, on behalf of the Depository Trust Company ("DTC") and its broker-dealer participants, that requests the Division of Market Regulation ("Division") not recommend enforcement action to the Securities and Exchange Commission (the "Commission") if DTC broker-dealer participants treat their investments in DTC Series A Preferred Stock as allowable assets when calculating net capital pursuant to Rule 15c3-1 (the "net capital rule" or "Rule 15c3-1") under the Securities Exchange Act of 1934 as amended.

Based upon your letter of September 20, 2006 and the Division's letter to Mr. Richard B. Nesson of DTC dated August 21, 2000, I understand the following facts to be pertinent to DTC's request. DTC is a limited purpose trust company under New York Banking Law and operates as a securities depository and clearinghouse for the settlement of securities trading activity. 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 provides custodial and processing services to banks, broker-dealers, clearing agencies, securities exchanges and other financial institutions, which are known as "participants" under DTC's rules. All participants must be approved by DTC and deposit cash into a Participants Fund maintained by DTC. DTC uses this Participants Fund as a risk management device to protect against losses incident to its custodial and trade processing operations.

In letters to the Commission dated January 19, 1999 and February 2, 2000, DTC proposed to increase its capital by restructuring DTC's Participants Fund. It proposed to reduce the cash deposits in the Participants Fund and issue a corresponding amount of preferred stock. DTC, as a depository institution, is subject to risk-based capital

guidelines issued by the Board of Governors of the Federal Reserve. The issuance of preferred stock assists DTC in meeting those regulatory capital requirements.

On August 21, 2000, the Division stated, in a letter addressed to Richard B. Nesson of DTC, that it would not recommend enforcement action to the Commission if broker-dealer participants treated their investments in DTC Series A Preferred Stock as allowable assets when calculating net capital. In the fourth quarter of 2000, DTC issued 75,000 shares of variable rate non-cumulative nonvoting Series A Preferred Stock ("Preferred Stock") at the par value of \$100 per share and reduced the Participants Fund deposits from \$400 million to \$325 million. Then, the DTC participants collectively purchased the Preferred Stock.

This August 23, 2006, DTC's Board of Directors voted to approve the issuance of 500,000 additional shares of Preferred Stock at the par value of \$100 per share. Accordingly, aggregate cash deposits in the Participants Fund of all participants will be reduced by \$50 million, and replaced with \$50 million worth of the additional Preferred Stock. This will increase the outstanding Preferred Stock to \$125 million and reduce the Participants Fund deposit to \$475 million, maintaining the total amount having the characteristics of clearing fund deposits at \$600 million. DTC Participants will collectively purchase all of the \$50 million worth of additional Preferred Stock in accordance with DTC's rules.

You have represented that, under DTC's rules, the Preferred Stock will be treated similarly to the cash portion of the Participants Fund deposit. For example, when an entity ceases to be a participant, the remaining participants will be required to purchase pro rata the departing participant's Preferred Stock position. The proceeds from the Preferred Stock 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 Fund deposits. 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 be so deducted." Pursuant to this provision, broker-dealer participants may treat their required cash deposits in DTC's Participants Fund as allowable assets. You ask that this treatment be extended to the par value of the additional 50,000 shares of Preferred Stock DTC intends to issue and which the participants will be required to purchase pursuant to DTC's Rules.

Based on the foregoing facts and representations in your letter dated September 20, 2006, 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

Mr. Richard Nesson  
September 29, 2006  
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from its net worth the par value of the Preferred Stock it is required to purchase pursuant to DTC's Rules. 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 the 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,



Thomas K. McGowan  
Assistant Director

cc. Mr. Grace B. Vogel, NYSE  
Ms. Susan DeMando, NASD

TKM/edh