



Inventory Management System Expands Recycling Capabilities

By Edward C. Kelleher

DTCC's Inventory Management System (IMS) has begun offering new recycling capabilities that give customers even greater control over the order and timing of their trade submissions for settlement, allowing them to route deliveries for a secondary authorization before processing, and includes initial public offering (IPO) transactions for the first time.

The enhancements offer two new recycle profiles [continued on page 5]

GFI, ICAP, and Tullett Prebon Team with DTCC To Launch Multi-Broker Check Out Service

By Judy Inosanto

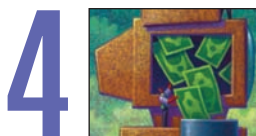
Leading inter-dealer brokers GFI Group (GFI), ICAP, and Tullett Prebon have agreed to launch a common electronic check out service for over-the-counter (OTC) derivatives to be operated by DTCC Deriv/SERV LLC, a wholly owned subsidiary of The Depository Trust & Clearing Corporation.

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Helping Customers Manage Through Disaster: DTCC's Response to Katrina

By Melanie S. Best

Like many businesses, DTCC faced some difficult problems in the immediate aftermath of Hurricane Katrina last August. One involved determining which local municipalities might be delayed in making payments due on their bonds so that DTCC could, in turn, make the corresponding allocations to customers all across the country. The other entailed tracking flooded or badly damaged areas where agents weren't able to transfer securities or forward physical securities in time to settle trades—and then deciding what to do about it.

Principal and Income (P&I) Cash Processing, which collects dividend, interest and redemption payments from issuers' paying agents and allocates the funds to DTCC participants, and Securities Processing were the two DTCC areas most involved in working with customers to manage through Hurricane Katrina and its aftermath.

While DTCC has long experience dealing with localized natural disasters, this event, more than most, required a concerted effort to keep customers informed and quickly restore

business as usual. As part of DTCC's response, product managers kept in close contact with industry groups while monitoring the news media to gather information pertinent to entitlement payments and securities processing.

First Dilemma: Suppress Payments?

P&I Cash Processing operated a "war room" to manage its post-Katrina response, with DTCC staff making rounds of calls to agents and municipalities along the Gulf Coast to ascertain the status of personnel and operations there. In the first days of the storm and its aftermath, the team met every few hours to update the status of issuers and paying agents in the Gulf region.

Although many P&I payments from local issuers were scheduled for Sept. 1 (a peak payable day), the P&I Processing staff knew many could be delayed.

Issuers Regrouped

To address these issues, the team implemented a major policy change at the outset of the disaster: daily automatic allocation of P&I payments to participants was suppressed for issues handled by Louisiana and Mississippi paying agents. Allocations could be released and distributed, but only if DTCC could confirm by 3 p.m. it had received funds to make the necessary payments from the issuer's agent.

"We proceeded conservatively," said Peter Gleeson, vice president, Operations, "under the assumption that, in the short term, some municipalities hit by the storm might be unable to funnel their P&I payments to their agents. For all local issues, we reprogrammed our system to block automatic allocations and instead required payment on each issue to be released manually upon receipt of funds matched to these issues."

Using DTCC's cash processing system, the team easily identified all the local agents impacted by Katrina and the issue payments associated with them. But it was trickier to track down and suppress payment for the bond issues handled by paying agents located outside the region.

"We couldn't globally suppress these agents," noted Robert Olivari, manager, P&I Processing, "so we needed to identify at the CUSIP level all the local issues they were servicing."

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Lessons Learned: Lose the Paper and Bolster Business Continuity

For those in the financial sector promoting dematerialization, Hurricane Katrina vividly demonstrated the merits of taking paper certificates out of circulation and replacing them with electronic versions. In Louisiana, a new rule took effect Aug. 1, 2005 – not soon enough, unfortunately – that allows physical certificates to be dematerialized.

"It's unfortunate dematerialization didn't start there a year sooner," said Joe Trezza, vice president in DTCC's Asset Services Product Management group. "Some of the retail investors who kept stock certificates under their mattresses might have had a chance to convert them to electronic form, and that would have allowed them to avoid the uncertainty – and expense – of losing and replacing certificates."

Jamie Balbo, managing director of DTCC Asset Services, added, "These events should make clear to intermediaries the benefits of more aggressively pitching dematerialization to their legislatures in states where it is not yet allowed, as well as directly to customers in places like Louisiana where it is an option."

Another trend that many hope will gather steam in Katrina's wake is for the SEC to impose business continuity mandates on transfer agents similar to those now required of banks and of DTCC.

"More robust disaster recovery plans and secure back-up sites could have spared many investors in Louisiana and Mississippi the loss of their assets or market losses due to missed opportunities," said Trezza.

For DTCC, the "one-two" punch of Katrina and Rita helped Asset Services hone its hurricane-specific response procedures.

"These types of disasters have highly unpredictable consequences," said Robert Olivari, manager of P&I Processing, "and the increased frequency of hurricanes over the past couple of years underscores the need to make them an integral part of business continuity planning. At DTCC, our business continuity plan worked well, but there is no doubt that next time, whenever and whatever that is, we'll be even more proactive."

Breakpoints Made Easier Through New NASD Online Tool

By Karen Gregory

Through a link to DTCC's Mutual Fund Profile Service (Profile), a new online tool from NASD will allow investors and brokers to identify available breakpoint discounts for substantial investments in Class A mutual fund shares.

NASD's Mutual Fund Breakpoint Search Tool offers users a groundbreaking way to research eligibility for breakpoint discounts. Investors and brokers can retrieve information on breakpoint schedules and linkage rules for mutual funds with front-end sales charges, most commonly A shares.

What prompted establishing the link was a growing recognition that one of Profile's databases – the Security Issue Database – was a logical, centralized place to house this information, a recommendation made by the Joint NASD/Industry Task Force on Breakpoints.

The Joint NASD/Industry Task Force on Breakpoints was convened by NASD at the request of the Securities and Exchange Commission in 2003, after a regulatory sweep determined that many investors were not receiving breakpoint discounts to which they were entitled. That sweep led to an industry-wide refund program and a number of enforcement actions by NASD and the SEC.

"Because of our role in the industry, we don't have the ability to deliver this information outside of our member group. Therefore, we welcomed the opportunity to work with NASD to create a way that they could retrieve the schedules and rules, and provide access to their broader membership and the investing public," explained Ann Bergin, managing director, DTCC Distribution Services. The link

allows NASD to pull from Profile's Security Issue database information that has been populated by fund companies, and repopulate it within its own Web site.

DTCC staff worked with NASD staff to determine what data fields were appropriate for the NASD Web site, as well as resolve connectivity and digital certificate issues. DTCC also developed a new XML schema to facilitate the transfer of information from the database. Mutual Fund Profile Service is an offering of National Securities Clearing Corporation, a DTCC subsidiary.

Users can look up a single fund or fund family, or compare two funds side-by-side; view information on a fund's breakpoint schedule; see whether a fund allows for Rights of Accumulation or Letters of Intent; and also determine whether 529 Plan assets, investments in annuities, unit investment trusts and individual retirement accounts can be used toward Rights of Accumulation (ROA) or Letters of Intent (LOI). For more information, readers can refer to www.nasd.com/fundsearch.

Fee, Expense Data

NASD's new and improved Mutual Fund Expense Analyzer will allow investors to determine quickly and easily the expenses associated with a particular mutual fund or exchange traded fund investment.



The Analyzer delivers fee and expense information for virtually all of the more than 18,000 mutual funds and 160 Exchange Traded Funds (ETFs). It will also estimate and graph a fund's value over time – for any holding period specified by the user, as well as over a 20-year period – providing a running total of expenses the investor would pay during each period.

The Analyzer will compare the expenses of up to three ETFs, mutual funds, or share classes of the same mutual fund simultaneously. Users simply enter a ticker symbol or select a fund, share class or fund family from a drop-down menu, and the tool automatically displays a screen with expense and fee information.

Editor's Note: Readers who would like more information on NASD's Mutual Fund Expense Analyzer can go to:

[@www.nasd.com/fundanalyzer](http://www.nasd.com/fundanalyzer).

DTCC to Automate, Standardize Broker/Dealer Annuity Fund Transfer Requests

By Nicholas Clarke

In an effort to strengthen supervision of broker-initiated fund transfers within variable annuity products, DTCC is developing a new service that will launch next year aimed at helping broker/dealers more closely monitor and manage the activities of their registered agents.

The future new service – called “In-Force Transactions for Fund Transfers” – is a response to regulatory concerns surrounding illegal market timing and late-day trading. These concerns stem from recent regulatory actions to curtail abusive trade activities by brokers within several prominent broker/dealer firms. As part of the regulatory sanctions, firms paid substantial fines and were required to implement new procedures to maintain and monitor all broker-initiated transaction requests involving sub-account transfers within annuity products held with outside insurance carriers.

The insurance industry has made it a priority to better identify and monitor broker-initiated fund transfers. Recently, the Securities Industry Association (SIA) Insurance Panel issued an advocacy paper highlighting the need for quick resolution and calling for a standardized, centralized industry solution through DTCC.

“The current regulatory climate is challenging broker/dealers to exercise tight oversight of fund transfer requests made by their agents,” said Nancy Jansen, co-chair of the SIA Insurance Panel and managing director of Operations at Piper Jaffray. “With so much concern being focused on this issue by regulators, it’s vital that we communicate to insurance

carriers and the broader distribution community our commitment and support to fast-tracking an industry solution.”

As envisioned, the new service, which will be offered through DTCC’s National Securities Clearing Corporation subsidiary, will give broker/dealers an automated, centralized, standardized and secure platform for submitting agent requests for



fund transfers. The service will enable broker/dealers to link their front-end monitoring technologies to DTCC’s centralized processing hub and ultimately provide the level of supervision and control required by regulators.

“The IFT for Fund Transfers service will work in coordination with several existing DTCC services to provide a comprehensive tracking and processing solution,” said Randi Gordon, director of Product Management, DTCC Insurance Services, who is overseeing the initiative. “By vetting annuity contact detail, provided through

the Positions & Valuation service, against their internal product and processing rules, broker/dealers can validate that the trade is in good order prior to submitting the transaction to the carrier.

“Once the request has been validated and approved by the broker/dealer, a real-time request will be routed through the IFT for Fund Transfers service where editing will

take place to ensure compliance with industry-defined standards,” she continued. “DTCC will then forward the request to the carrier for immediate validation and confirmation. The transaction will be pending by the insurance carrier to be processed during nightly batch cycles. Once that happens, distributors will receive transaction details for the completed fund transfer through the Financial Activity Reporting service.”

Traditionally, DTCC services have been built using fixed-length, flat-file formats. However, at the request of the insurance industry, IFT for Fund Transfers is being developed in cooperation with the Association for Cooperative

Operations Research and Development (ACORD) and will incorporate ACORD’s Extensible Markup Language (XML) messaging solutions. XML is playing an increasingly important role in the exchange of a wide variety of data on the Web and elsewhere. Use of XML in the new service marks the first time that DTCC has incorporated this text processing language in any of its insurance services or products, although it has been used previously in its Mutual Funds services. A customized version of XML, FpML, is also [continued on page 8]

Inventory Management System Recycling Capabilities

Continued from cover

that enable customers to process deliveries in a strict, pre-determined order, or allow them to hold back all, or a specific group of deliveries, until the customer is ready to release them. The enhancements, offered through The Depository Trust Company (DTC), a DTCC subsidiary, were approved by the Securities and Exchange Commission and implemented in September.

“With the new recycling capabilities, customers can send all their deliveries to IMS, moving them closer to straight-through processing and increasing business continuity by having all their deliveries residing at DTC throughout the day,” said Julie Krill, director, Product Management, DTCC. “This maximizes a customer’s priority deliveries and associated settlement credits as well.” Prior to the new recycling profiles, customers withheld transactions outside the settlement system until they were ready for processing.

The two new recycling profiles – called “yellow” and “red” – join the first “green” recycling profile that was introduced in early 2005. The green profile enables customers to develop their own submission and recycle profile, but if it cannot complete each transaction in the order specified, it overrides the desired order and moves on to the next transaction.

Yellow Recycle

With the yellow recycle queue, customers can route a delivery so that it recycles in a strict order. IMS will not process the next delivery in the recycle queue unless sufficient shares have been received to process the first delivery. If the customer has sufficient shares to complete the delivery, but the transaction recycles because of insufficient risk management controls, such as a net debit cap problem, the shares will be reserved until the control deficiency is satisfied.

If a customer does have a collateral or net debit cap deficiency, the system automatically uses its “look ahead” feature to pair off pending receives with pending deliveries. When the transaction is complete, IMS will attempt the next delivery in the queue. As new deliveries are entered into the system, they are automatically slotted into the recycle queue based upon the appropriate profile.

“Fortunately, DTC’s IMS system offers a low cost alternative with robust tools and increased functionality that has allowed us to avoid costly internal development.”

Red Recycle

When a transaction is submitted in the red recycle queue, it will be held for processing until the customer releases it individually or via a global release instruction such as by time or by a securities group. “The red recycle queue oversees transactions that require special attention, such as securities with a buy-in,” said Krill.

Customers can direct their transactions to any of the three recycle queues by selecting one of the following profiles:

- Asset Class profile, sending particular assets – equities, corporate bonds, municipal bonds or money market instruments (MMI) – to the selected queue. With this profile, a customer can, for example, have all its MMIs executed in strict order by sending it to the yellow queue.
- Activity profile, allowing users to direct specific types of transactions such as reclaims or CNS transactions to a recycle queue. So, for example, a customer can have an MMI reclaim directed to the green recycle, while all other MMI transactions go to the yellow queue.
- Security profile, sending all transactions for a specific security to one queue. So a customer can have all the commercial paper of XYZ Corporation sent to one recycle queue, regardless of the asset class or activity profiles.

Secondary Approvals

In addition to adding IPO deliveries to the recycling profiles, the IMS enhancements enable customers to route deliveries for a secondary authorization before being processed. Secondary approvals are useful for certain deliveries such as overvalued or undervalued transactions.

More and more DTCC clients are signing on for IMS. “We had been reviewing how to optimize our delivery process and our position controls,” said William Gallagher, vice president, Lehman Brothers, Inc. “Based on our analysis, we believed that we would have had to develop our own system to maximize our deliveries and position. Fortunately, DTC’s IMS system offers a low-cost alternative with robust tools and increased functionality that has allowed us to avoid costly internal development.” @

Industry's "No-More-Paper" Drive Hits Stride in 2005; State Legislation Paves Way for Further Dematerialization

By John Koegel

The financial services industry moved closer – a lot closer – in 2005 to its longstanding goal of “dematerialization” or eliminating paper, including paper certificates, from the securities processing cycle.

Over the past 12 months, for example, the number of certificates in DTCC's vaults declined more than 12%, from 4 million in November 2004 to 3.5 million in November 2005, according to Kirk Matthews, DTCC product manager, Custody and Safekeeping.

The passage of landmark legislation updating state securities laws, the endorsement by major exchanges of electronic listing requirements, and the expansion of several DTCC programs that eliminate paper stock certificates and attachments all combined to make 2005 a year of significant accomplishments in the campaign to achieve greater elimination of paper in securities processing.

Delaware Law Change

Perhaps the most significant event in the campaign to dematerialize paper stock certificates by replacing them with electronic ownership records was Delaware's decision in 2005 to update provisions of its corporate law that require the routine issuance of securities certificates. Under the new provisions, companies incorporated in Delaware no longer have to issue paper certificates for new shares, transfers or corporate actions.

“This was a major milestone in the national drive to eliminate paper stock certificates, because more than half of all publicly traded companies in the United States and almost 60% of the Fortune 500 are incorporated in Delaware,” said Jamie Balbo, DTCC managing director for Asset

Services Product Management. “It will save investors and companies millions of dollars a year.”

Louisiana and Missouri also enacted similar legislation in 2005, leaving Arizona and Puerto Rico as the only jurisdictions that still require companies to issue paper stock certificates.

Many securities today – including corporate and municipal bonds, U.S. government securities, money-market instruments, futures, options and mutual funds – are issued and traded in a paperless, electronic format that allows for automated processing and safekeeping.

Paper stock certificates cost companies, investors, banks and brokers hundreds of millions of dollars each year to print, register, ship, examine, file and keep safe. The Securities Industry Association (SIA) estimates the annual cost of handling paper stock certificates to be \$250 million or more.

Electronic ownership of securities is not only more economical, but also safer than holding physical certificates. Well over a million paper securities are reported lost, stolen or counterfeit each year, according to the Securities Information Center, which helps investors replace missing stock certificates.

Shortly after Delaware's law went into effect, a number of companies began issuing new equity shares only electronically. The list, which has grown to nearly 50 companies, includes some of the biggest names in the business world: Chevron Corporation, Federated Department Stores, Intel Corp., MetLife Inc., Microsoft Corp., Starbucks, United Parcel Service, and US Airways, according to Joe Trezza, DTCC vice president for

Asset Services Product Management.

New Listing Requirement

Had the enactment of these state provisions been the only accomplishments in the campaign to eliminate paper certificates, 2005 would have been a banner year. But as the year was drawing to a close, several equally momentous events were taking place at the American Stock Exchange, New York Stock Exchange and Nasdaq Stock Market, where the governing bodies of these three organizations were discussing the possibility of making electronic stock ownership – through DTCC's Direct Registration System (DRS) – a listing requirement for certain issues.

The number of DRS-eligible issues, which include corporate bonds and many other issues in addition to equities, surpassed the 1,000 milestone in 2005. But adoption as a listing requirement, followed by an expected Securities and Exchange Commission rule filing, would cause the number of DRS-eligible issues to skyrocket to 9,000 or 10,000.

DTCC continued to work with regulators and industry groups, including the SIA and the Securities Transfer Association, to eliminate certificate issuance for withdrawal by transfer (WT) processing.

In years past, when shares were sold, new certificates had to be issued to effect withdrawals by transfer. Today, the aim is to keep those shares that are already held in street name, or DRS, in electronic format. DTCC's cooperative efforts with regulators and industry groups have begun to pay off.

“In recent months, requests for WTs in statement format climbed from 5% of all DRS-eligible WTs, which had been the

norm for more than a year, to 17%," said Trezza.

Another milestone was the introduction in the second half of 2005 of higher indemnity insurance coverage for transactions moving through the DRS Profile Modification process. Under the new program, transfer agents and others may opt for surety coverage of as much as \$25 million per paperless transaction, thus easing processing constraints and reducing risk for all DRS users.

Restricted Securities Solution

While most types of equities are moving away from physical forms of ownership, one growing category remains paper-intensive. Restricted securities, which are used in executive compensation programs, private placements, and corporate mergers and reorganizations have become much more popular over the past few years.

One major reason is the change in accounting rules that require public companies to expense stock options on their balance sheets, thus lowering corporate profits. As a result, more companies are issuing restricted stock in

place of stock options.

According to a recent analysis of proxy statements of 350 of the largest U.S. corporations by *The Wall Street Journal* and Mercer Human Resource Consulting, restricted securities as a percentage of total long-term incentive pay for chief executive officers (CEOs) nearly doubled over the past three years, rising from 12% in 2002 to 23% in 2004. At the same time, the use of stock options in the CEO pay mix plummeted, from 76% in 2003 to 57% in 2004.

To help participants streamline the process of restricted securities, DTCC introduced a new and more complete level of service within its Restricted Securities Family of Services. Called Total Processing Solution, the new service constitutes the top level in DTCC's three-tiered Restricted Securities Family of Services, and it builds on the other two levels to provide a comprehensive service that lifts the "restricted legend" from restricted securities so that they may be traded.

Total Processing Solution is designed for firms with mid-to-high processing

volumes and firms requiring a fully integrated restricted processing solution. It not only bundles together the options found in the Restricted Deposit Service and the Web Guide, but it also automatically supports the tracking of securities in the process of having their restrictions removed. At the same time, it maintains connections to other depository services, including Custody safekeeping. As a result, it offers additional functionality to support an end-to-end process to lift restrictions.

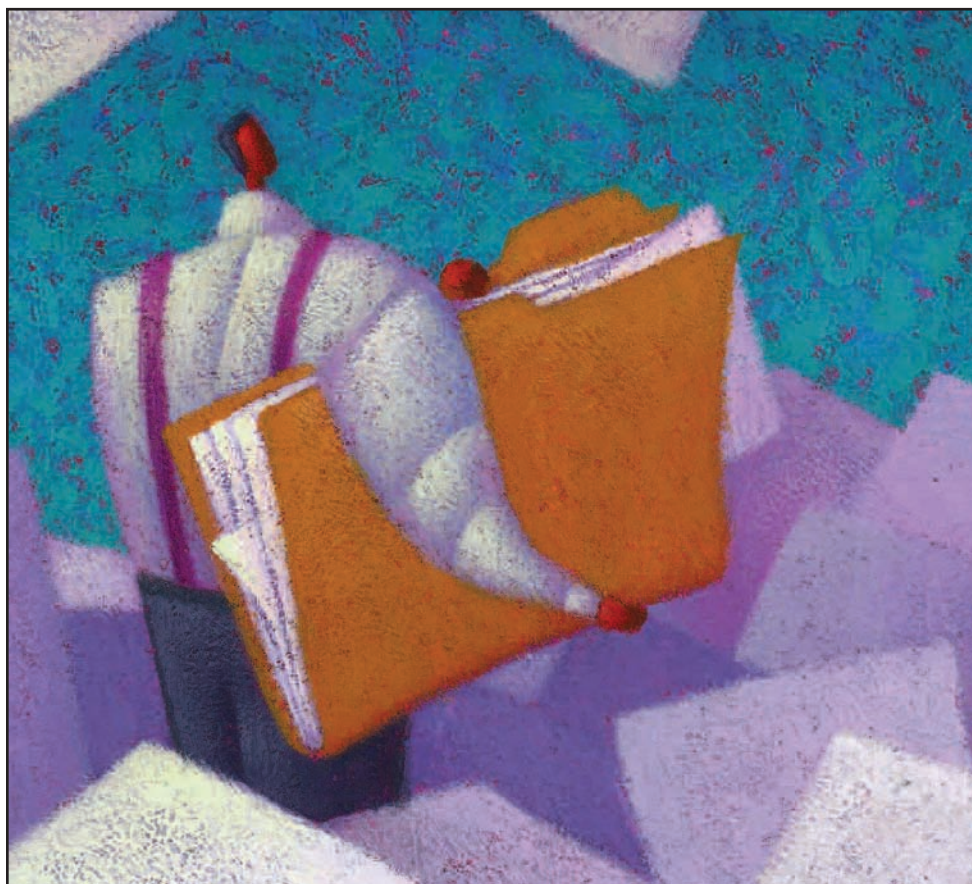
Other Programs to Eliminate Paper

In addition to these efforts to automate and streamline the flow of financial information, several other DTCC programs helped reduce the amount of paper associated with securities ownership:

- **Paperless Legal Program:** Working with industry members, DTCC expanded the Paperless Legal Program in 2005 to include 90% of the issues eligible for deposit at the depository. This program eliminates the cumbersome and costly handling of documentation for non-routine transfers, commonly referred to as legal transfers. Members of the Canadian Securities Transfer Association joined the program early in the fourth quarter. Looking ahead, DTCC plans to market the service to a number of large "issuer own" agents – companies that serve as their own transfer agents.
- **Destruction of Non-transferable Certificates:** DTCC's depository subsidiary expanded its program of destroying non-transferable certificates – securities for which transfer services have not been available for at least six years. After shredding 13,000 certificates in 2004, the depository destroyed more than 75,000 in 2005. Most of these were equity certificates of companies that have become inactive or insolvent.

Participants have an incentive for seeing the certificates destroyed: they now face a surcharge of \$5

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Multi-Broker Check Out Service *Continued from cover*

The service, which can apply to trades executed anywhere in the world, will provide a single point for the integration of dealers' trade capture systems to multiple inter-dealer brokers. It will create a single centralized hub where dealers can review, verify and affirm OTC derivative trade information, regardless of which inter-dealer broker arranged the trade. At the option of the dealer, electronically verified transactions can be automatically submitted to DTCC Deriv/SERV, resulting in legal confirmation within seconds of trade verification.

Expected to go live early in 2006, the service will initially include single name credit default swaps, as well as credit default index and tranching products. Expansion to other OTC derivative products, such as interest rate swaps and swaptions, equity options and other equity derivatives is also planned. DTCC and founding inter-dealer brokers, who together represent a significant portion of OTC derivatives trades, intend to operate this service in a pilot mode for one year, after which they plan to have other inter-dealer brokers participate. The inter-dealer brokers intend to offer the service at no charge to their customers. DTCC will also waive any recovery of its operating costs during the pilot phase.

"The industry needs a truly independent mechanism for managing, transmitting and verifying important trade data, and we are pleased to provide this solution with our peers and DTCC," said Colin Heffron, president and director of GFI. "Traders have asked us to be able to electronically check out details of derivatives transactions across multiple brokers on a single platform, so we are sure this will be well received."

Ron Purpora, co-chief executive, ICAP North America said, "We are pleased to be part of an industry effort which affords our mutual customers the ability to seamlessly submit credit default transactions according to the DTCC standard. By extending post-trade feed capabilities for more complex products, this initiative is part of ICAP's overall objective of improving trading efficiency

in the interdealer markets."

"We are delighted that DTCC has agreed to operate this electronic checkout capability on behalf of us all," said Ed Novak, executive vice president and head of credit derivatives, Tullett Prebon. "It has the infrastructure and resources in place to support this service worldwide, and is already a major player in post-trade processing of credit derivatives transactions. The link between this trade checkout capability and DTCC's legal execution service will further streamline post-trade processing for our mutual customers."

As the derivatives industry continues to evolve with new market participants and new products entering the market at a rapid pace, the development of automated solutions remains an important priority. "DTCC is committed to working with key market participants, such as these leading inter-dealer brokers, to further enrich our platform and to continue delivering innovative products that will help the industry attain its goal for full market automation," said Peter Axilrod, managing director, DTCC New Business Development. @



Automate, Standardize Broker/Dealer *Continued from page 4*

used by DTCC in processing OTC derivatives.

To help guide the development of the new service, DTCC formed an advisory group last July comprising more than 20 individuals from carriers, distributors, and other industry players, including the National Association of Variable Annuities, SIA, and ACORD. The advisory group is working on developing business

requirements for the new service, including recommendations on technology, process definition, and best practices.

From this group, DTCC will also establish firm and carrier commitments for pilot testing early next year. Launch of the service is expected in the second half of 2006.

"With this new service, broker/dealers will be afforded the capability to establish

the controls required to monitor their agents' activities," said Lana Macumber, director of Marketing and Business Development, Insurance Services. "In the larger scheme of things, the insurance industry is taking yet another step towards adopting automated and standardized technology solutions that promote straight-through processing." @

DTCC's Response to Katrina *Continued from page 2*

Sorting By State

This task was accomplished by systemically identifying issues in DTCC's master file with the "state of incorporation" documented as Mississippi or Louisiana and attaching a special code, KATR (Katrina – Hurricane Disaster), to those issues managed by out-of-region agents, which individually suppressed payments. This code was transmitted by DTCC to participants on cash settlement statements, allowing them to segregate these issues themselves. (When Hurricane Rita was approaching the Gulf Coast two weeks later, the company again instituted selective suppression using a new code, RITA.)

Olivari and his team produced a daily report on suppressed issues, P&I payments received and allocations made. DTCC's Settlement and Redemptions groups communicated this information to participants via daily broadcasts on the network and through e-mail alerts.

In one instance, an agent allocated funds to DTC before realizing it had not received the funding from local municipalities. "Once the agent became aware of the shortfall, it asked DTC to return the funds to it, which meant taking back payments we had allocated to participants on its behalf," Pete said. "Then, a few days later, once the agent had received the money from the municipalities, we reallocated the funds."

Handling Operational Risk

"The precautions we took were not about mitigating credit risk – possible defaults are something we'll deal with down the road – but about managing operational risk," said Bill Hodash, managing director, Operations.

The magnitude of Katrina's disruption, combined with the effects of Rita, the hurricane that followed, caused suppressions to continue through the Nov. 1 payment date. From Sept. 1 through Nov. 1, DTCC temporarily suppressed approximately 13,000 issues representing \$1.3 billion in payments. Most of these cleared by Payment Date+1.

While the majority of affected issues and their associated dollar amounts were relatively small – interest payments of \$2,000 to \$10,000 on \$1 million issues were typical – the payment interruptions nevertheless roiled normal operations for many DTCC participants for weeks.

Second Quandary: Deposits and Withdrawals

Members of DTCC's Securities Processing team, having tracked Hurricane Katrina's path that last weekend in August as it proceeded toward New Orleans, also took to the phones when they returned to the office Monday morning.

The Katrina response team first placed calls to some 230

transfer agents in Louisiana, Mississippi and parts of Alabama. Then, as the storm continued moving inland, employees kept in close contact with the U.S. Postal Service and express couriers to map where the movement of physical securities had come to a halt.

It didn't take long for Securities Processing to determine that shipments of physical securities, by First Class mail and private couriers, would be suspended for days, if not weeks.

"By the afternoon of Aug. 29, the situation was becoming clear, and by Tuesday night we knew exactly where mail and courier services were shut down," said John Carvalho, director, Securities Processing. In fact, only 30 transfer agents in the region were reachable by phone on Aug. 29 and 30.

Under these circumstances, it was obvious customers would run the risk of uncompleted trades, either because physical securities couldn't be shipped or agents no longer had functioning computer operations to make electronic transfers.

A Temporary Halt

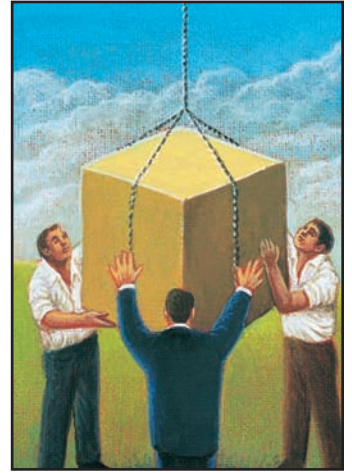
After careful consideration, on Aug. 30, DTCC notified participants and transfer agent industry groups that it would temporarily reject all deposits and withdrawals for pending securities transfers from the local agents it had been unable to contact.

"If we couldn't reach an agent, it meant the agent couldn't get to its certificates and, for the time being, brokers couldn't settle any trades involving these securities," explained John Mancuso, vice president, Securities Processing. "We had to reject these deposits and withdrawals and return them to the brokers, since DTCC could not assume the liability attached to uncompleted trades."

Mancuso noted that transfer agents could have continued to process trades in the aftermath of Katrina if they had functioning back-up sites and participated in DTCC's Direct Registration System.

"If they had the right software, they could do transfers on a PC from an alternate location," he said. "But most agents in this region are on the small side, and only a few had back-up centers."

In any case, transfer agents in the region were back in business within two weeks of the storm, some with new phone numbers and contact information, and deliveries to and from them returned to normal. @



How DTCC Partners with Customers

By Lisa Argento

Giving customers a say in the Global Corporate Action (GCA) Validation Service is what DTCC's GCA Working Groups are all about.

These groups bring customers together to exchange ideas, leverage work experience and pool their knowledge – all with the aim of strengthening the GCA solution. Broker/dealers, banks, investment managers and hedge funds from across the globe participate in these monthly meetings.

One working group focuses on Europe and the Americas, and the other concentrates on the Asia-Pacific region.

“The input and insight we gain from our working groups is invaluable in helping us evolve GCA,” said James Femia, DTCC managing director and head of the Global Corporate Action business. “We’re delivering a global solution to a very diverse set of financial institutions. And it involves some of the most challenging and complex transactions in financial services. Working in a vacuum is not an option.”

The GCA Validation Service provides comprehensive, accurate and timely corporate action announcement information for equities and fixed-income instruments traded in Europe, Asia-Pacific and the Americas. The service is provided by Global Asset Solutions LLC, a DTCC subsidiary.

Experts Across the Globe

“Most of our working group members are hands-on users of GCA,” said Chad Richman, DTCC's GCA Product Management director, who chairs the GCA Working Group for Europe and the Americas. “Our meetings are constructive because the people who participate understand the nuts and bolts of the corporate actions business. They’re bringing a wealth of information and experience to the table.”

Representatives from eight customers

actively participate in these monthly sessions, which are “virtual meetings” that take place via conference calls. Often, more than one representative participates from the same firm.

“For example, we may have a representative from a customer's London office and one from the U.S. – or a dividends expert and a reorg expert,” said Richman.

GCA customers from Hong Kong, Japan and Singapore, as well as the U.K, take part in the monthly GCA Working Group for the Asia-Pacific region. Andrew Barnes, DTCC manager of the GCA's Shanghai service center, leads this group.

“Customers based in Asia are particularly enthusiastic about having a voice in the way GCA handles corporate

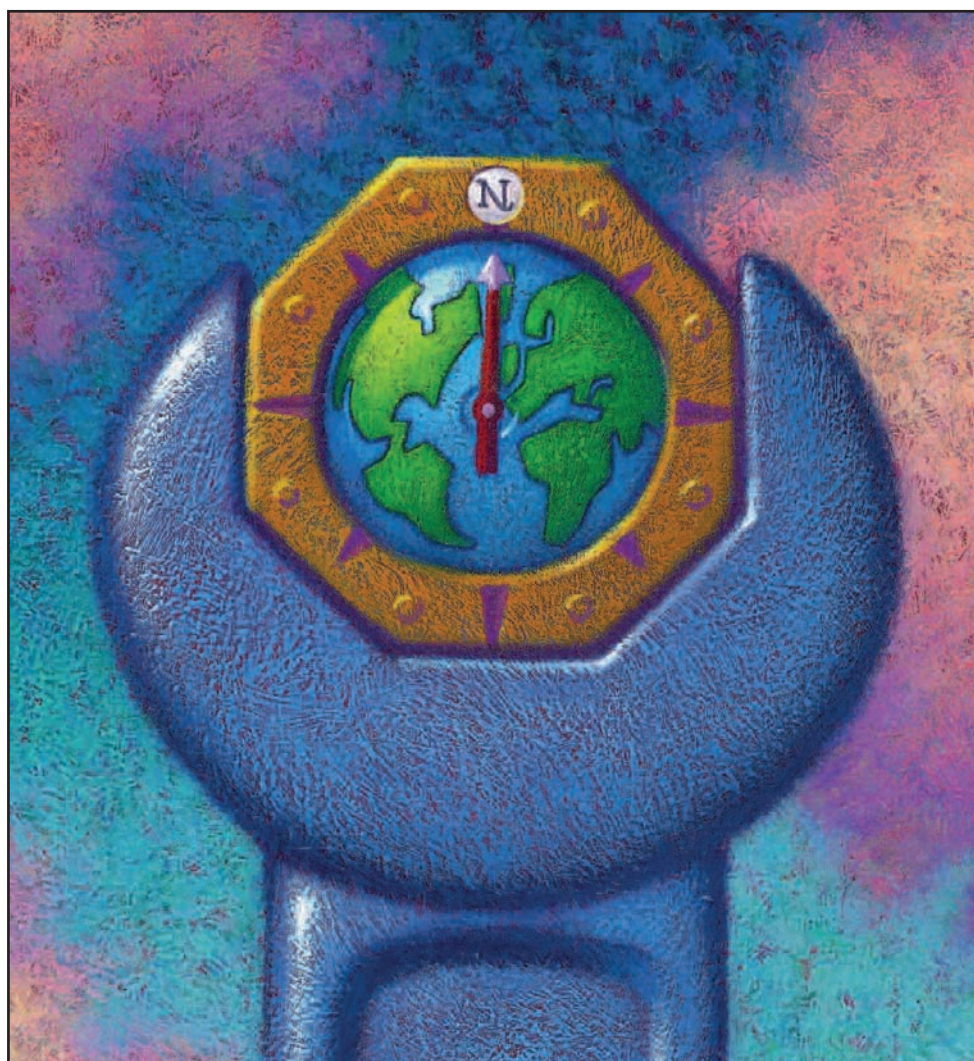
actions across the Asian markets,” said Barnes. “Not only do we have the advantage of a meeting time in our local time zone, but we’re also able to be more responsive to local market processing needs in Asia.”

“That said, there is a lot of information sharing with our counterparts overseas,” continued Barnes. “We circulate our minutes to the other GCA Working Group, and they provide us theirs.”

Tackling Tough Issues

So what kinds of issues are discussed by the GCA Working Groups?

“We talk about the complexities of the corporate actions themselves, and we make decisions on how to treat them in GCA,” said Richman. “For example, we get into the specifics on how we handle



on the Global Corporate Action Solution

liquidation announcements, or stock/cash coupon rights, or rights subscription offers in certain markets.”

“We also discuss how to improve GCA,” said Richman. “We implement enhancements based on ideas that customers bring to the working group. Or we may talk about enhancements that we want to make, such as improving the usability of our browser interface.”

Customers were instrumental in helping DTCC develop text templates, which format the text associated with complex U.S. events, such as tender offers and exchanges. Structured text allows customers to pass the GCA corporate action announcement to their clients without changing it.

The working group helped DTCC develop its GCA Service Level Agreements (SLAs), which were then revised by the group in August 2004. SLAs are a set of business and technical metrics that measure GCA's service quality in terms of accuracy and timeliness.

“Our SLAs spell out exactly what customers can expect from us, so there are no surprises,” said Femia. “We publish our scores to customers on a monthly basis, and we're subject to financial penalties on the fees customers pay to us if we don't hit our marks. SLAs are a powerful incentive to get the job done right.”

GCA is also guided by a customer advisory committee, which provides counsel on strategy, overseeing GCA's direction at a high-level. The committee, which meets quarterly, is led by Femia.

“The GCA Advisory Committee may make a decision that requires an enhancement to GCA, for example,” said Richman. “The working group then picks up on it. How do we implement

it? What should it look like? How should it work?”

Collaboration for Best Practices

“Our meetings are truly open discussions,” added Richman. “It's a very collaborative process. No one holds back.”

“Because of the diverse make up of the group, we don't always get 100% agreement, but we do generally gain consensus. If we can't, an issue may find its way to the Advisory Group.”

According to Richman, the meetings also promote dialogue on some of the toughest issues in the corporate action business.

“GCA Working Group meetings are an excellent forum to exchange ideas and promote best practices for corporate actions across the industry,” said Joseph Covello, director, Product Development, Transaction & Custody Services, Merrill Lynch, who is a member of the group. “It's been helpful to gain perspectives about how other firms deal with complex events.”

These customer forums are just one of the ways DTCC is working with customers to evolve and shape GCA.

“We also frequently meet with customers one-on-one,” said Femia, “both to better understand the challenges they face and ensure we're delivering a solution that's on target with where our customers' businesses are headed. The complexity of corporate actions demands this level of commitment to partnering with customers.”

Editor's Note: For more information on the GCA Validation Service, please contact Susan Spivey at (212) 855-4144 or sspivey@dtcc.com. @

“No-More-Paper” Drive Hits Stride in 2005 *Continued from page 7*

per month for every non-transferable issue in DTC's vault for which they have not relinquished their position.

• Destruction of Paper Securities

Registered in Street Name: In similar fashion, DTCC's depository subsidiary continued its program of eliminating paper securities registered in street name by shredding more than 330,000 such certificates in 2005.

Reflecting the substantial decline in the use of paper certificates, in 2005 DTCC's depository ended the Transfer Agent Drop

Service that had provided firms outside New York City with a central location on Wall Street for depositing securities from banks, broker/dealers and shareholders – a vestige from the time when most securities were issued in physical form and transfer agents used messengers to deliver and pick up securities that had been traded. The depository continues to accept delivery of physical securities at its own New York City offices.

Another major thrust in 2005 was the “No More Paper” campaign to educate

industry members and investors to the advantages of electronic stock ownership.

In addition to creating a Web site (www.dtcc.com/nomorepaper) containing valuable industry and consumer information, DTCC “spread the word” by speaking at industry events, such as the SIA's Annual Operations Conference, and by publishing educational articles in industry journals and consumer news media. @

DTCC Announces 2006 Fee Reductions Totaling More Than \$161 Million

By Edward C. Kelleher

The Depository Trust & Clearing Corporation (DTCC) announced this month 2006 fee changes for its subsidiaries that implement net fee reductions totaling \$161.3 million, the largest net reduction in fees ever made by DTCC.

The fee changes, which will generally take effect January 2, 2006, are being made across DTCC's subsidiaries including National Securities Clearing Corporation (NSCC), The Depository Trust Company (DTC) and Fixed Income Clearing Corporation (FICC).

"Driving down clearance and settlement costs in the U.S. capital market not only benefits our customers, but further ensures that overall transaction costs remain low, keeping our markets the most vibrant and desirable place for issuers and investors to meet their financial needs," said Donald F. Donahue, DTCC's chief operating officer.

"The fee reductions are consistent with our efforts to continue to 'right-size' our fees," said Donahue. "On a gross basis, we reduced fees \$183.7 million, but this figure was partially offset by increases in fees in certain categories."

Donahue pointed out several factors that enabled DTCC to achieve the fee reductions, including the tight expense controls management has put into place and the fact that processing volumes for most businesses were up substantially this year. Also, several initiatives causing DTCC to incur significant "special expenses" over the past four years – such as establishing the Southern Business Center in Tampa for business continuity purposes and the insourcing of certain data processing done by the Securities Industry Automation Corporation (SIAC) – have now been completed.

"We remain committed to achieving

sustained reductions in the costs of our traditional services," Donahue said. "DTCC has already delivered an impressive series of fee reductions during the first half of this decade, and we are making every effort to deliver further reductions over the next five years."

The fee reductions are as follows:

- NSCC fees will be reduced by approximately \$99.4 million, with significant reductions in fees for trade comparison and recording services. The mutual funds business will see reductions in Fund/SERV and Networking fees. The reduction in Networking fees will occur on February 2, as part of a broader revision of the Networking fee structure.

- DTC fees will be reduced by approximately \$36.6 million over the next year, including the complete elimination of fees for messaging and file transfers for all depository services. Settlement services fees also will be reduced.

- FICC fees will be reduced by approximately \$25.3 million, with reductions for trade submission and trade netting for U.S. government securities and for Settlement-Balance Order options and trade-for-trade submissions in mortgage-backed securities.

New disincentive fees were announced as part of DTCC's effort to discourage behavior that keeps the industry from achieving peak efficiency. The disincentive fees include charges for the physical movement of securities certificates, late submissions of deposits on restricted securities, ACATS rejects, and late notifications to FICC regarding repo substitution requests.

DTCC is owned by its member firms including international broker/dealers, correspondent and clearing banks, mutual fund companies and investment banks. It operates on an "at-cost basis," returning

excess revenues from transaction fees to its members. Since the late 1970's when DTCC subsidiaries began operations, the average transaction cost per trade has gone from \$1.64 in 1977 to 86 cents in 1986 and to just 7 cents in 2005.

Editor's Note: Complete and detailed lists of the fee changes are available on Important Notices available on www.nssc.com, www.dtc.org, and www.ficc.com. @



DTCC's purpose is to help grow the world economy by furthering the development of low-cost, efficient capital.

Our mission is, by 2010, to be the acknowledged world-class provider of servicing solutions to financial markets through leadership, innovation, technology, risk management and strategic alliances.

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