



DTCC Deriv/SERV Signs 100th Customer For Credit Default Swap Matching Service

By Judy Inosanto

DTCC marked a milestone this month by signing the 100th customer for its Deriv/SERV automated credit default swap (CDS) matching service, solidifying its position as the leading global service provider for post-trade processing of these instruments.

Launched in November 2003, Deriv/SERV's already has the largest customer base for its credit default swap matching [continued on page 7]

Delaware Law Change Will Save Investors Millions of Dollars

By James Conmy

By eliminating its legal requirement that companies issue paper stock certificates, Delaware's state legislature will save investors and companies millions of dollars a year, said Jill M. Considine, chairman and CEO of The Depository Trust & Clearing Corporation (DTCC), which handles the post-trade processing and settlement of securities transactions for most U.S. markets. [continued on page 5]

in this issue



Customer Portal Opens New Doors



The Shape of Things To Come



FICC Tackles Collateral Substitution Surge

DTCC's Customer Portal Opens New Doors

New "Common Entry" Provides Improved Customer Service and Access to DTCC's Products and Services *By Crystal Bueno*

Customer Portal, the new Internet browser "common entry point" into DTCC's family of Web-based products and services, will be piloted to a select group of customers for six weeks this summer, beginning in late June.

With single sign-on access into the Customer Portal, a customer's entire set of DTCC permissions and credentials can now all be securely managed with a single ID, password and/or digital certificate, instead of juggling between multiple IDs for different subsidiaries' products.

DTCC expects pilot users to rigorously put the Customer Portal through its paces, accessing products such as Restricted Securities System, Corporate Action Liability Notices, DTax, LENS and various DTC.org and SMART services. Pilot users will also test features like setting and managing their own passwords, and they will be able to log in to online training modules and automatically link to various DTCC forms, file formats and technical documentation.

Pilot users will also have access to the "messaging platform" on the portal, which will carry broadcast information on items such as any processing problems or changes upcoming for a customer's products. DTCC is enhancing this facility next year so that customers will can subscribe to various events and get notification right on the DTCC home page.

Feedback from the pilot group, and from the 4,000+ Customer Desktop users who will next be given access to Customer Portal in late August, will be used to guide the progressive rollout of a fully integrated portal for all DTCC browser-based products later in the year.

"Customer Portal raises the bar for customer service across DTCC," said Fran Lapinski, senior product manager, DTCC Network & Internet Services. "In one place, customers will be able

to 'self-service' and manage their access with us, jump into various applications, enter problem tickets and access support, research product information, and even enroll in training – and this information is all completely tailored and targeted to a firm's unique profile and relationship with DTCC."

Evolution of a Portal

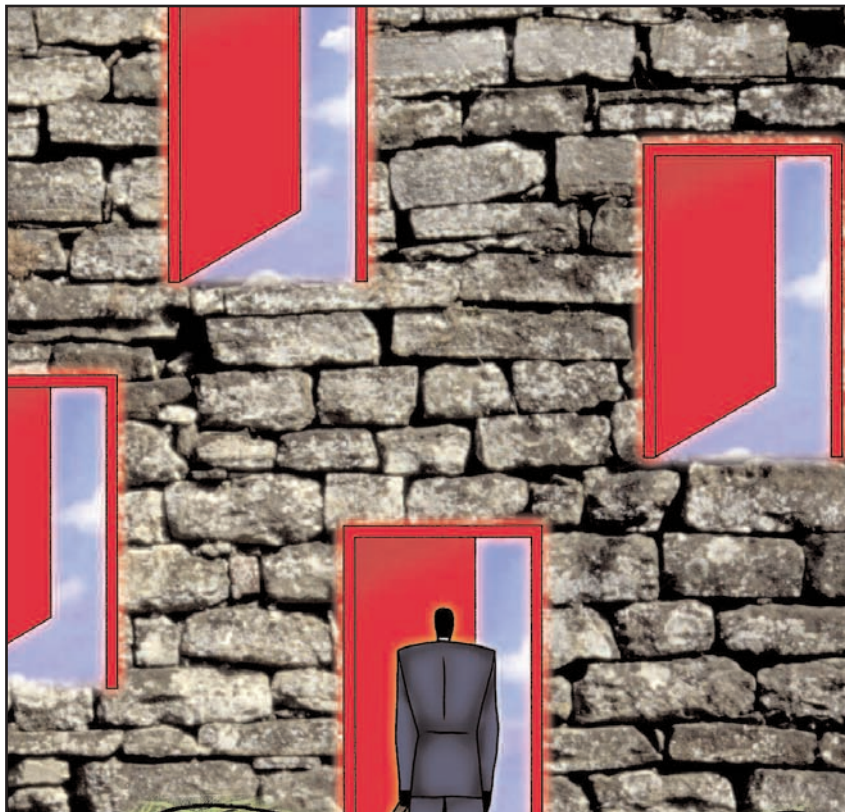
The sophisticated features of Customer Portal - recognizing user registrations across multiple legacy systems and products, managing a robust security architecture, and reengineering a Web

framework to support the integration of DTCC's different products and services - evolved over several years, as the "next generation" of technology finally caught up with the strategic vision of what DTCC wanted this kind of customer-focused environment to be, said Andrew Reres, director, DTCC Internet Product Management.

"At the formation of DTCC, we recognized there was a common customer base shared among the subsidiaries. However, the challenge

was that the Web-based products and services of DTC, NSCC and FICC were all driven from different mechanisms, different networks, and different system frameworks," said Reres. "Our strategy was to follow what other industry leaders were doing as they underwent their own transformation and consolidation – namely, to reengineer our system architecture so that it could provide a common entry point into DTCC, recognize a customer's credentials, and serve up a range of applications, products and relevant bits of information with an industrial-strength search capability that a customer would need to do his or her job."

Editor's note: For more information about Customer Portal, please contact Fran Lapinski (flapinski@dtcc.com) or Andrew Reres (areres@dtcc.com). Customers interested in joining the Customer Portal pilot group should contact their Relationship Managers. @



Real-Time Message Interface Streamlines Prime Brokerage Settlement

By Edward C. Kelleher

National Securities Clearing Corporation (NSCC) and Omgeo will implement a new real-time message interface for Prime Brokerage activity, including municipal securities, in early July.

The interface, an improvement from the existing batch process which operates between NSCC, a DTCC subsidiary, and Omgeo, a joint venture of DTCC and Thomson Financial, connects NSCC's Continuous Net Settlement System (CNS) and Omgeo's TradeSuite System. The TradeSuite/CNS interface is an option that streamlines the processing of Prime Brokerage trades.

Prime Brokerage activity includes a variety of services that many clearing firms provide for clients, including securities lending, leveraged trade executions, and cash management. The interface for Prime Brokerage activity was developed largely in response to hedge funds, which place large trades and are involved in many activities including buying and selling on margin and lending and borrowing securities.

"This effort to streamline settlement for Prime Brokerage activity is made in support of the securities industry's continued straight-through processing efforts," said Peter Inguanta, director, DTCC's Product Management. "This change enables NSCC to continue its efforts to mitigate the impact of external system failures or backlogs as a result of heavy volumes. Should the market be disrupted for any reason, real-time trade submission helps ensure that the number of Prime Brokerage executed but unsubmitted trades is kept to a minimum or eliminated. NSCC already provides a real-time message interface for the New York Stock Exchange, American Stock Exchange and the Nasdaq stock market transactions."

Currently, equities, corporate bonds and Unit Investment Trusts (UITs) are eligible for the TradeSuite/CNS interface, but in conjunction with the new real-time message interface, municipal bonds will be processed for the first time.

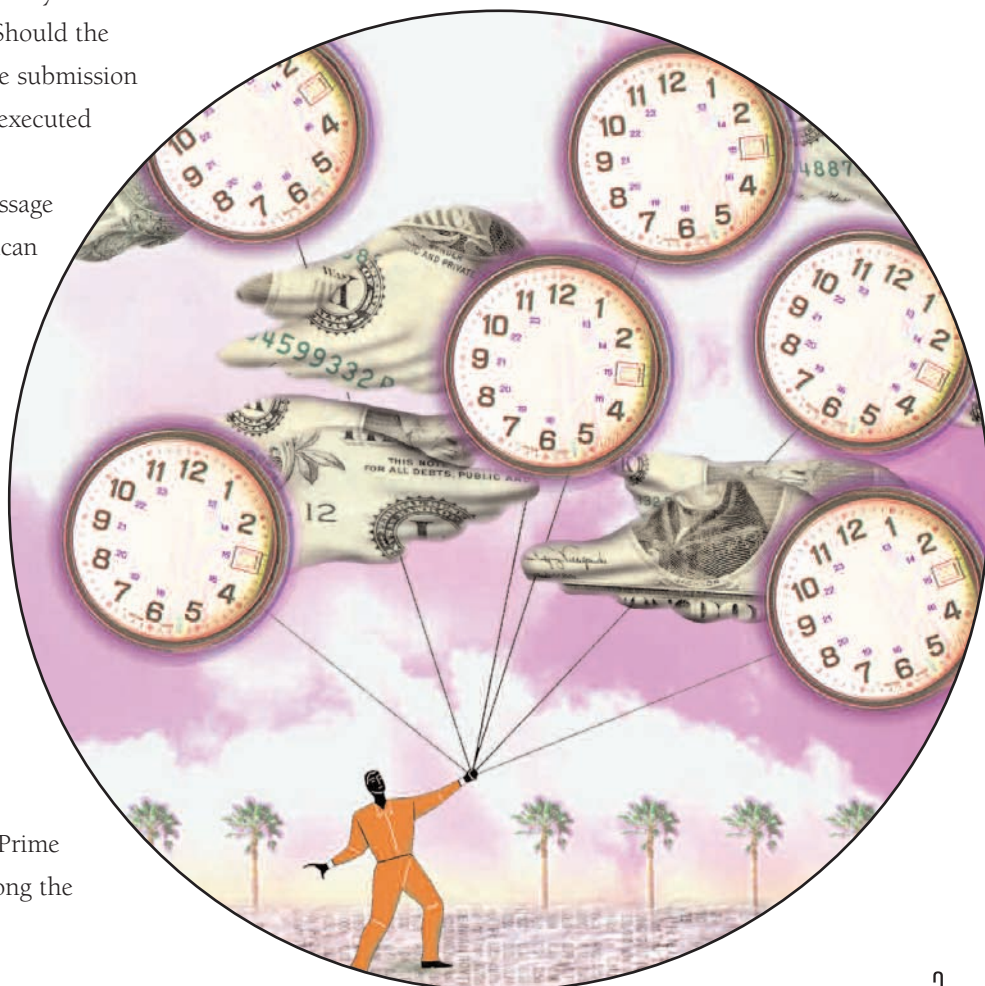
Customer reaction to the enhancement was positive. "It's great that DTCC and Omgeo are adding munis at the same time they are implementing a real-time interface," said Godfrey Moore, technical director, Settlement Operations, Charles Schwab & Co. "Anyone familiar with the Prime Broker flip to CNS process should be happy." Among the

benefits Moore cited were "reduction in reclaims, reduction in buy-ins, better fail control environment, reduced cap charges, reduction in re-cap transactions, reduced delivery order charges, and automatic partials."

The Regional Interface Operation (RIO) – which is the actual trade recording application that receives the real-time data feed before CNS – and its machine-readable output (MRO) and reports will be enhanced to reflect new values for municipal bonds, corporate bonds, and Unit Investment Trusts (UIT). Previously, they were identified as debt securities only.

Inguanta said NSCC participants should see if they need to make some minor system and work flow changes to accommodate municipal bonds. The new real-time interface, however, will be transparent to the industry. Testing for the enhanced interface has begun and participants are encouraged to begin testing before the interface implementation next month.

Editor's Note: For detailed output and reporting changes, participants should review NSCC Important Notice A6011 posted on April 19, 2005. For more information on the TradeSuite/CNS interface for Prime Brokerage, please call your Relationship Manager or e-mail Peter Inguanta at pinguanta@dtcc.com.



DTCC Meets Press During “Day on the Street”

By John Celock

DTCC provided reporters with a rare tour of its vault and presentations on dematerialization of equities and the launch of new services for OTC derivatives during the annual “Day on the Street” sponsored by the Securities Industry Association (SIA).

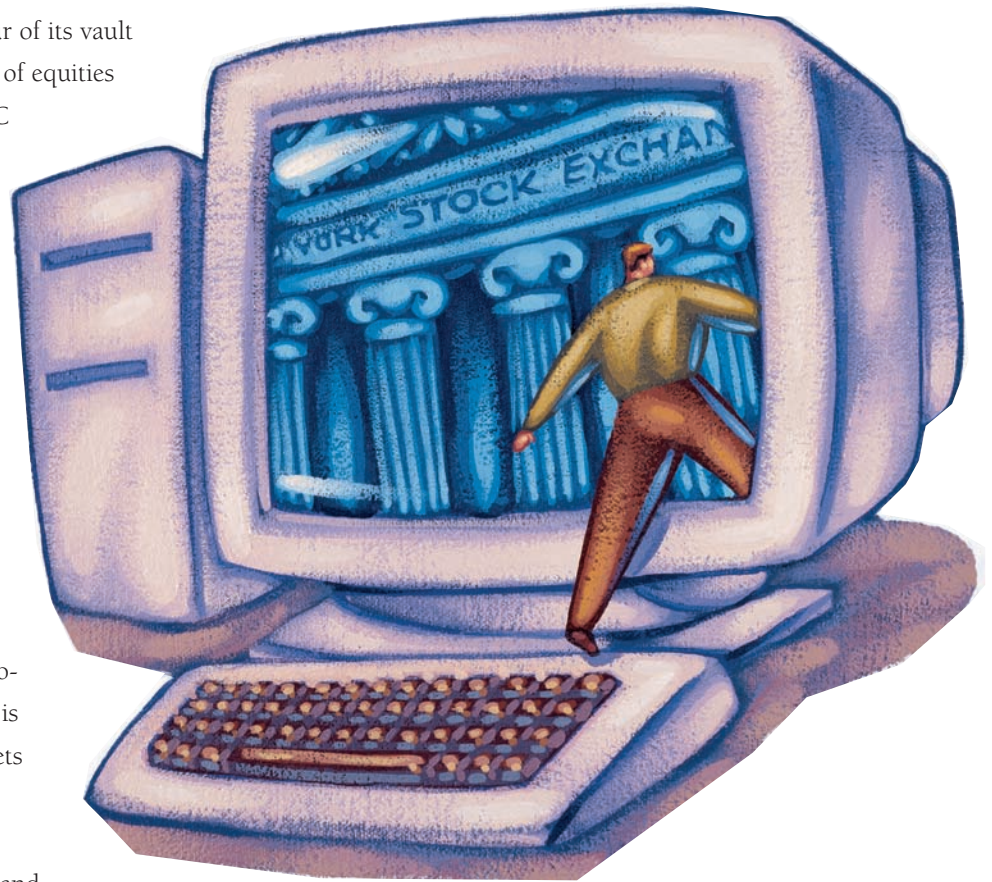
The annual event gave about 25 reporters an “insider’s” perspective of the securities industry. Among the media organizations attending the program were: *Bloomberg Wealth Manager*, *BusinessWeek Online*, *Dow Jones News Service*, *Euromoney*, *Financial News*, *Money Magazine*, *Registered Rep*, *Seattle Times*, *Wall Street Journal Online*, *Waters magazine* and *American Public Radio*.

Nine host organizations participated in the two-day program, which focused on why each group is critical in ensuring that the nation’s capital markets are the deepest, most liquid and most efficient in the world. Program participants met with representatives of securities firms, stock markets and DTCC.

DTCC’s presentation focused on a number of areas in which the corporation provides services to the financial services industry. Presenters and topics included:

- Larry Thompson, DTCC first deputy general counsel: The history of DTCC and the corporation’s role in the industry.
- John Mancuso, DTCC vice president for Securities Processing: A tour of the depository’s vault and a briefing on how physical securities are processed.
- Joseph Trezza, DTCC senior product manager in Restricted Securities, Asset Servicing: A briefing on the corporation’s dematerialization initiative and the effect it will have on the industry.
- Janet Wynn, managing director and general manager, DTCC Deriv/SERV, International and Asset Servicing: A briefing on the over-the-counter derivatives service.

“I want to thank The Depository Trust & Clearing Corporation for participating in SIA’s Day on the Street,” said Christina Martin, senior vice president for the SIA’s Corporate Communications. “DTCC’s presentations to visiting journalists clearly demonstrated the speed, methods and security involved in successfully clearing and settling a trade. DTCC was the perfect complement to two days of in-depth education on the full spectrum of the financial



services industry.”

Banc of America Securities, BNP Paribas, Nasdaq, Merrill Lynch, UBS, the New York Stock Exchange, the International Securities Exchange, and Wachovia Securities, LLC joined DTCC in participating in “Day on the Street.” Presentations at the other firms included an update on the European Union constitutional referendum, the regulatory effects on trading, fund management, market structure, and the options industry and life goals planning.

During the securities processing presentation, reporters were given a chance to observe the entire process in action. They witnessed the process used to image security certificates, among other steps in the process. For many in the press group, this was their first time seeing securities processing in action.

“SIA Day on the Street provides DTCC with the chance to share with the media our unique role in the industry,” Mancuso said. “Clearance and settlement are important, yet little known parts of the securities industry, and it is important to educate the business press about these functions so that they can write informed articles.” @

Delaware Law Change Will Save Investors

Continued from cover

Delaware was one of three states still requiring public companies incorporated in the state to issue paper certificates for equities, which are the last financial instruments still using physical ownership records. 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.

Delaware's new regulation, House Bill 150, was signed by Gov. Ruth Ann Minner on May 17, and will take effect on August 1.

"This is a significant step in the national drive to eliminate paper stock certificates," Considine said, "because more than half of all publicly traded companies in the United States and almost three-fifths of Fortune 500 companies are incorporated in Delaware."

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, even though they're involved in only about one-tenth of one percent of all trades daily on U.S. markets. One study, released by the Securities Industry Association (SIA) last year, puts the annual cost of handling paper stock certificates at \$250 million or more.

"We believe Gov. Minner's signing into law the amendments approved by Delaware's legislature earlier this month will have an effect nationwide," Considine said. "DTCC will continue to work with the SIA to help eliminate paper certificates in the other states that still require them."

Electronic ownership of securities is not only more economical, Considine noted, but much safer. 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.

On 9/11, some \$16 billion worth of certificates disappeared in the collapse of the World Trade Center towers, and it took many months of record checking and millions of dollars to replace them. Electronic shares, in contrast, were not affected at all.

The SIA has been leading the securities industry's effort on "dematerialization" – the elimination of paper certificates.

"Since DTCC's subsidiary is the world's largest securities depository and holds in custody securities valued at more than \$28 trillion, we are actively supporting the SIA in achieving this shared objective," Considine said.

The two states and one commonwealth that still require companies to issue paper certificates are: Arizona, Louisiana, and Puerto Rico. @

Congratulations to THE CANADIAN DEPOSITORY FOR SECURITIES LIMITED on its 35TH ANNIVERSARY

DTCC extends heartfelt congratulations to The Canadian Depository for Securities Limited, for its enormous accomplishments in providing safety and security to Canada's financial community for the past 35 years.

To our North American partner, we'd like to take this opportunity to also recognize the strong links forged between our two organizations over the past 25 years



*The Depository Trust &
Clearing Corporation*

Cox Nominated as SEC Chairman After Donaldson Announces Plan to Resign

Compiled from published reports

President George Bush has nominated Rep. Christopher Cox, a California Republican, to be chairman of the Securities and Exchange Commission.

Cox will replace William H. Donaldson, who will resign at the end of June, ending a 2½-year tenure that marked one of the most active periods for the SEC since the agency's founding.

Cox, a congressman since 1988, is probably best known as the chairman of the House Committee on Homeland Security. He graduated from both Harvard Law School and Harvard Business School and has served on several committees with oversight over securities regulation. One of his principal achievements was as chief advocate for a law limiting securities lawsuits by private investors and for tax code changes reducing levies on income from investments, including dividends.

The 52-year-old Cox was a White House lawyer during the Reagan administration and a corporate attorney specializing in securities law with the firm of Latham and Watkins before being elected to the House of Representatives.

In nominating Cox, the President said, "In the years ahead, Chris will vigorously enforce the rules and laws that guarantee honesty and transparency in our markets and corporate boardrooms."

Cox said the U.S. has "the most dynamic and vibrant capital markets in the world," and he vowed to push for "clear and consistently enforced rules."

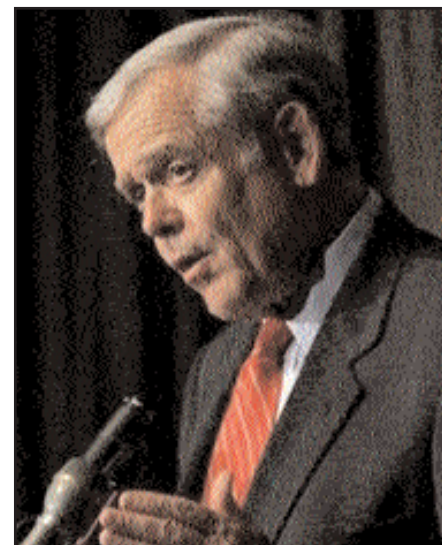
Securities Industry Association President Marc E. Lackritz said that Cox was an excellent choice to head the SEC, and urged the Senate to confirm him.

"Rep. Cox is a knowledgeable, experienced legislator with a demonstrated understanding of the capital markets – his leadership on securities litigation reform was instrumental in bringing efficiency and fairness to dispute resolution," Lackritz said. "There are a number of important issues facing the SEC, and we look forward to working with Chairman-designate Cox in addressing them. SIA will continue to support the commission's preeminence as the industry's primary, national regulatory authority, and its efforts to enhance effective investor protection while providing relief from burdensome, costly, and unnecessary

regulation."

The Bush Administration had tapped Donaldson in 2003 to help clean up the securities industry after Wall Street trading abuses and scandals at Enron Corp. and WorldCom Inc. shook the stock market.

According to published reports, under Donaldson's watch, the agency hired 1,200 new employees and brought a record 1,700 enforcement actions against a wide array of securities violators, collecting about \$7 billion in disgorgement and penalties. But in recent months, business groups had begun to complain that the SEC has gone too far in interpreting the 2002 Sarbanes-Oxley Act requirements. They argued the agency imposed too many new costs without producing enough benefits.



(l,r) Rep. Christopher Cox, William H. Donaldson

Donaldson's departure could mean an era of dramatic change. On several key issues, including rules on stock market structure and the imposition of civil penalties against corporations, Donaldson has cast his vote with the agency's two Democrats, both of whose terms will end this year.

Democrat Harvey J. Goldschmid will leave this fall to return to Columbia University, where he will teach. Democrat Roel A. Campos' term expires later this year. Senate Democrats have proposed elevating SEC market division director Annette L. Nazareth to fill Goldschmid's shoes, but the White House has not yet acted on the recommendation. @

DTCC Deriv/SERV Signs 100th Customer Firm

Continued from cover

service of any other service provider worldwide. Its 100 customers include the 20 largest global dealers in credit derivatives and over 80 leading buy-side firms including hedge funds and investment managers.

“DTCC, in discussions with leading market participants, identified early on the need to offer a complete range of automated end-to-end post-trade processing solutions for OTC credit default swaps. This includes the affirmation and confirmation of credit default swap trades, as well as payment matching and bilateral netting,” said Peter Axilrod, managing director, DTCC New Business Development.

“As a market leader in the OTC derivatives market, we are quickly expanding into other sectors, offering a global OTC equity derivatives matching and confirmation service and later this year, interest rates swaps matching and confirmation and portfolio reconciliation,” he added.

Rapid Industry Adoption

The rapid growth of over-the-counter (OTC) derivatives has helped forge industry consensus around the need to bring greater efficiency and soundness to this market via straight-through processing (STP) solutions. The International Swaps and Dealers Association (ISDA) issued a 2004 report outlining a strategic plan and calling for industry automation of all OTC derivatives products by 2006.

“Strong customer uptake of Deriv/SERV services clearly demonstrates the industry’s commitment to streamline and improve processing practices in this dynamic market,” said Janet Wynn, managing director and general manager, DTCC Deriv/SERV.



Wynn noted that DTCC signed its 100th customer just 18 months after launching Deriv/SERV’s CDS matching and confirmation service and has an additional 100 buy-side firms in various stages lined up to join the service. A key driver in advancing STP, in just one year since Deriv/SERV entered the market, electronic processing for credit derivatives increased nearly sixfold to 35% in 2004, according to data recently released by ISDA, up from about 6% the previous year. With the advent of automated processing for such trade lifecycle events as assignments, Wynn said electronic processing could reach as much as 75% of the market in the near future.

Wynn expects DTCC’s market entry to have an enduring impact.

“By helping broker/dealers and buy-side firms strengthen the existing infrastructure for OTC derivatives, our services will solidly position the market to continue to expand and grow globally with reduced operational risk,” she said.

Young and growing

OTC derivatives, which represent a relatively young market, have experienced phenomenal growth in the past few years. According to ISDA, the global OTC derivatives market reached about \$197 trillion in notional value as of December 2004. The notional market value for credit derivatives alone grew 213% last year to \$8.42 trillion in notional value.

Historically, trades for credit derivatives have been processed manually for the most part, involving labor-intensive, paper-driven fax and telephone exchanges. As a result, confirmations on a swap could take several weeks to complete. But with volume skyrocketing during the past few years, the need to improve efficiency and reduce risk in the processing of these securities has gained increasing urgency.

“From the outset, we have worked closely with the dealer and buy-side community to address this issue and deliver services that can be adopted in a timely and cost-efficient manner,” said Axilrod. He sees the movement towards automation as an inevitable trend for derivatives processing.

“As the market continues to evolve, DTCC will work with key industry players to deliver value-added services that foster fully automated, straight-through processing through all stages of the derivatives trade life cycle,” he noted. @

Sketching Out the Shape of Things to Come

Among the challenges on the “road to the year 2010” for all of those involved in investment processing are three that The Depository Trust and Clearing Corporation (DTCC) has already begun working with the industry to address, DTCC Chief Operating Officer Donald F. Donahue told delegates to the Securities Industry Association’s 32nd Annual Operations Conference and Exhibit in Florida in early May.

One is to integrate the activities of all parties to the trading process within the post-trade processing infrastructure. “This doesn’t happen today,” Donahue said. The second is to complete integrating today’s still-fragmented process itself within the asset servicing infrastructure. And the third, Donahue said, is to make sure all aspects of the industry’s infrastructure “support the way people actually trade today.”

Centralizing and standardizing account opening and maintenance is one way to bring trading parties into the process from the very beginning, Donahue noted. And to help do that, DTCC is working to define with the industry a possible service that would assist in new customer account

screening and help industry members deal with their anti-money laundering requirements.

Combating Money Laundering

The potential service, according to Managing Director Susan Tysk, DTCC’s New Business Development, is currently under study by an industry working group formed to define and analyze business requirements.

Screening of new customer accounts is inconsistent, not only from firm to firm but often within firms, Tysk noted. “Localized screening at each firm does not lend itself to information sharing across the industry,” she said. Often, she added, the process is not automated either, and the information is not always retained and available to audit.

The proposed service would provide highly automated, consistent processes; a good platform for sharing data within privacy law limits; state-of-the-art information storage; security; retrieval and audit trails; and highly scalable systems. Tysk noted that, subject to a final decision by the working group, the system would be available for operation by the first quarter of 2006.

Bringing Buy-Side Into FICC

DTCC’s netting and risk management services have historically brought substantial benefits to the broker/dealer community but, for several reasons, they’re not as widely used in the fast-growing institutional side of the business, Tysk said.

In response, Tysk said, DTCC is attempting to make its services more accessible for buy-side firms, particularly in support of the industry objective to increase the levels of netting for institutional trades. DTCC, she said, brings two types of netting benefits to the industry –

operational netting benefits and balance sheet relief. Operational netting relieves delivery-versus-payment volume on the Fedwire and at DTCC’s depository, and Tysk presented a model that would allow broker/dealers to settle at the block level and net this activity with their sell side activity. The model would also support the buy-side by providing flexible alternatives that include settlement on a trade-for-trade basis, netting by custodian, or netting at the account level.

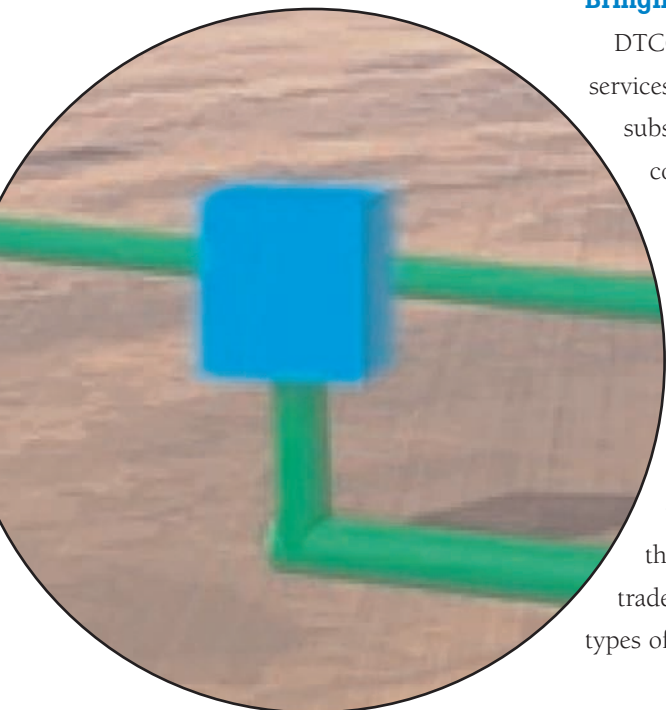
The second type of netting, balance sheet netting, makes it easier for broker/dealers to cope with leverage constraints by offsetting certain sell-side and buy-side financing transactions against a central counterparty. To improve balance sheet netting, DTCC currently has taken a proposal to create “sponsored memberships” for buy-side firms. Tysk said the sponsor picks up some of the membership responsibilities for the buy-side member. In return, the sponsor can structure transactions so as to achieve favorable balance sheet treatment for both a reverse repo initiated by the buy-side and the repo itself with the street.

Following SEC approval, which is pending, Tysk told the conference, DTCC plans to implement sponsored membership initiative as soon as possible. “This initial implementation will support well capitalized banks as sponsors, along with registered investment companies and sponsored members. DTCC will seek to expand this proposal to other types of entities in the near future,” she said.

Post-Settlement Environment

Today’s trading across markets and new asset classes have introduced tremendous challenges to all post-settlement processing, said Janet Wynn, managing director of DTCC’s asset servicing and Deriv/SERV businesses.

“Faster than real-time algorithmic



trading has upped the ante on the value of timeliness and accuracy,” she said.

“Meanwhile, the widespread use of structured products has increased the complexity of payment calculations and trading across markets has necessitated a global perspective on corporate actions,” Wynn explained. “Structured trades and synthetic assets require new servicing models akin to an ‘asset servicing hub,’ where instructions can be received from many issuers, paying agents and individual counterparties.”

DTCC, for its part, she said, has already begun to deal with these changing markets. In the cash markets, DTCC now receives automated file input from over 90% of agents helping to boost the on-time rate for announcements and payments to 98.5%. “But three 9’s – 99.9% – remains our ultimate target,” Wynn noted. In the OTC derivatives markets, DTCC has introduced real-time payment reconciliation for credit default swaps, achieving a 94% match rate in support of bilateral netting. But this still leaves thousands of exceptions, she pointed out, which won’t be improved until the service actually extends to manage the payment settlement.

“Additionally,” she said, “some of our customers are actually calling for a ‘trade warehouse,’ where payments could be calculated centrally and the central clearing agent is, in effect, the paying agent.”

Risk Management

“The industry doesn’t do a good job of sharing information and coordinating margining and other risk management tools,” Jeff Ingber, managing director and general manager for DTCC’s Fixed Income Group, told the audience. “As a result, market participants end up having to post much more margin worldwide than they should. There are also lost trading

opportunities and settlement inefficiencies, such as having to settle similar products in multiple locations.”

The problem, Ingber suggested, is that the various industries that make up the “financial markets” haven’t recognized the synergies to be achieved from links and better information flow among the markets. The clearing structure, he noted, does not match market structures, and a lot of trading activity is left out of the structure entirely.

“We should move to a common settlement structure,” he said. “It would mean less risk, better efficiency, lower costs – and an opportunity to introduce other products.”

U.S. and foreign markets also act in an insular fashion, Ingber added, with clearing and settlement structures focused on the notion that U.S. dealers trade U.S. products and European dealers trade European products. Instead, he said, the industry should be trying to facilitate cross-border trading of U.S. and European debt products.

One example of how expanded central counterparty services can improve market operation is in mortgage-backed securities, Ingber said. DTCC’s introduction of a central counterparty for this market will provide guaranteed settlement and pool netting, which in turn will reduce risk and increase operational efficiencies. Ingber said the new service would also facilitate



balance-sheet offset, generate increased liquidity by getting margin returned earlier, and establish a blind-brokered repo market.

Making Account Transfers Easy

DTCC’s Automated Customer Account Transfer Service (ACATS) and Cost Basis Reporting Service (CBRS) have been updated and expanded into new areas, Edlyn Meringolo, vice president, DTCC Product Development and Marketing, told the conference. She said that the services are:

- Currently pilot testing a standard way to automate the transfer of account information on insurance investments – initially annuities – with production implementation scheduled for June 6.
- Providing cost-basis reporting for a growing number of firms;
- Increasingly used by banks interested in the capabilities to re-register annuity and mutual fund products and provide tax-lot information.

Volume moving through the cost-basis reporting service is rising rapidly, she reported, and in May, DTCC made it

[continued on page 11]

FICC Tackles Surge in Repo Collateral Substitutions In U.S. Government Securities Market

By Nicholas Clarke

In response to continued growth in the repurchase agreement (repo) market and dramatic increases in the number of collateral substitutions involving U.S. Government securities, the Fixed Income Clearing Corporation (FICC), a DTCC subsidiary, is implementing a series of systems enhancements to improve the efficiency of the collateral substitution process and, ultimately, remove inter-dealer brokers from the process.

The need for these enhancements became clear on June 30 last year, when FICC experienced a significant spike in requests for collateral substitutions on outstanding repos for U.S. Government securities. (Repos allow financial firms to use securities as collateral in secured cash borrowing transactions—please see box on page 14 for more on repos.)

More than 500 repo substitution requests in excess of \$130 billion in collateral poured into FICC that day from inter-dealer brokers – a 70% surge over the previous quarter-end requests. Substituting repo collateral involves manual processes in close coordination with participants. Not surprisingly, the surge of requests created challenges in processing this record number of substitutions. It resulted in an extension of FICC's collateral substitution deadline, and ultimately caused an extension of the Fedwire close.

FICC immediately began preparations for the end of the next quarter, anticipating even larger volumes in substitution requests. First, it reached out to participants and convened a Repo Substitutions Working Group. The group consisted of representatives from clearing banks, dealers, and inter-dealer brokers. Together with the working group, FICC identified several initiatives aimed at potentially reducing the total number of substitution requests and improving the overall efficiency of the collateral substitution process.

“Helping ensure the continued growth and liquidity of the repo market is mission-critical, and one that FICC is ideally suited to,” said Jeff Ingber, DTCC managing director and general manager of the Fixed Income Group. “Right after the June spike, we started digging into what was going on with all the

substitution requests and working on a solution.

“Part of the fix involved making certain internal processing enhancements, which proved invaluable to us in managing the September quarter-end. In fact, due to the changes we instituted, FICC was able to process 40% more substitution requests that day than the previous peak in June,” he said.



High-volume days are nothing new. But what is new is how high the spikes are and how regularly they are occurring. Clearly, part of the reason for the surge in collateral substitution requests can be traced to the popularity of repos themselves. Repos represent a significant portion of the transactions submitted to FICC. Each day, FICC processes more than \$1.5 trillion in repo trades in U.S. Treasury bills, bonds, and other securities.

Solutions

FICC's initial response was to evaluate its current procedures, looking for ways to streamline

[continued on page 14]

Shape of Things to Come *Continued from page 9*

possible for firms using the service to submit cost basis and tax data via the Internet.

BCP Backup and Testing Costs

In a separate conference session focused on business continuity planning (BCP) priorities, DTCC Managing Director for Business Continuity George Perretti talked about the impact that BCP has had on the company's operations.

He outlined the increased costs DTCC has faced in establishing its various redundant facilities elsewhere in the country, including leasing space and equipment, hiring or relocating staff, and testing and site certification. Additional costs companies need to keep in mind for BCP initiatives, he noted, include command team activations, the maintenance of crisis-management sites, "tabletop" exercises, building evacuations and safety training.

While data replication for back-up data centers in the New York City region is synchronous, Perretti said, sending data to centers outside the region relies on asynchronous technology that has a possible lag time, and therefore a potential for data loss. "DTCC is working with a vendor on a new data replication process for extended distances," he said, "and we estimate we can cut the lag time to a few minutes." DTCC also plans to talk through with participants in the next few months the implications of this potential loss of data and steps participants can implement to provide safeguards in such an event.

Breakpoint Boogie

Although DTCC has long had a non-trade-related information service in place between mutual funds and firms to help them comply with regulatory requirements, according to Ann Bergin, managing director of Mutual Fund Services, only in the last year has the

industry really begun to make full use of it.

"The report by the Joint NASD/Industry Task Force on Breakpoints, which noted that our Mutual Fund Profile Service provides a database that can be used to deal with breakpoint problems, changed industry perceptions," Bergin said. "In the last year, we've made a number of important enhancements to the database

"DTCC is working with a vendor on a new data replication process for extended distances," Perretti said, "and we estimate we can cut the lag time to a few minutes."

to accommodate more breakpoint information, such as including full breakpoint schedules and money market fund assets in breakpoint calculations."

Work now in progress on the Profile Service includes creating new fields to support the new SEC rule on voluntary redemption fees, she said. "We're excited about the potential for our Profile service to help the industry in other ways," Bergin added, "such as creating an alert service for data discrepancies and supporting 'point-of-sale' requirements."

Liability Notifications

A pilot program begun last November to channel and automate corporate action liability notifications through DTCC's Web-Based SMART/Track system has proven highly successful, Tom McCarthy told convention delegates.

In fact, added McCarthy, DTCC managing director for product development, the pilot, which began with 19 participants, grew to 46 and resulted in DTCC and the SIA meeting with the New York Stock Exchange in April to suggest that the exchange mandate SMART/Track as the way to transmit liability notifications involving NYSE securities. The exchange has agreed to consider a petition to modify its rules and require SMART/Track for transmitting liability notifications.

Reengineering Project

DTCC's multi-year re-engineering project aimed at the consolidation of underwriting, reorganization and dividend processing within a single operating platform is at the point where it's "getting legs," Lori Trezza, DTCC Operations vice president, said.

"We held a series of customer focus group meeting earlier in the year," she said, "and, based on the feedback we received, we're finalizing the business requirement documents and developing the project plan for the next phase."

Several of the new features customers are looking forward to, she added, are Web browser access with better reporting and export functionality, and a "dashboard" feature that "pushes" critical information to the forefront so that customers can see it in time to take action. @

Canadian Tax Law Changes Affect U.S. Investors

By Judy Zuckerman

U.S. customers holding certain types of Canadian mutual fund trusts and Canadian mutual fund corporations through DTC have been affected by recent changes in Canadian withholding tax that impose a 15% tax on all non-residents that invest in those securities.

These Canadian mutual fund trusts and mutual fund corporations are popular investment vehicles that include energy, timber and real property investments in Canada. The 15% withholding tax is being imposed on capital gains and returns of capital, starting with January 2005 payments. A withholding tax is also

imposed on payments from mutual fund corporations where more than 5% of the distribution is paid to non-resident recipients.

The biggest impact of these changes is on U.S. Individual Retirement Accounts (IRAs) and pension funds holding Canadian mutual fund trust and mutual fund corporations, which will now incur a 15% withholding tax. The only entities exempt from this new withholding tax are Canadian broker/dealers, Canadian pension plans and U.S. charitable organizations. Those entities have obtained a tax exemption control number from the Canada Revenue Agency (CRA) that begins

with an “eight” (Canadian broker/dealers), a “nine” for Canadian pension funds or a “one” for U.S. charitable organizations.

Although mutual funds declare distributions throughout the year, after the end of the year they may reclassify those distributions for tax purposes into other types of income, (e.g. capital gains, return of capital, dividends, etc.) Difficulties can arise from the fact that these reclassifications are “post-event” and may not occur until well after the tax year ends. For instance, mutual funds in Canada have until March 31 of the following year in which to notify holders of the exact tax [continued on page 13]

The table below summarizes the withholding tax rates applicable to distributions from Canadian mutual fund trusts and corporations.

Treatment of Distributions From Canadian Mutual Fund Trusts and Mutual Fund Corporations

Applicable Withholding Rates	25% Statutory Rate		15 % Treaty Rate		0% Exempt Rate	
	Mutual Fund Trust	Mutual Fund Corporation	Mutual Fund Trust	Mutual Fund Corporation	Mutual Fund Trust	Mutual Fund Corporation
Tax Characterization of the Distribution						
Unknown	4	4	4	4	4 ¹	4 ¹
Return of capital – mutual fund (MF) invested in resource properties	N/A	N/A	4	4	4 ¹	4 ¹
Return of capital MF not invested resource properties	N/A	N/A	N/A	N/A	4	4
Gains on Taxable Canadian Property (TCP) where >5% paid to non-residents	4	4	4	4	4 ^{1,3}	4 ²
TCP Gains from investments in resource properties where <5% paid to non-residents	N/A	N/A	4	4	4 ¹	4 ¹
TCP Gains not from investments in resource properties where <5% paid to non-residents					4	4
Capital gains other than TCP invested in resource properties	N/A	N/A	4	4	4 ¹	4 ¹
Capital gains other than TCP not from investments in resource properties					4	4
Other income distributions	4	N/A	4	N/A	4 ^{1,3}	N/A

¹The only entities eligible for the 0% exempt rate are those with a tax-exempt control number issued by CRA beginning with 8 (followed by 5 digits) denoting a Canadian intermediary or 9 (followed by 5 digits) denoting a Canadian pension/retirement plan. ²0% exempt rate is available to all Canadian and non-Canadian residents with a tax-exempt control number issued by the CRA. ³0% exempt rate is available to U.S. charitable organizations with a tax-exempt control number issued by CRA beginning with a 1 denoting a charitable organization.

nature of the distributions.

Since withholding agents in Canada must remit all funds to the CRA by January 15 of the following year, they would not have funds available from the correct tax year in which to make refunds if they failed to withhold the funds at the time of the event. As a result, holders of these securities will now have to file for a tax refund, instead of obtaining tax relief at the time of payment.

Since the exact tax nature of these distributions will not be known at the time of the event, in most cases DTC's withholding agent in Canada, The

Canadian Depository for Securities Ltd. (CDS) has been advised by financial authorities in Canada to withhold 15% across the board, except in cases where the holder enters a tax exempt control number indicating it is either a Canadian pension plan or broker/dealer or a U.S. charitable organization.

Editor's Note: For more information, please check the following Important Notices: B#7426 dated January 31, 2005 as well as B#7600 and B#7604. You may also e-mail DTCC's Tax Services at globaltaxservices@dtcc.com. @



Xcitek Enhances XSP™ to Support DTCC's Global Corporate Action Validation Service

Xcitek, a leading global provider of corporate actions automation, market data solutions, and operational staffing services, enhanced its software solution, XSP™, to support DTCC's Global Corporate Action (GCA) Validation Service.

Brendan P. Farrell, Jr., managing partner at Xcitek, says, "Through the combined forces of XSP and the GCA Validation Service, we are offering the global marketplace a robust and powerful end-to-end solution to manage the day-to-day operations of corporate actions processing. Accurate, cleansed data is the first crucial step in this complex process. With this new interface, XSP clients have access to this premium data service allowing users to further maximize their operational efficiencies."

The GCA Validation Service provides a centralized source of "scrubbed" information about tender offers, conversions, stock splits, and nearly 100 other types of corporate actions for equities and fixed income instruments traded in Europe, Asia-Pacific and the Americas. The service delivers comprehensive, accurate and timely

information, helping to reduce operational losses, optimize front-office trading and streamline operations for financial institutions worldwide. It is provided through Global Asset Solutions LLC, a DTCC subsidiary.



"We have been working closely with Xcitek for a number of years now," said James Femia, DTCC managing director and head of the Global Corporate Action business. "This latest initiative represents each of our own firm's ongoing commitment to provide value-added solutions to the industry. By accessing the GCA Validation Service through XSP, XSP's clients can eliminate the time-consuming and manual efforts associated with the corporate actions process to reduce risk and lower costs."

Corporate actions are considered one of the last significant areas of risk associated with largely manual and non-standardized processing in the securities industry.

In addition to Xcitek, several other corporate action solutions providers support the GCA Validation Service. @

FICC Tackles Surge in Repo Collateral Substitutions Continued from page 10

processes. “In addition to our own internal systems enhancements, which make it easier and faster for us to process requests, we wanted to go deeper to determine what we could do to improve the substitution process on the participant end as well,” said Rachel Tyler, director, FICC Planning Division. “We identified the street’s increased use of forward-starting general collateral repos as a financing tool and a possible cause of the growth in substitutions.” (Forward-starting repos are contracts where settlement of the start-leg occurs one or more business days after trade date.)

FICC then focused on helping customers “pair off” forward-starting repo trades. The idea is that if customers have the ability to recognize offsetting, forward-starting repo and reverse trades executed with the same counterparty, they could elect to pair off these trades prior to their start date. Pairing off would eliminate the need for participants to allocate collateral, thereby potentially reducing further collateral substitution requests throughout the life of the trade.

In late March 2005, FICC introduced a new tool to help customers meet that need. The tool is in the form of two reports that are published daily in the FICC Report Center, an extranet portal for FICC customers. The first report displays a listing of a participant’s outstanding forward-starting general collateral trades sorted by contra party, and subsequently by generic CUSIP. The second report provides the same information in a file that customers can download into an Excel spreadsheet.

“Everyone should take a look at these reports and execute potential pair-offs where possible with their brokers,” said Joe Hoermann, senior vice president at Tullett Liberty Brokerage, Inc. “This will do away with the need to allocate collateral and make substitution requests for these repos on start date and reduce the overall amount of securities that need to be moved street-wide.”

In addition to the reports, FICC is finalizing another solution to allow customers to allocate collateral on forward-starting repos

prior to their start date. Customers who “pre-allocate” collateral would be eligible for FICC’s netting service, whereby offsetting deliver and receive obligations resulting from forward-starting trades are aggregated to establish a single net settlement position.

In instances where flat net settlement positions are established, customers would not have to deliver securities to FICC. That, in turn, would lead to fewer collateral allocations on substitution date, therefore, allowing participants to focus exclusively on the substitution process. Rollout of the pre-allocation service is

expected in June.

By early 2006, FICC is also working to support the ability of repo brokers and dealers to make repo collateral substitution requests to FICC without having to simultaneously submit replacement collateral details. Upon receipt of a request indicating only the original collateral, FICC will automatically identify the associated reverse repo and create delivery instructions to immediately return collateral to the repo dealer. This proposal aims to spread out broker processing across the business day and ease substitution request volume at the trading deadline.

“With spikes in the number of requests for repo collateral substitutions quickly becoming

the norm rather than the exception,” Ingber said, “the FICC will continue to work with our customers and the industry to look for new ways of meeting this challenge. Our ultimate goal is to develop a service that allows repo dealers to submit collateral substitution directly, effectively taking the inter-dealer brokers out of the collateral substitution process.”

Editor’s Note: Customers interested in learning more about FICC’s collateral substitution processing enhancements should contact FICC Client Support at 212-855-7651/7652. @

What’s a Repo?

Repos, short for repurchase agreements, are financial instruments that enable broker/dealers, banks, and other financial firms to sell securities, such as Treasury bills, with an agreement to repurchase them at original principal plus repo interest, at a specified future date.

As a secured form of financing, repos offer more favorable terms than traditional money market cash-lending transactions and provide liquidity and balance sheet relief needed by customers to finance their trading activity.

Repos are backed by collateral such as Treasury securities or cash. During the life of a repo, a lender may recall the securities or cash pledged as collateral by a borrower, or the collateral may simply mature, forcing borrowers to replace, or substitute, new collateral of equivalent market value.

DTCC Releases New Definition Standards Dictionary, Plans Other Changes for Enhancing Mutual Fund Profile

By Karen Gregory

To help funds and broker/dealers meet new industry requirements for processing breakpoint information, DTCC recently issued a revised dictionary of standard business definitions for its Mutual Fund Profile Service (MFPS).

The new standards, released in March, provide clients with common terminology to describe breakpoint opportunities, thus making it easier and faster for them to populate MFPS with security data and to update it.

Culminating a three-month effort by a DTCC Mutual Fund Task Force comprising 35 fund, broker/dealer, and trust company representatives, the standards dictionary is consistent with recommendations proposed in a 2003 report by the NASD/Industry Task Force on Breakpoints. The task force called on the industry to adopt common definitions of terms frequently used in defining breakpoint opportunities. The report also singled out MFPS as a critical component of the overall solution.

“With the standards dictionary now complete, we’ve reached the point where we need the industry to move forward and begin populating the database,” said Randy Solomon, director and product manager, Mutual Fund Services. “We want the users of this database to help make it as robust and accurate as possible and tailored to their needs. The goal here is to work together with funds and broker/dealers to develop best practices for data design and input, and to do so in a timeframe

that clients can meet.”

In addition to the standards dictionary, a by-product of the DTCC task force was a series of recommendations outlining enhancements to MFPS for short-term redemption (STR) fees. The recommendations, contained in a concept paper that is currently under review by the Investment Company Institute, seek to automate the handling of STR fees and enable firms to return the fees to funds at the time redemptions occur. Among the recommendations is a proposal for a new record that would include effective dates of fees, types of transactions for which fees are applicable, minimum and maximum fee amounts, and fee waivers.

Other changes to MFPS are planned, as well. For example, DTCC is currently beta-testing a concept that would allow individuals to access MFPS through the

NASD Web site.

DTCC is also keeping its eye on a Securities & Exchange Commission proposal concerning mutual fund confirmation and point-of-sale disclosures. Although the proposal has yet to be finalized, when it is, DTCC will join with the industry to determine how best to modify MFPS to reflect the new SEC requirements.

“We continue to look for new ways to expand the reach and scope of MFPS and enrich its value to users,” said Rita Gribben, product manager in Mutual Fund Services. “For the remainder of the year, DTCC will be working closely with the industry on a number of changes to ensure the database reflects the evolving needs of clients and continues to deliver maximum value in meeting those needs.” @



Annual DTCC Customer Survey Under Way

The annual DTCC customer satisfaction survey is currently under way.

The survey, which seeks information from a broad cross section of DTCC's customers in virtually every product area, provides DTCC with key information on how it is performing. Customer

comments and ratings are key to determining priorities and focusing attention on areas that may need improvement.

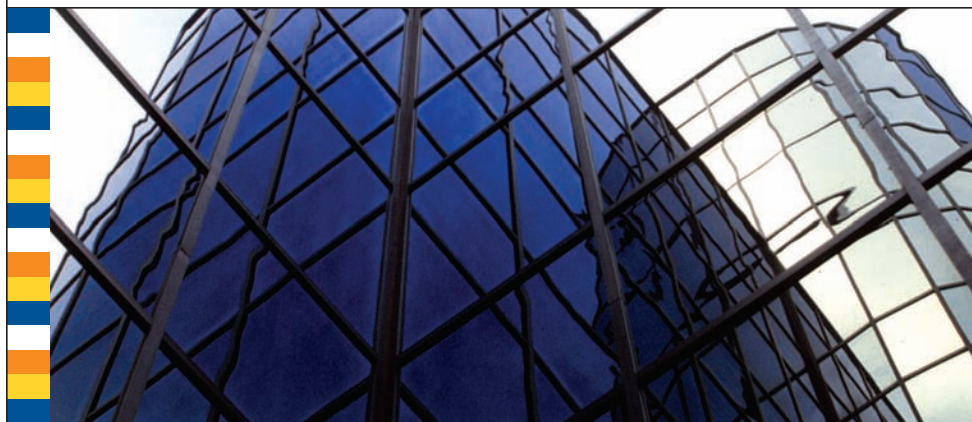
If you are asked for your input during the survey period, please take the time to respond to the survey by the due date of July 1. @



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