

Keynote Remarks by Donald F. Donahue, Chairman and CEO  
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Leveraging DTCC to Support Industry Transformation

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Good morning, everyone, and welcome. It's very good to see you all, and we're very grateful you could find time to join us today, because—believe me!—we understand very well how busy you are.

Some weeks ago, I attended a conference of our Asian Central Securities Depository counterparts to speak to them about our “lessons learned” from the financial crisis of the last year plus. Somewhat to their surprise, I began my remarks by describing the galleries in the Vatican Museum that hold the museum's collection of hand-drawn maps. If you've been there, you know what amazing art works they are, picturing an ancient or medieval map maker's view of what the world looked like.

If you've been there, you also know that many of these ancient maps bear a legend at the edges of the map where the map maker thought the end of the world was. What the legend says is: “There be dragons.” The map maker was saying: there is the very dangerous place where the world ends, where unknown monsters live, and where very frightening things can happen.

I was reminded of that by an article that appeared last spring in the New York Times Sunday Magazine reviewing how the financial crisis had changed the industry's thinking about risk and risk modeling. Towards the end of the article, the writer talked about a conference he had recently attended on that subject, at which one of the presenters had talked everybody through a series of slides showing how standard “value at risk” distribution curves had been impacted at various points during the crisis.

As the presenter went through his slides, the writer noticed that on the tail of the distribution curve shown on each of the slides were the letters “TBD.” The writer assumed this signaled that the data about the tails remained “To Be Determined.” But those letters appeared in the same place on each and every slide that the speaker was using. So after the speaker finished, the writer asked him why he had put that legend down on all of the tails of the curves he had shown. The speaker then explained that “TBD” stood for “There be Dragons.”

Just as the medieval mapmakers knew that very dangerous things lurked at the edge of the known world, modern day risk analytics understands that very extreme things can sometimes happen in the financial markets. The risks and dangers that we all run into in those extreme circumstances can be very challenging, indeed.

But as I told my Asian audience, we in the industry's infrastructure have to understand that fact. We have to act in the knowledge that it is precisely in those extreme situations that it is most crucial that the infrastructure be able to withstand the challenge...and meet the severest tests of our risk-management skills and capabilities. We have to prepare ourselves so that we are sure we're ready to face those dragons in the rare occurrence when they actually arrive.

## Recovering from the market meltdown

As you all know, the industry had come through just such a situation at this time last year. Last time we met, many of us were still looking in the rear-view mirror, trying to catch our breath from the market meltdown and the collapse of Bear Stearns and Lehman Brothers. I'm sure we all felt like the character in the first Jurassic Park film, who sees the Tyrannosaurus Rex chasing him in the rear-view mirror, and notices the label at the bottom, which says "Objects in the mirror are closer than they appear."

We all came through. DTCC and the industry did a spectacular job withstanding and helping to extinguish that fire last year. With that having been said, we need to "about-face," and think about what all this means going forward. At DTCC, we certainly have been focusing on how we can strengthen our risk-management and crisis-management capabilities, improving our dragon-slaying skills, if you will. I certainly will spend some time this morning talking about what we are doing on that score.

At the same time, the industry also faces major transformational changes ahead, and we need to talk about how you can leverage DTCC and our resources to continue to shape that transformation.

## On the precipice of re-regulation

Most prominently, we are poised on the precipice of a major push for re-regulation of the financial services industry in the U.S. and overseas. We all know that the regulatory and legislative winds that are blowing will be transformative for the industry, driving change through both domestic and global markets. Not surprisingly, there is legitimate concern in the industry over what re-regulation will bring, and the adverse consequences that over-regulation could have on the capital markets.

Over the past year, DTCC has been trying to demonstrate that the infrastructure can play an important role in mitigating potentially more draconian regulatory measures. For instance, we have been able to leverage systemic risk tools, like our Trade Information Warehouse, to create transparency and demystify concerns that may exist about the OTC derivatives markets.

That may serve as a model for other similar measures that can mitigate the impact of new regulations on the industry. We have no illusions that by ourselves we can head off what may be over-reactions from the regulatory and policy-making communities; but we hope that by working collaboratively with you, our customers, we can leverage our resources and credibility to find a middle ground.

So we plan to focus part of our discussion later today on regulatory and legislative issues. Of course, we also want to talk about other initiatives we are working on to bring greater risk reduction, efficiency, and cost savings to our customers, both with new or expanded services here in the States, and with our increasing presence on the global stage. Most importantly, we hope to use today to get your thoughts and guidance on the priorities DTCC needs to focus on, as well as other directions or other projects you think we ought to explore.

A crisis is a terrible thing to waste, as the current Washington adage has it. So let me begin by talking about how we are building on the experience of last fall.

## New look at risk management

Last year's events brought into sharp relief how robust the industry's infrastructure's risk-management capabilities need to be. We are working with our regulators on a broad range of projects to further build up those capabilities, deepening our standby liquidity support for settlement in the depository and the clearing corporations; improving the margining of more illiquid instruments or positions; and improving stress-testing capabilities as examples. But we also have to look at higher-level issues, as well.

The experience of the last two years underscored vividly that structural changes in the way the industry does

business—the growth of the “originate to distribute” model, for example—can drive fundamental changes in the nature and the extent of risks the industry is exposed to, requiring that the industry’s infrastructure think about risk issues more strategically, as well.

Much as the aftermath of September 11, 2001, fundamentally changed how we think about business continuity, the aftermath of September 15, 2008, changed how we need to think about risk, insisting that DTCC move beyond an essentially bilateral focus on how we’re managing the risk of an individual member to encompass risk at the systemic level...ensuring that we can address system-level risks as well, fulfilling our responsibility to support safe and sound operation of the industry’s infrastructure.

That’s a fundamental expansion of focus. To take that challenge on, we have established a separate risk position with a mandate to think about and address systemic risks. DTCC’s new Chief Systemic Risk Officer will be responsible for considering those broader issues.

How do our day-to-day risk-management activities impact the overall stability of the financial system? How could our response in a crisis impact overall stability? What risks do we assume from the potential failure of those we are interconnected with, or rely heavily upon? How do we need to modify existing procedures to deal with risks that may no longer be appropriate for us to accept? What kinds of risks to stability could new services that we are offering create? And how can we act to mitigate them?

As you can tell, it’s a very challenging responsibility, but also one that will contribute substantially to expanding DTCC’s ability to deliver even more effectively on our risk- management mission.

### Challenge for the Board of Directors

This evolution in our thinking about risks also imposes new challenges for our Board—and part of our Board’s response has been to undertake an extensive review of how DTCC governs itself. This review represents a real rethinking of how the Board oversees the organization, with particular attention to how DTCC can more effectively handle its broad risk-management responsibilities. But beyond risk management, this rethinking reflects a more holistic approach to DTCC’s oversight generally, and casts a wider lens on such matters as how we evaluate and approve new initiatives, and how we manage a growing portfolio of businesses that increasingly are independent of each other, however much they may leverage a common infrastructure.

The review has suggested a series of changes that we’re currently assessing. I expect that we’ll be putting many of these changes into action in the coming months, resulting in a significant recasting of DTCC’s governance process by mid-next year. Another feature of these changes will be a heightened emphasis on how well we educate you, our users, so that you have sufficient information to assess your risks in interacting with us, and what issues you need to think about in terms of the residual risk of using the industry infrastructure to clear and settle trades, and to handle other financial activities.

Two months ago, we posted to the DTCC website a significantly expanded review of DTCC’s compliance with global standards for the operation of central counterparties and securities settlement systems. These are the standards that were promulgated by the Committee on Payment and Settlement Systems for the Bank for International Settlements (the international organization for the central banks, as you know) and the International Organization of Securities Commissions.

These self assessments of NSCC, FICC and DTC against the CPSS-IOSCO standards are meant to be a foundation for your own thinking about these risks, and your risks in your interactions with us. I’d certainly encourage you to consult them. You should also watch out for new risk material to broaden the educational resources we provide your staff about how we manage risk at both the micro- and the macro-prudential level, as well as

more information about the overall program to strengthen DTCC's governance that will be appearing later next spring.

So, as I've said, there's much going on in the risk space, building on the lessons we've taken away from the events of the financial crisis. You'll also be hearing more about that later on this morning. But we have a much broader agenda, and the focus on risks permeates how we are proceeding on those broader initiatives, as well. Let's turn to that.

### OTC market success: infrastructure

It's interesting that even with all of the political firestorms of recent months about the over-the-counter derivatives markets, one of the biggest, however unheralded, success stories in recent years is how effectively the industry addressed the operational risk issues associated with credit default swaps.

Much of this success story revolves around the implementation of the Trade Information Warehouse, the global market's first and only comprehensive repository for post-trade processing of CDS contracts. The warehouse now houses north of 2.3 million global contracts, and monitors changes in the contracts as long as they are in force. The warehouse has also proven instrumental in ensuring that the industry can handle credit events on credit default swaps smoothly and efficiently.

I very vividly remember how concerned—and I would say frightened is not an inappropriate word—industry members were several years ago, about the prospect of a credit event on General Motors. There be dragons, indeed. Of course, this past June, the warehouse, in fact, did process the General Motors bankruptcy, and thanks to all the sterling effort the industry put into building the warehouse capabilities over the past two years, the process was a non-event. In total, we have seamlessly managed 42 credit events through the warehouse, and in each case, we have brought stability and certainty to that processing.

That experience has underscored what an industry asset the warehouse is; and on this issue, the right risk management strategy, in our view, is to preserve and to build on that asset. For that reason, we have been very firm in our dialogue with policy makers and regulators in Washington that a single global repository provides the only kind of system-wide central vantage point for both the industry and regulators to assess system-wide risks.

### The safety of one data warehouse

As you know, many of the legislative proposals in the U.S. and overseas call for trading these instruments on exchanges, or clearing them through a central clearing house. However we proceed on these proposals, it is imperative that the data about these markets, data that the industry has very carefully gathered into one warehouse, not be fragmented across regional repositories or in different clearing houses. If that were to happen, data retention standards could begin to fracture, and the industry and its overseers would no longer have a single central vantage point from which to view trading positions, contract values and risk across that entire asset class. In short, the very problem the policy makers are trying to avoid—systemic risk— would be right back with us.

A global marketplace demands a coherent set of regulations that applies on a global basis. There needs to be a global approach that may have a regional component, rather than a series of regional approaches that don't provide a global perspective. In our view, the warehouse is not a solution in search of a problem. It represents a problem that has effectively been solved. That solution needs to be preserved and built upon. It's quite clear that the industry agrees with that, so much so that recently, industry members agreed to adopt the warehouse concept and technology for over-the-counter equity derivatives, which we'll be working to deliver in 2010.

Reaction to that view among policy makers also appears to be very positive. In the U.S., Congress appears to

have pulled back from legislating the elimination of non-standard OTC contracts, based on language assuring trade data will be kept in a central repository. In Brussels, policy makers in the EU are showing signs of willingness to accept a trade repository that is not physically located in Europe.

The debate on these issues will drag into next year, at least into next year, before they are resolved. But we're making progress in having infrastructure viewed as a way to achieve transparency without hampering the function of an over-the-counter market.

### **NYPC: Innovation in risk management**

We strongly believe that strengthening risk management will be a net positive for the industry. In other words, improving how we margin, for example, doesn't necessarily mean just raising the amount of clearing funds that we collect.

An excellent example of this is New York Portfolio Clearing, our proposed joint venture with NYSE Euronext. We think the idea behind it is one of the most imaginative to surface in a long time. It has the potential to remake market structures and longstanding business assumptions. The new company, which we hope to have up and running in the second quarter of next year, will offer something the markets have never had, and have always wished for. We will give traders the opportunity to margin their government securities portfolios across the cash, futures and, ultimately, the OTC markets, in a single pool. As a result, they will be able to take advantage of the natural offsets in the different markets, permitting us to effectively manage the risk, while actually reducing the margin outlays we need.

Trades executed on the NYSE Liffe U.S. futures exchange, for example, could be margined with trades in the cash market that clear through our Fixed Income Clearing Corporation. Many traders, as you well know, don't even consider executing a trade on one market alone. Their practice is to assume that what constitutes a single trade is really a transaction in the cash market, and an offsetting position in the futures market.

By combining the margining for the two transactions into a single pot, dealers will be able to take advantage of the offsets between the cash and futures markets, and reduce their margin accordingly. We think it's one of the best ideas to come along in a long time. It helps us bring a user-governed approach to the futures markets, which have had little experience with this kind of ownership and governance structure.

Based on our analysis, it also lets us improve capital utilization in the markets for our members, to the tune of billions of dollars a day. In addition, it brings a much greater degree of transparency and risk control to the business, because it offers the industry and regulators a way to view portfolio risks across multiple markets simultaneously, which is something they can't do at present.

We're in the process of making the necessary filings with regulatory bodies right now, and we certainly intend to stress these benefits as we seek approval for this highly innovative approach. Most importantly -- let me underscore this -- NYPC is founded on a commitment to provide open access to other derivatives trading platforms and organizations that wish to use our single-pot margining process, provided that they, also, offer open access to their clearing services for other trading platforms. Our expectation is that the at-cost, user-governed service model we provide to lower margin costs will be very warmly received. So far, the response we're getting from the industry has been quite positive.

### **Pressing ahead on mortgage-backed securities CCP**

Meanwhile, we're now in the third month of testing our new central counterparty for mortgage-backed securities trades, another initiative that will definitely reduce risk by guaranteeing the completion of those trades. The tests have been highly successful, and this initiative, three years in the making, is primed and ready to go. We're confident that, in addition to reducing counterparty risk in this critical market, this initiative will also

reduce capital and administrative expenses for our members.

In the wake of last year's financial meltdown, however, the level of regulatory scrutiny over new initiatives has been heightened even further. As a result, we're still waiting for the final "go live" on this project, although we understand approval could come in the very near future.

### Equity trade guarantee

In our equities clearing business, we also have several other initiatives underway. Primary among these is our plan to accelerate the NSCC trade guarantee from midnight of T+1 to near real time. This is, again, a risk issue that I suspect the industry didn't really focus on. As a legal matter, NSCC did not and actually does not guarantee trades until 36 hours or so after their execution, and technically, retains the right to disavow trades that have not yet reached that point.

I've emphasized the technical and legal qualifiers because, as you all recognize, there is no practical way that the clearing corporation could refuse to accept responsibility for those trades. So in reality, regardless of the technical or legal loopholes, the clearing corporation has to step in and guarantee those trades, as we did when Madoff failed last December, even though we hadn't included them in our risk-margining modules, and hadn't factored them into the clearing fund calculations. Accelerating the trade guarantee recognizes the reality of the situation and ensures that these trades are, in fact, included in the risk-margining process. We are anticipating that the SEC will approve the related filing, bringing legalities and realities back in sync in the near future.

### Broadening distribution capabilities

Helping the industry manage its operational risk is something that DTCC has been involved in for decades, and we continue to extend this kind of risk management capability, as well. This year, another innovative idea to reduce operational risk is gaining traction in the paper-intensive world of insurance processing. As we did with our mutual fund business, we're moving to automate the insurance industry and give our customers an easier way to market annuities and other insurance products. The insurance industry could see from the beginning how automation through our network would be a tremendous money-saver for them. But not until this year has the industry succeeded in convincing a number of its own companies and broker/dealer distributors to give the project the heft it needed to take off.

So far this year, total transaction volume is already up 16 percent over 2008, and earlier this month, we went live with our web-based service, which, for the insurance world, is a revolution. At last, they have an automated way to process all the paperwork and signatures required for issuing annuity contracts.

We're seeing a similar scenario play itself out in our Managed Accounts Service, which we rolled out several years ago to give the same operational efficiencies to this segment of the market. To speed up adoption of the service, which many in the industry tell us is transformative, UBS signed on as a sponsor earlier this year, and we have since rolled out a portal that gives investment managers a direct doorway into the service. As a result, we now have some 15 investment managers actively testing, with another 25 lined up in the pipeline.

We will continue to chip away at these kinds of operational risks going forward.

I've only touched on some of the development projects that we have underway, and more will be covered over the course of the day in our panel discussions.

### The global front

As you know, part of our commitment to the industry is to help mitigate risks and increase efficiencies wherever our customers choose to operate. To live up to this commitment, we're trying to create the kind of business initiatives that can transform the global market for our customers, while maintaining the high standards

you've come to expect from DTCC in the past. I'd like to touch on several of those.

Two months ago, our EuroCCP subsidiary completed its first year of clearing operations in the European equities markets. Over this period, the level of clearing fees charged by competing CCPs in Europe has plummeted by over 80 percent in some cases. We know that EuroCCP is the driver of that change, by posing a credible, competitive threat to the incumbents. In this regard, EuroCCP has succeeded beyond the wildest expectations of our customers.

With our mission to deliver the economies of scale already achieved in the U.S. market to Europe, we have every intention of keeping the pressure on. Last month, EuroCCP launched a new pricing structure to encourage users to concentrate their business at EuroCCP, offering U.S.-level pricing equivalent to one third of a U.S. cent, or one fifth of a Euro cent, to clear a side of a trade to high-volume users. There are no hidden fees or increases elsewhere in the tariff, which is not a statement that other competitors in the clearing space in Europe necessarily can make.

However, Europe continues to struggle with high frictional costs in cross-border trading. While the Markets in Financial Instruments Directive opened up the market for multilateral trading facilities to compete with national exchanges, open competition in clearing is still elusive because of strong commercial barriers. So major trading venues in Europe do not offer EuroCCP as a choice available to their trading firms -- even though EuroCCP has the lowest clearing fees in Europe, and is supported by robust and battle-tested risk management know-how. If we can get customers control over this choice -- and ensure that the trading venues make EuroCCP available to them, EuroCCP will then be able to fulfill its mission of delivering the ultimate efficiency and safety to the European markets.

While I'm on this subject, I should also bring you up to date on a disappointment we had relating to European clearing. As you may recall, at this time last year, we anticipated that DTCC would be merging with LCH. Clearnet to create what we expected, and were very confident, would be a very strong transatlantic clearing capability. Of course, as you also know, that merger came apart in the spring, as the LCH Board decided that it wanted to take a different course of action. We think their decision was seriously mistaken, and missed a golden opportunity to dramatically accelerate progress in Europe. Nonetheless, we are moving forward, and through EuroCCP, we will be continuing to construct the transatlantic clearing capability that we believe the markets are demanding.

Beyond equities clearing, we're looking to roll out all of our new services on a fully global basis, where that's relevant, rather than as services focusing on a particular regional market. Along these lines, one significant new global initiative is MarkitSERV, the joint venture we launched in August with Markit Partners, to consolidate our respective infrastructures for OTC derivative trade confirmation. It is one more way we can continue to bring safety, standards, and reliability to the global OTC marketplace. MarkitSERV will continue to have a significant role in expanding confirmations and matching of CDSs and interest rate derivatives while extending its capabilities to other asset classes.

Our Loan/SERV business is also drawing a strong international following, and has been particularly well received in Europe. The Loan/SERV offering is automating and will revolutionize the syndicated loan market. We now have over 1,500 investment funds and 100 leading fund managers and banks linked to the Loan/SERV services, and we're now looking at opportunities for additional services in this market for these customers.

### **DTCC's tenth anniversary**

Today's meeting is actually two weeks shy of DTCC's tenth anniversary. It is difficult to imagine that just in the last decade we had numerous clearing corporations and depositories, all operating separately in the United

States. We now function as a much more cohesive organization, even with the strong growth we've had since the creation of DTCC. As we prepare for our second decade, let me give you a quick snapshot of the company and how much has changed since 1999.

We are a much more global business than ever before. As your businesses have grown more global, we've expanded right along with you, to ensure that we can sustain the stability, resilience and trust our infrastructure can deliver. As we continue to support operations and businesses operating out of London, Shanghai, New York and Tampa, we've taken on far more customers from outside the United States than we had a decade ago.

Some 160 of our customers operate directly from offices outside the U.S. If we count the firms served by our joint venture with Markit, that number would be closer to 600. In addition, our clearing houses have all opened their doors to direct membership by non-U.S. firms. FICC's membership, for example, now includes sovereign wealth funds from Asia and the Middle East, not to mention the World Bank.

We still have a proposal pending with the SEC to extend membership in our government securities business to mutual funds and other buy-side entities. We think it makes good sense for the industry as a whole to bring these businesses inside DTCC, where they will meet our membership and risk management requirements. We now provide clearing services for an ever larger number of trading platforms. In the old days, we supplied clearing for all the recognized U.S. exchanges as well as the small group of new electronic communications networks that was then taking shape.

Today, as you know, because you don't hesitate to use them, trading platforms have sprung up everywhere. We now supply centralized risk management and oversight of trading activity across more than 50 exchanges, ECNs, and alternative trading systems in the United States alone. As we grow our services in Europe, this number, and the industry's ability to leverage our clearing platforms, will expand.

### The technology quotient

To support all these trading platforms, as well as the increasingly sophisticated and demanding needs of our other businesses, we have continued to keep the throttle open on the development and deployment of our technology. Last year, we moved to the cutting edge of mainframe technology when we became one of the first companies in the industry to install the IBM Z10, which is considered the first commercially available "super computer" on the market.

As you may know, we also earned the distinction last year of becoming the only U.S.-headquartered financial services organization to achieve the coveted CMMI level-3 rating across our entire applications development group. We continue to make sure that the industry has access to the processing capacity it needs, most recently ensuring that DTCC can now process up to 850 million sides a day without any impact on our service level agreements with you.

One of the most impressive parts of our track record over the past 10 years is our success in driving fees to their lowest levels ever, even as volumes surged during that period.

Today, DTCC's members pay the lowest equity clearance fees in the world, an average of just 66 thousandths of a penny per hundred shares, or a third of a penny per transaction. In fact, DTCC's fees represent just a tiny sliver of the cost of overall trading.

### DTCC and a Nobel Prize

In closing, let me briefly mention the work of a recent Nobel Prize winner. And no, I am not intending to weigh in on the recent award received by the President. How many of you ever imagined you would be the

subject of Nobel Prize-winning research? Frankly, it never occurred to me. As it turns out, however, we've actually all been under the microscope of Professor Elinor Ostrom of the University of Indiana. She's one of this year's winners of the Nobel Prize for Economics. I believe she's the first woman to win an Economics Nobel.

What's fascinating is that her work focused precisely on the kind of institution the industry established when it created DTCC. What she studied is called "the Commons," which is really another term for what DTCC is—an enterprise commonly owned and commonly governed by all of the parties that use it. Among the discoveries of her research are two remarkable findings.

The first thing she found is that, when people use or run something on a common basis, they create much more practical and equitable rules for operating it than people who try to impose rules or practices from the outside. In the heat of the current legislative and regulatory debate, that's something worth remembering. We are—all of us here—in a better position to suggest how things might be improved because we deal with the day-to-day realities of processing them.

Dr. Ostrom's other remarkable observation is that, at the core of successful collective enterprises, there are three key ingredients: reciprocity, reputation and trust. Those are the exact words she uses to describe why commonly owned and governed enterprises can function so well.

It is, of course, both reassuring and reinvigorating to know that world-class research has validated the concept and operation of the industry's primary infrastructure organization. In the midst of the changes now transforming the financial services industry globally, it's also reassuring to know that some things remain constant. The industry can rely on the value provided by DTCC's infrastructure, which is built on reciprocity, reputation and trust—and a good deal of hard experience, solid technology and a dedicated team of professionals who have been trained at many of your institutions.

Let me end by thanking all of you again for coming today. As we've said, our objective this year is to have a good deal more interaction. So please take us at our word, and participate in the dialogue today. I want to invite you again to offer us your thoughts and insights in the various sessions that are coming up, and I want to assure you that we are here to listen and to learn. We look forward to hearing from you. And we welcome your ideas and suggestions.