

## DTCC Settles \$1.1 Quadrillion in 2004 on Record Volumes

Total revenue exceeds \$1 billion before discounts, rebates *By Steve Letzler*

The Depository Trust & Clearing Corporation for the first time cleared and settled securities trades worth more than \$1 quadrillion in 2004, up 22% from the prior year's \$923 trillion, while setting new transaction processing records in most subsidiaries.

The volume of transactions handled by DTCC subsidiaries grew at double-digit rates across most major business [continued on page 6]

## The Legacy Broker and Access Networks: UNPLUGGED

*By Crystal Bueno*

DTCC's latest important notice about required network upgrades, issued to customers in mid-April, delivers the message loud and clear: the legacy Broker and Access networks will no longer be supported for clearing corporation applications, and those few customers who continue to rely on them after July 1 will be responsible for their portion of the full [continued on page 5]

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**CSD8: Bringing a Global Outlook to the Securities Depository Business**



**Agency Lending Disclosure Takes Center Stage: An Interview with Les Nelson**



**DTCC Hits New Record for Transactions Processed on April 15**



# CSD8: Bringing a Global Outlook to The Securities Depository Business

By James Conmy

More than 160 delegates from 64 countries met in New York the last week in April. But they didn't gather at the United Nations building and they didn't come for a 2012 Olympic Committee meeting.

Instead, they were representatives of central securities depositories (CSDs) from around the world, coming together for their eighth biennial conference, and they got down to business quickly, examining everything from risks in corporate actions processing to depository business models to global trends in clearing and settlement.

## Critical Role of Central Depositories

Hosted jointly by The Depository Trust & Clearing Corporation (DTCC) and The Brazilian Clearing and Depository Corporation (CBLC), the gathering was the Eighth Conference of Central Securities Depositories or, more briefly, CSD8.

Opening the conference were Gilberto Mifano and Jill Considine, CEOs of the host depositories. "What makes this kind of meeting so interesting," Mifano said, "is that, although we are all in the same industry, sharing the same problems and issues, we also have different approaches and sometimes very different market realities to deal with."

Timothy Geithner, president and CEO of the Federal Reserve Bank of New York, noted that the conference agenda closely mirrored the degree to which CSDs are now considered critical components of the economy by

regulatory authorities and the securities industry all over the world.

"This is probably the first meeting of the century in which we can build on a perception in the capital markets of what the future will hold," added Donald F. Donahue, DTCC chief operating officer who co-chaired conference sessions with Amarilis Sardenberg, chief operating officer of CBLC.

Delegates, for their part, many of who actively participated in drawing up the agenda, were not shy in voicing their opinions about the changing and increasingly competitive business environment for CSDs.

## Curing Global Corporate Actions

One of the key agenda items – corporate actions processing – sparked considerable commentary and debate.

"Everyone is seeking a cure for the problem of global corporate actions," added Jorge Hernan Jaramillo, president of DECEVAL, Columbia's CSD. "The aim is to

protect investor rights, but corporate actions can be a 'shock factor,'" he noted.

Fod Barnes, a principal of Oxera, the London-based economic consultancy whose research last year revealed very high loss potential in corporate actions processing, briefed the conference delegates on his company's study and the implications for the industry.

Marco Strimer of SIS, Switzerland's CSD, stressed that issuers need to be brought into the corporate actions process to get standardization and guarantees of information. "You know the saying," he said, "garbage in, garbage out. We need to end that."

"The conclusion of our discussion group," said DTCC Managing Director James Femia, who served as moderator, "was to hold off on forming yet another industry working group, but to leverage all

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Among the delegates attending CSD8 were, from left to right, Endang Triningsih, division head, the Indonesian Central Securities Depository, Kong Khai Chua, head of depository, Bursa Malaysia Depository Berhad, and Jane Yeo, vice president, The Central Depository (PTE) Limited of Singapore.

Jill Considine, DTCC chairman and CEO, welcomes Alan Cooper, CEO of the Canadian Depository for Securities Limited, left, and Gerardo Mejia, CEO of SC Indeval SA de CV of Mexico.



Delegates at the opening session of the conference.

# DTCC Elects Board of Directors at Annual Shareholder Meeting

by Edward C. Kelleher

**D**TCC shareholders elected new directors and returned others for another term to its 20-member Board of Directors at the company's annual shareholder meeting in April.

Seven new directors are: Gerald A. Beeson of Citadel Investment Group, LLC; J. Charles Cardona of The Dreyfus Corporation; Arthur Certosimo of The Bank of New York; Randolph L. Cowen of Goldman Sachs; Heidi Miller of JPMorgan Chase; Diane Schueneman of Merrill Lynch & Co.; and Timothy J. Theriault of The Northern Trust Company.

DTCC's directors are elected for one-year terms and also serve as directors of the company's operating subsidiaries. Sixteen are representatives of participants, including international broker/dealers, correspondents and clearing banks, mutual fund companies and investment banks. Two directors are designated by DTCC's preferred shareholders: NASD and the New York Stock Exchange. The remaining two are the chairman and chief operating officer of DTCC. Individuals are nominated for election as directors based on their ability to represent participants of each of DTCC's operating subsidiaries, and Board committees are specifically structured to help achieve this objective. In addition, non-Board members serve on a number of DTCC Board committees as full voting members to ensure broad industry representation and expertise on key industry subjects.

## New Directors

**Gerald A. Beeson**, senior managing director and chief financial officer of Citadel Investment Group, LLC, is responsible for asset and liability management, financial reporting, global operations and real estate functions for the firm. Prior to becoming CFO, he was global controller for Citadel. Beeson is a certified public accountant and is a member of The Chicago Board of Trade and The Chicago Mercantile Exchange.

**J. Charles Cardona**, vice chairman and director of the Dreyfus Corporation and president of The Dreyfus Institutional Services Division, is responsible for managing the institutional selling efforts of nearly 40 regional vice presidents through four national sales managers. This unit is responsible for the growth and maintenance of approximately \$110 billion of client assets. He is a member of The Dreyfus Senior Management Committee and the Corporation's Operating Committee.

**Arthur Certosimo**, executive vice president of Broker/Dealer Services for The Bank of New York, manages the bank's

broker/dealer services business, which delivers collateral management and securities clearance services to financial institutions and corporations worldwide. In this capacity, he oversees all client services, product management, sales, operations and technology activities on a global basis. Prior to the Bank of New York, Certosimo was a principal of Morgan Stanley Asset Management and a vice president at The Chase Manhattan Bank's Global Investor Services Group.

**Randolph L. Cowen** is global head of Technology and Operations for the Goldman Sachs Group, Inc. Prior to assuming this role, he was global head of technology for the firm. He joined Goldman Sachs in 1982 and was named a partner and managing director in 1996.

**Heidi Miller** is chief executive officer of JPMorgan Chase & Co.'s Treasury and Securities Services unit. Prior to the merger with JPMorgan Chase in July 2004, Miller served as chief financial officer and as a board member for Bank One, positions she held since 2002. She previously served as a managing director at Chemical Bank and as chief financial officer at Travelers Group. She is a trustee of Princeton University and also serves on the board of directors of General Mills, Inc.

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Gerald A. Beeson



J. Charles Cardona



Randolph L. Cowen



Heidi Miller

# CSD8: Bringing a Global Outlook *Continued from page 2*

the existing standards efforts now going on in the industry. This includes pursuing 'at source' initiatives and finding a way to utilize the work of standards bodies such as the regional CSD associations."

## Challenges of Consolidation

"Consider this," said Paolo Cittadini, General Manager of Monte Titoli S.p.A., Italy's central securities depository, who spoke about the progress in Europe toward integrating securities settlement systems. "In the course of streamlining the securities business through the consolidation of depositories, you might end up with one central securities depository, but if it has four, five or six operating platforms, the problem is still the same."

Earlier in the conference, Joël Mérére, the CEO of Euroclear France and the chairman of the European Central Securities Depositories Association, talked about the regional association's role in working with the European Union Commission and European regulatory authorities to find ways to improve cross-border clearing and settlement throughout Europe.

The aim, he emphasized, was not only to harmonize securities processing but to centralize market liquidity into a larger pool.

## Growing Importance of Regional CSD Bodies

"The deepening bonds among depositories – sharing information and solving problems regionally – is a very encouraging and progressive trend," DTCC's Considine said in her opening address.

Sardenberg added that the role the regional associations can play in coordinating CSD aims is "growing in importance." She noted that a new CSD regional association – for Africa and the

Middle East – had actually been "born" on the first day of the conference. The new regional association joins four other regional groups already organized for Europe, Central and Eastern Europe, the Asia-Pacific region and the Americas.

## Singing the Paperwork Blues

"Look at this," said Barbara Amsden, an assistant vice president of the Canadian Depository for Securities, holding up a one-foot-high stack of papers and folders. "These are all the assessment and evaluation documents our depository has to fill out every year for various agencies and businesses. This is a huge paperwork burden and, as an industry, we need to find a way to rationalize it," she said.

Amsden was the moderator for a group of conferees examining the rising number of forms, surveys and assessments securities depositories now fill out so that regulators and others can measure liquidity, efficiency and risk in post-trade processing. The group had a chance to grill representatives from many of the organizations seeking data, including the Association of Global Custodians, the International Securities Services Association (ISSA) and Thomas Murray, a London-based risk rating and advisory company.

What the CSDs want, Amsden said, is to have some common terminology, to avoid duplication and to be able to update information regularly online. There was also a recommendation that CSD working groups meet with the International Organization of Securities Commissions (IOSCO) to standardize both central and regional data bases involving CSDs.

## Evolving CSD functions

In an examination of how far many CSDs are moving beyond their core functions, Elzbieta Pustola, president and CEO of Poland's CSD, raised questions

about how deeply CSDs may expand into related lines of business and how the expansion might affect risk control.

As CSDs evolve, she said, they find themselves bumping into the business of global custodians, clearing firms, service bureaus and other participants in the securities industry. "Is there a clear dividing line between these functions?" she asked. "How far should CSDs go?"

In formally closing the conference, DTCC's Considine announced that, based



Gilberto Mifano, CEO of the Brazilian Clearing & Depository Corporation, addresses delegates.

on the decision of the regional CSD associations, CSD9 would be held in Asia in 2007, and that serving as co-hosts would be Japan's Securities Depository Center, Inc., and Securities Settlement and Custody organization, together with the Korea Securities Depository and the Taiwan Securities Central Depository.

Speaking on behalf of his co-hosts for CSD9, Michael Lin, the senior executive vice president for Taiwan's central securities depository, said he wanted "to thank DTCC and Brazil's CBLC for organizing such a successful event. We'll see you in Asia in 2007."

*Editor's Note: The conference Web site, [www.csd8.com](http://www.csd8.com), created and operated by CBLC in Brazil, is currently posting conference presentations and related documents to the site in English. @*

# Legacy Broker and Access Networks *Continued from cover*

cost – expected to be in the millions of dollars – of supporting and maintaining them.

“There are many reasons why it is important to upgrade the network, but chief among them is business continuity planning,” said George Perretti, managing director, Business Continuity Planning, DTCC. “The SEC has mandated that we make certain the industry’s communications infrastructure is resilient and protected from a large-scale disruption. However, until all customers complete these network upgrades, any firm accessing our clearing services through the legacy connections could be exposed – as could that firm’s counterparties. The legacy Broker and Access network connections will not automatically ‘fail over’ to DTCC’s multiple remote processing sites, and therefore, do not meet the regulatory requirements.”

DTCC established operations and staff in multiple locations last year, including locations outside the immediate New York City area as well as outside the region. All

of those locations, including multiple data centers, are fully operational, and all critical business functions can be conducted from locations outside the metropolitan area if necessary.

Customers have a choice to migrate their connections either to DTCC’s SMART network, which links these multiple sites, or SIAC’s SFTI network. Firms who choose to use SFTI must connect to at least one access center outside the New York area, either in Chicago, Boston or Philadelphia.

“We had previously stated everyone had to complete the migration from the Broker and Access networks by December 31, 2004. However, it became clear some customers who were working hard against the clock would still have difficulty

meeting that deadline. So we significantly increased the resources dedicated to the update, and relaxed the December deadline,” said Jim Umberger, managing director, DTCC Customer Access.

“But now we’re in the second quarter of

## Network Support Costs

**To avoid Broker and Access network support costs being assessed it is mandatory that customers:**

- Ensure adequate communications connectivity through SMART and/or SFTI. DTCC members using SFTI must connect to at least one access center outside the New York area. These access centers are located in Chicago, Boston and Philadelphia.
- Complete testing of the new pathways.
- Complete full conversion of all input and output for clearing corporation applications directly to/from DTCC through SMART and/or SFTI.
- Cancel the legacy Broker or Access connections.

2005, and it’s an unavoidable fact: further delays will both prevent DTCC from meeting overall business continuity expectations and also impose significant costs on customers. We need everyone on board.” @

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## Paperless Legals Program Attracts AFLAC

*by James Conmy*

The industry’s “Paperless Legals” program, which finished its pilot test only late last year, has grown so fast that it now involves transfer agents generating 85% of all certificate transfer activity at The Depository Trust Company (DTC).

The latest agent to join the program, and the first issuer/agent to do so, is AFLAC, the Georgia-based insurance company which has maintained its own in-house stock transfer service since 1991.

“This will be a huge time savings for us,” said Joan DiBlasi, AFLAC’s senior manager for shareholder services. “We handle ‘legals’ every day, and now my staff won’t have to review all the accompanying documentation, or forward it for additional review, or make copies of everything.” she said.

“Legals” are the industry’s name for stock transfers that must be accompanied by paper legal documents such as birth or death

certificates in order for the transfer to succeed. The “Paperless Legals” program eliminates the need for the accompanying paper documents by having them remain with the institution requesting the transfer.

Instead of forwarding all the documents, the transfer agent simply warrants that it has all the paperwork by affixing its medallion to the transfer request.

“Our attorneys feel we’re covered by the medallion program and can get into the program safely with minimal risk,” DiBlasi said.

“We won’t have a huge savings in processing costs,” she added, “but we will have a huge savings in staff time and effort. That adds up.”

**Editor’s Note:** For more information about paperless legal stock transfers, contact Joe Clemente at 212 855-2425 or [jclemente@dtcc.com](mailto:jclemente@dtcc.com). @

# DTCC Settles \$1.1 Quadrillion in 2004

segments. For equities processing, volume increased 21%; volume rose 17% for U.S. government securities, and mortgage-backed securities declined 4% due to the slowdown in this market; mutual fund volume was up 19%, and insurance services volume for commission, application and premium transactions increased 19%.

DTCC's total revenue climbed to \$1.1 billion from \$947 million in 2003, up 11%. DTCC, which operates on an "at cost" basis, returned \$219 million to customers in discounts and other refunds.

## Customer Satisfaction

One of DTCC's key achievements during the year was a world-class overall customer satisfaction rating of 90% and a rating of 89% for integrity in its customer survey. The survey also found that 86% of the respondents perceived DTCC as "a premier provider of investment servicing solutions," which fulfills a major corporate goal established five years ago.

Among the key transaction highlights from 2004:

- Processed approximately \$4.5 trillion worth of transactions each day. In effect, DTCC turns over the equivalent of the U.S. GDP every 2.7 days.
- Processed \$100.4 trillion in equity, corporate and municipal bond transactions and \$709.8 trillion U.S. government securities.
- Settled \$275.2 trillion in institutional and money market instrument transactions.
- Processed \$45.1 trillion in mortgage-backed securities.
- Handled 103.8 million mutual fund transactions valued at \$1.5 trillion.
- Processed \$11.3 billion worth of insurance applications, premiums and commissions.
- Maintained custody of 2.5 million securities worth \$28.3 trillion.

- Processed a record \$2.3 trillion worth of corporate actions, including reorganizations, redemptions, dividends and interest.

## Future Goals

DTCC also announced the adoption of a new mission statement: "By 2010, to be the acknowledged world-class provider of servicing solutions to financial markets through leadership, innovation, technology, risk management and strategic alliances."

"The new mission statement is intended to unify our purpose and focus our energy," said DTCC Chairman and CEO Jill M. Considine. "There are many drivers of change that continue to challenge the

financial industry, including demographics, technology innovations, the speed of consolidation and globalization. While not losing focus on our core responsibilities of clearing and settlement, we recognize that our customers want a broader range of investment servicing solutions. DTCC is well positioned to be this logical solutions provider to new market sectors and offer a wide array of services."

Considine noted that examples of DTCC's global focus were the launch of services for the over-the-counter derivatives markets worldwide, called Deriv/SERV, and the Global Corporate Actions (GCA) Validation service, which



**Continued from cover**

provides corporate actions information globally.

Deriv/SERV showed exceptionally strong growth in 2004, breaking even in its first year of operation. Deriv/SERV quadrupled its customer base in its first full year of operation, and has rapidly expanded services to include payment reconciliation and equity derivatives. In 2005, it will expand to include matching and confirmation of interest rate derivatives. GCA Validation also showed strong growth, with major offices established in New York, London and Shanghai to collect and validate corporate actions data. In early 2005, the service added Credit Suisse First Boston and JPMorgan Securities as new clients.

Among the other major 2004 accomplishments were:

- Opening of a new operations center in Tampa, Florida, a critical part of the company's business continuity strategy for further diversifying operations to multiple operating and data centers ensuring continued operation under almost any circumstance.

- Obtained the highest rating (AAA/A-1+) for FICC from Standard & Poor's, and confirmed that rating for both DTC and NSCC.
- Completed the insourcing of all NSCC technology applications to DTCC's data complex from the Securities Industry Automation Corp. (SIAC), and began insourcing FICC applications from SIAC.
- Completed virtually all the planned straight-through processing phase steps, including a major redesign of the Continuous Net Settlement System and initial Inventory Management System phases, to allow a shorter settlement cycle if the industry decides to move to something less than T+3 settlement.
- Launched implementation of real-time trade matching (RTTM) for all fixed income securities, and continued development of links that will allow the matching system to support real-time price reporting through the RTTM system input.
- Implemented a series of initiatives designed to further eliminate use of physical securities certificates for equities and other securities.

**Editor's Note:** Full details on DTCC's 2004 results are available in the company's 2004 Annual Report, "What's a Quadrillion?" which is now being distributed. Request for hard copies of the report can be made via DTCC's Web site at [www.dtcc.com](http://www.dtcc.com). @

## Board of Directors *Continued from page 3*

**Diane Schueneman** is senior vice president of Merrill Lynch & Co.'s Global Operations and Infrastructure Service Group. She has been with Merrill Lynch since 1971 and has served in a variety of roles including senior vice president in Merrill Lynch's Global Private Client Services and Technology Division where she was responsible for all banking and brokerage services and technology provided to the firm's retail, middle market and 401K clients. Schueneman currently serves on the board of managers of Omgeo, a joint venture between DTCC and Thomson Financial.



Diane Schueneman

**Timothy J. Theriault** is president and business unit head of Worldwide Operations and Technology at The Northern Trust Company. In this position, he leads the bank's efforts to deliver fully integrated products and services to customers using the latest technology available. Prior to this, he was chief technology officer and head of worldwide technology for the bank. Theriault, a member of The Northern Trust Corporation's management committee, also serves as a director of the Make-a-Wish Foundation, Junior Achievement, the Hinsdale Hospital Foundation Board and various advisory boards for technology companies.



Arthur Certosimo

Outgoing board members include: John W. Cummings, senior vice president and Head of Global Technology and Services, Merrill Lynch and Co., Inc.; George Hrabovsky, president, Alliance Global Investor Services; James Palermo, vice chairman, Mellon Financial Corporation and president, Mellon Global Securities Services; and Thompson M. Swayne, executive vice president, JPMorgan Chase. @



Timothy Theriault

# Agency Lending Disclosure Takes Center Stage: An Interview with Les Nelson

By Edward C. Kelleher

For more than two years, securities industry leaders and regulators have been working to provide greater transparency in agency lending security transactions, emphasizing the need for borrowers, that is, broker/dealers, to know who their principal lenders are and how they can monitor credit exposures and calculate required regulatory capital charges based upon the loans with each principal. Les Nelson, a managing director in Global Securities Lending for Goldman, Sachs & Co., has been leading this effort and served on the Agency Lending Disclosure Taskforce since it was formed in early 2004. The task force has mapped out the steps and timeline that the industry needs to follow in order to meet a February 2006 deadline, a date that was set based on the project plan and in consultation with regulators. @dtcc asked Nelson to discuss the work of the task force, agency lending requirements and how they will impact the industry.

*@dtcc: First of all, will you tell us what an agent lender is and what role they play in the securities industry?*

Nelson: As the name suggests, an agent lender lends securities to borrowers on behalf of other parties who are the actual principals in the transaction. For example, if a borrower comes to an agent lender – say, someone like State Street – and requests 5,000 shares of XYZ stock, State Street will lend these shares and will allocate the loan to various funds and institutions that participate in its lending program – say 1,000 from a pension fund, 2,000 from a mutual fund and 2,000 from another fund. Then in one transaction, they will lend the shares to the borrower. The agent lender, however, remains a go-between and is not a principal in the transaction.

*@dtcc: When did regulators first look at agency lending disclosure issues and what was it that prompted them to do so in the first place?*

Nelson: In early 2003, the Securities and Exchange Commission (SEC) approached the industry with concerns about the level of information provided borrowers by the agent lender. There had been an industry default that many connected with the regulators' inquiries,



Les Nelson, Goldman Sachs and Co.

but really their concern was that the industry follow existing guidelines and that borrowers be given more information on who their lenders were.

The SEC was joined by the New York Stock Exchange in a series of discussions that began with the Securities Industry Association's (SIA) Capital Committee, and later the Securities Lending Division of the SIA. I was president of the division at the time, and that's how I first became involved. It was after these initial discussions that an industry task force was formed in January 2004 with representatives from the SIA, the Risk Management Association's Committee on Securities Lending, The Bond Market Association and other organizations, including

DTCC. To date, we have more than 240 active members on the task force in various working groups, including credit, capital, infrastructure, legal, and testing, and have a consulting firm, Capco, as the project manager to help direct the effort.

*@dtcc: Essentially, what were the greatest concerns when the task force began its work?*

Nelson: There was a definite lack of transparency in this business, and the borrower didn't know, on a loan-by-loan basis, who the underlying counterparties, or principal lenders, were. This has implications for credit and capital aspects of the business. From a credit perspective, if you don't know who the ultimate counterparty is, then you can't determine your credit exposure on any given day. In addition, there are very specific capital rules intended to capture the exposure that a broker/dealer borrower has to a lender and vice versa. Let's just talk borrower to lender in this case. If a borrower has collateralized a lender at greater than 105% of the value of securities borrowed – 105% is specified by existing regulations – the borrower may be required to take a regulatory capital charge as a result of that exposure. But if the borrower doesn't have the information from the agent

lenders on who the underlying loan-by-loan counterparties are, it's impossible to do this capital monitoring and determine if a capital charge is needed with respect to the individual principals to whom the broker/dealer has exposure.

*@dtcc: Can you provide an example where these rules come into play and explain why a borrower may have to take a capital charge?*

Nelson: Let's say that I borrowed one share of stock from you that is currently selling at \$100. You deliver the share and I give you cash collateral of 102%, or \$102 - more specifically, you've debited my account at DTC for \$102. Let's say the stock drops in price that day from \$100 a share to \$95 a share. I see an exposure the next morning of \$7, a stock loan worth \$95 versus the \$102 collateral that I gave you.

U. S. regulators, as I mentioned, allow borrowers to provide collateral worth up to five percent more than the value of what is borrowed. Beyond this level of over-collateralization, regulatory capital charges are required due to the exposure that the borrower has to the lender. Continuing our example, if our counterparty goes bankrupt, there will be a shortfall of \$7 in the value of the stock versus the collateral we've provided...take that number and multiply it by the hundreds, thousands, or millions of shares you've actually borrowed.

What we can do here is "cure" that exposure, for example, by doing a "mark to market" and getting back some of my collateral in order to reduce the collateral level to less than 105 per cent. And if I do this within 24 hours of when the exposure occurred, I don't need to take a capital charge.

*@dtcc: So what will the requirements call for lenders and borrower to do?*

Nelson: Basically, the task force recommendations call on the agent lender to provide data to the borrower so their credit departments and groups

that monitor regulatory capital are able to determine credit exposure on a principal-by-principal basis every day, and allow them to calculate capital charges that exist if the exposures are greater than 105%, again at a principal level. This data will allow borrowers to monitor the amount of credit exposure they have with each principal lender, so they can say "Okay, for XYZ Pension Plan, here's the market value of what I'm borrowing, here's the market value of the collateral I'm giving and this is the amount of exposure that I have."

## **"Both regulators and the SIA Securities Lending Division turned to DTCC at the start of the project because of DTCC's connectivity throughout the entire financial services industry."**

*@dtcc: Will borrowers need a whole new recordkeeping system to meet these requirements?*

Nelson: We were concerned about the bookkeeping issue and we spent a long time talking to the regulators about this because the impact on our business could have been very serious.

For example, if Goldman Sachs borrows 60,000 shares of General Electric stock from JPMorgan Chase, we currently book one loan in Chase's name on our securities lending system.

Regulators at first indicated that our books and records should reflect who the actual principal lender is on a loan-by-loan basis...so you would have to record that of the 60,000 shares, 12,000 was borrowed from pension plan ABC, 8,000 came from this mutual fund, 14,000 from this entity and so on. Factor into this that there are thousands of underlying counterparties, and you see how this would seriously burden the borrowers in terms of the dramatic increase in the number of loans they would have to book and the corresponding increase in transactional activity. Also, agent lenders were concerned about the broker/dealers' securities lending trading desks becoming aware of the loans being made from individual principal lenders' portfolios and the possibility that the broker/dealers would attempt to establish direct relationships with the principal lenders.

Taking both of these factors into account, the regulators agreed that the borrowers wouldn't have to book the individual loans by principal lenders, but the records transmitted by the agent lenders would have to be retained in accordance with existing regulations relating to books and records.

*@dtcc: Agent lenders will still have to transmit information on a loan-by-loan basis. Isn't that still a tremendous undertaking?*

Nelson: Of course it is, and it's why this is a multi-year project. We calculated that somewhere between three and four million individual loan records will need to be transmitted each day to borrowers from the agents they're working with. And that number is expected to grow at an annual rate of 20%. The amount of information processing will be enormous.

*@dtcc: What role has DTCC played in these discussions thus far, and what will be its role going forward?*

DTCC has been involved from the start and plays a [continued on page 14]

# No-More-Paper Campaign Kicks Off, Talks About Savings Millions of Dollars

By James Conmy

In a style reminiscent of a political campaign, right down to campaign buttons, DTCC kicked off an anti-paper securities campaign during the Securities Industry Association's 32nd annual Operations Conference and Exhibit in May.

"Processing physical securities eats up millions of dollars every year," said Janet Wynn, managing director of DTCC's Asset Services unit. "We want to help people in the industry understand where these costs come in and how to avoid them if possible."

Conference attendees received distinct campaign flyers each day of the conference as well as buttons showing a cancelled certificate and listing DTCC's special email address – **nomorepaper@dtcc.com** – for questions about how to save on physical certificate processing costs.

The flyers, all part of DTCC's new "no-more-paper" series, focused on the average monthly savings brokerage firms and custodians can gain by avoiding paper-based transactions, including corporate actions, withdrawals-by-transfer, "legals" and restricted securities.

Many securities traded in U.S. markets today are paperless, including corporate and municipal bonds, U.S. government securities, money market instruments, asset-backed securities, financial futures and options, commodity futures and options and, most recently, U.S. savings bonds.

"Equities are one of the last



vestiges of paper," Wynn said. "But if people can get by without passbook savings, they should be able to do the same with their securities."

According to the "Idea No. 2" flyer in the series, many brokerage firms, custodians and transfer agents can generate estimated savings each year approaching \$1 million simply by using DTCC's programs and services to process securities or to keep electronic assets from being converted into paper certificates.

DTCC is working closely with the Securities Industry Association, which has been leading dematerialization efforts for the industry and estimates that the annual cost for processing paper certificates is \$250 million.

Wynn said DTCC is focusing its campaign on three targets:

- Getting the industry to look at its real costs for handling paper certificates and understand what it can do to reduce them immediately;
- Educating investors about alternatives to paper certificates, which are costly to handle and keep safe; and
- Working with the various states that still require companies to issue paper certificates.

"The main reason we still face the costs of handling paper

certificates," Wynn said, "is that some investors continue to ask for them and several states continue to require companies to issue them. Our goal is to educate both investors and lawmakers about how much paper certificates cost us all."

**Editor's note:** Questions about how to cut paper processing costs can be addressed to **nomorepaper@dtcc.com**.

The first four flyers in the "no-more-paper" series will soon be posted on the DTCC Web site, **www.dtcc.com**. @



## Industry costs for paper certificates

The cost<sup>1</sup> of issuing, storing and processing paper certificates every year:

DTCC physical security handling costs	\$ 86,300,000
Lost or stolen certificate replacements costs	49,400,000
Broker/dealers and custodian banks costs	48,500,000
Transfer agent service costs	45,000,000
Costs for issuing paper certificates	15,400,000
Securities Information Center operating costs	5,400,000
<b>Total</b>	<b>\$250,000,000</b>

# FICC Launches Real-Time Interactive Messaging Link to NASD for Corporate Bond Price Reporting

**Both Trade Matching and Price Reporting Come Together in One Seamless Process** *By Rosalie Jenkins*

Helping to satisfy an industry goal to combine real-time trade matching and price reporting into one seamless process, Fixed Income Clearing Corporation (FICC) recently enhanced its Real-Time Trade Matching (RTTM) service to support regulatory price reporting for over-the-counter (OTC) corporate bond trades.

The initiative, which enhances RTTM's interactive messaging capability, helps customers reduce risk and achieve greater efficiencies for the real-time price reporting of such transactions to the National Association of Securities Dealers' (NASD) Trade Reporting and Compliance Engine (TRACE). FICC is a subsidiary of The Depository Trust & Clearing Corporation (DTCC).

The interactive messaging functionality also will enable participants to meet the new TRACE trade reporting requirements for corporate bonds effective July 1, when the time frame for reporting such trades goes to 15 minutes from the present 30 minutes.

RTTM's new interactive messaging link for corporate bond price reporting was modeled after the one now being used for submitting municipal bond prices to the Municipal Securities Rulemaking Board (MSRB). That system went into effect January 31, 2005 and requires trade reporting within 15 minutes of execution.

"We expect that industry participants will see substantial benefits from this new enhancement because it provides a single pipeline for trade matching and price reporting in one real-time submission, just as we do with municipal bonds," said Jeff Ingber, DTCC's general manager, Fixed Income Clearance and Settlement. "A

single platform augments processing consistency, increases efficiencies and precludes the need to support multiple development projects for various processing functions."

The Fixed Income Group worked collaboratively with another DTCC subsidiary, National Securities Clearing Corporation (NSCC), to enhance NSCC's existing interface between TRACE and RTTM. NSCC operates the netting and settlement services for municipal and corporate bonds and unit investment trusts (UITs), as well as equities.

The Fixed Income Group has closely coordinated testing over the past four months with NSCC participants and the NASD to prepare for the interactive messaging enhancement to TRACE. Customer feedback on the new functionality has been very positive.

Charles Lichter, Brokerage Processing Services vice president of Automatic Data Processing, stated: "We are pleased that FICC and NASD have worked together to improve the NSCC TRACE interface. The real-time link will enable our clients to meet 15-minute reporting and have a single message that satisfies corporate bond trade reporting and trade matching requirements. This is a benefit that brings us closer to achieving straight-through processing."

Essentially, the new functionality allows broker/dealers to submit corporate bond



trade data to RTTM using a single interactive message that serves two purposes. Upon receipt of corporate bond trade data, DTCC immediately forwards a report of the trade to TRACE, while simultaneously passing the data onward internally for matching and, ultimately, clearance and settlement of corporate bond trades by NSCC. The RTTM service currently matches an average of approximately 5.4 million transactions a year in the over-the-counter corporate bond marketplace with a value of \$2.85 trillion.

For clearance and settlement purposes, the RTTM service has been matching corporate bond trades in real-time since June 2004, when the service was rolled out for corporate and municipal bonds and UITs. But DTCC did not provide real-time price [continued on page 12]

# DTCC Annual Report Highlights Settlement Milestone

By John Celock

**D**TCC's 2004 annual report, which highlights the corporation's settlement of more than \$1 quadrillion in securities transactions last year, is currently being distributed.

With the theme of "What's a quadrillion?" DTCC explores the magnitude of the figure (\$1,000,000,000,000,000) and the company's successful efforts to handle the industry's ever-growing trade volume. During 2004, DTCC settled approximately \$4.5 trillion worth of transactions each business day, which means the company turns over the equivalent of the U.S. gross domestic product every 2.7 days.

Also discussed in the report is DTCC's updated mission statement, which is "to be the acknowledged world-class provider of servicing solutions to financial markets."

In her letter to the company's stakeholders, DTCC Chairman Jill Considine wrote that "Our new mission statement is intended, once again, to unify our purpose, focus our energy and build on the momentum of the last five years. While many of the drivers of change continue" from 1999, when DTCC was formed, she said, "the speed of consolidation and globalization present even greater opportunities for DTCC to become a logical solutions provider in the financial services industry."

The report offers a consolidated look at DTCC's financial performance for 2004, including the contributions by its various

subsidiaries. DTCC reported an 11% increase in revenues to \$1 billion from \$947 million the previous year. Rebates and discounts to customers totaled \$219 million.

In response to frequent requests from customers, regulators and others, DTCC tucked into the back of its report this year a pamphlet giving an overview of the company's role in broker-to-broker and institutional trade processing.

One other special section in the report includes a case study of DTCC Deriv/SERV, the service the company launched in late 2003 to bring matching and confirmation to credit derivatives such as credit default swaps, equity derivatives including stock futures and options, and interest rate derivatives such as interest rate swaps and swaptions.

*Editor's Note:* Customers interested in receiving copies of the report can e-mail a request to [info@dtcc.com](mailto:info@dtcc.com) or fill out the request form at [www.dtcc.com/Publications/newssub.htm](http://www.dtcc.com/Publications/newssub.htm). They can also read the report online at [www.dtcc.com/AboutUs/annual.htm](http://www.dtcc.com/AboutUs/annual.htm). @



## Corporate Bond Price Reporting

*Continued from page 11*

reporting via RTTM for corporate bonds until now.

Ed Fanning, vice president of Product Management, explained that the previous NSCC-to-TRACE interface for corporate bond trades only provided TRACE Accept/Reject data via batch processing. So NSCC participants using this interface still needed to separately monitor the NASD TRACE Web screens to view the trade status for both customer and street side activity, and then input trade corrections directly on the TRACE screen.

"With this enhancement, NSCC participants can now obtain TRACE acknowledgement and reject messages on a real-time basis via RTTM," Fanning said. "They have the option to instantly monitor these output messages for further action through the RTTM service, or they can continue to utilize the TRACE Web screens.

"The FICC TRACE interface supports initial Trade Instructs,"

Fanning added. "FICC and NASD are also evaluating how the NSCC TRACE interface can be further expanded to support Cancels, Modifies, Reversals and DK's in the future."

The RTTM rollout for corporate and municipal bonds and UITs last year marked the last stage of FICC's multi-year effort to bring RTTM to all fixed income products. The DTCC subsidiary introduced RTTM for U.S. Government securities in 2000, followed by mortgage-backed securities (MBS) in 2002. Today, about 98% of all U.S. Government securities trades representing an average daily value of some \$2.4 trillion, and about 87% of MBS trades representing an average daily value of \$274 billion, are submitted daily in real time to RTTM. About 90% of corporate, municipal bonds and UITs are submitted via interactive messaging for matching with an average daily value of \$18.6 billion. @

# DTCC Forms Alternative Investment Products Advisory Committee by Karen Gregory

**D**TCC has announced the formation of an industry advisory committee on alternative investment products to develop an automated, centralized and streamlined approach to the processing of these instruments.

Comprising a cross-section of the industry, the advisory committee will look to leverage DTCC's existing infrastructure in support of the industry as it seeks to keep pace with current and future demands of a market that is undergoing explosive growth.

In recent years, the alternative investment market has been booming, with increases in both the amount of money being invested in these instruments and in the different types of alternative investments being offered, which today include hedge funds, managed futures, private equity/debt, and other nontraditional stock and bond instruments. According to *The Wall Street Journal*, investments in hedge funds alone have more than doubled to \$1 trillion in assets from \$400 billion since 2001, and some predict they will grow to more than \$4 trillion by 2010.

The majority of these trades are processed manually, making the complex paperwork labor-intensive and time-consuming. For example, paper-based matching and confirmations can literally take weeks to complete, a huge impediment given the size and complexity of some of these transactions. Where technology is used, it is largely expensive, unscalable and proprietary; and there is no single, standard system for processing trades of alternative investment products.

"This is a great step forward for alternative investments and hedge funds, specifically," said Robert Alderman, managing director and head of Alternative Investments for Merrill Lynch's Global Private Client Group and a member of the advisory committee. "As the industry continues to grow, efficiency has become more important, and the work being done will address this growing need."

"The alternative investment products industry is at a crossroads, much like mutual funds were 20 years ago," said Ann Bergin, managing director for Mutual Fund Services at DTCC and head of the advisory committee. "In the mid-1980s mutual funds were processed in a manual environment, but were growing by leaps and bounds. We're seeing the same situation today with alternative investment products. DTCC is working closely with the industry to build a solution, in much the same way we helped the mutual fund industry with Fund/SERV® and our other services."

Fund/SERV, introduced in 1986, is the industry standard for

processing and settling a broad range of investment funds and for linking fund companies with their distributor partners, including broker/dealers, banks and financial planners.

Bergin added that strong collaboration with industry members was a focal point of DTCC's business strategy. "By establishing customer involvement as early as possible in the research and development stage, we can ensure that a business can achieve critical mass and will be self-sustaining," she said.

As a first step in its needs assessment, the Steering Committee surveyed its members on a range of issues, including alternative investment products deemed to be priorities for automation, current and projected transaction volumes for various investment products, and preferred technology platforms on which solutions can be developed. Based on the survey results, the committee will focus its immediate attention on five areas: new accounts and subscriptions, purchases and redemptions, commissions, position reporting, and account maintenance. Additional areas of focus may include data exchange, such as prospectus information, breakpoints and rights of accumulation, offshore transactions, and exchange-traded funds. @

## Firms Team with DTCC for Alternative Products

**R**epresentatives from 15 financial firms will work with DTCC to study standard platforms for processing and settling alternatives investment products.

Participating firms include:

- Bear, Stearns & Co., Inc.
- Charles Schwab & Co., Inc.
- Man Investments Inc.
- Merrill Lynch & Co., Inc.
- Milestone International Asset Management
- Morgan Keegan & Co., Inc.
- Morgan Stanley
- Piper Jaffray & Co.
- Raymond James Financial Inc.
- RBC Dain Rauscher Inc.
- Rydex Capital Partners, a division of Rydex Investments
- Smith Barney, a division of Citigroup Global Markets, Inc.
- The Torrey Funds
- Tremont Capital Management, Inc.
- UBS Financial Securities Inc.

# An Interview with Les Nelson Continued from page 7

critical role in the project. Margaret Koontz and Tom McCarthy have been working with the task force since day one, as well as coordinating DTCC's efforts with regulators like the SEC. Industry officials suggested that DTCC act as the communications hub when an agent and its borrowing counterparty are using different vendor systems (e.g., Loanet and EquiLend). If agent lenders and borrowers are on the same technology platform, they can transmit information directly from one to another. Otherwise, regulators want them to use DTCC as their communications hub. Also, DTCC's role as the communication hub creates the opportunity for agent lenders and borrowers to not use a vendor as an intermediary, instead interacting directly with DTCC in sending and receiving the files associated with this project. Both regulators and the SIA Securities

Lending Division turned to DTCC at the start of the project because of DTCC's connectivity throughout the entire financial services industry. The connectivity that DTCC provides is critically important given the variety of systems that agents and broker/dealers choose to use and the amount of data that will be moving each day among industry participants.

*@dtcc: Can you discuss the timetable for implementation? Is everything and everyone on schedule for February 2006?*

Nelson: Actually, we've planned two separate implementations. The first is for the credit pre-qualification process. Firms should have testing completed by June 30. During July, the industry will send and receive incremental add/delete requests for credit prequalification of new principals. On August 1, we will begin a three-month period during

which borrowers will receive lender information in order to requalify existing principals. This process is scheduled to be completed by the end of October. The second implementation is for the daily detailed loan file. We hope to have this completed by the end of February 2006.

What is very important is for each firm to be doing its internal technology development in order to meet the schedule. Any firm that is not doing so already will have lots of catching up to do. If they have not done so already, firms really need to get someone in their organizations involved in the work of the industry task force so that they have someone who knows exactly what's going on.

**Editor's Note:** For more information on the Agency Lending Disclosure Taskforce, visit [www.stp.capco.com](http://www.stp.capco.com). @

## Insurance Services Will Host Fourth Annual User Meeting in June by Judith Inosanto

DTCC's Insurance Services will be hosting its fourth annual User Meeting in New York City June 9–10 at the Marriott Financial Center.

Approximately 150 customers in operations, compliance and technology from both insurance carriers and broker/dealer firms will attend. Service providers and third party vendors who partner with Insurance Services for straight-through processing and integrated solutions also will attend the user meeting.

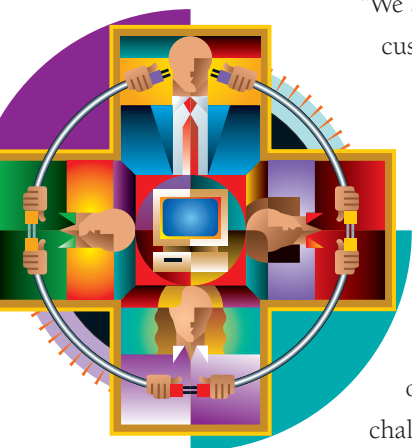
"We are excited to be able to bring our customers and vendor partners together to discuss the key issues of importance to the industry, including recent developments, the regulatory landscape, and how Insurance Services products are being applied to meet today's operational and compliance challenges," said Lana Macumber,

director, DTCC Marketing and Business Development. "Since hosting this event four years ago, it has evolved into an effective way to encourage market participants to share ideas and collaborate on ways to bring better efficiency into the insurance marketplace.

"We're also inviting other firms interested in Insurance Services to attend the meeting as well, so they can learn first-hand about our services and how we're working with the insurance industry," said Macumber.

Speakers will include senior members of the Insurance Services team, representatives from leading trade organizations such as the Securities Industry Association, insurance carriers, the broker/dealer community, and partnering vendor organizations. Sessions such as "Get a Life – Focus on Life Processing" will cover some of the challenges the industry faces in automating life insurance processing. Another session will focus on the impact of both proposed and enacted federal and state legislation.

For more information on the conference please call Insurance Services at 212-855-4477 or e-mail: [insurance@dtcc.com](mailto:insurance@dtcc.com). @



# DTCC Hits New Record for Transactions Processed on April 15

by Edward C. Kelleher

**D**TCC processed a record 34.8 million transactions on April 15, surpassing by 8% the previous record of 32.2 million transactions set on January 4, 2005.

DTCC, through its National Securities Clearing Corporation (NSCC) subsidiary, provides clearance and settlement services of virtually all broker-to-broker trades done on the New York Stock Exchange, Nasdaq, the American Stock Exchange and all the regional exchanges and electronic communications networks

(ECNs) in the United States.

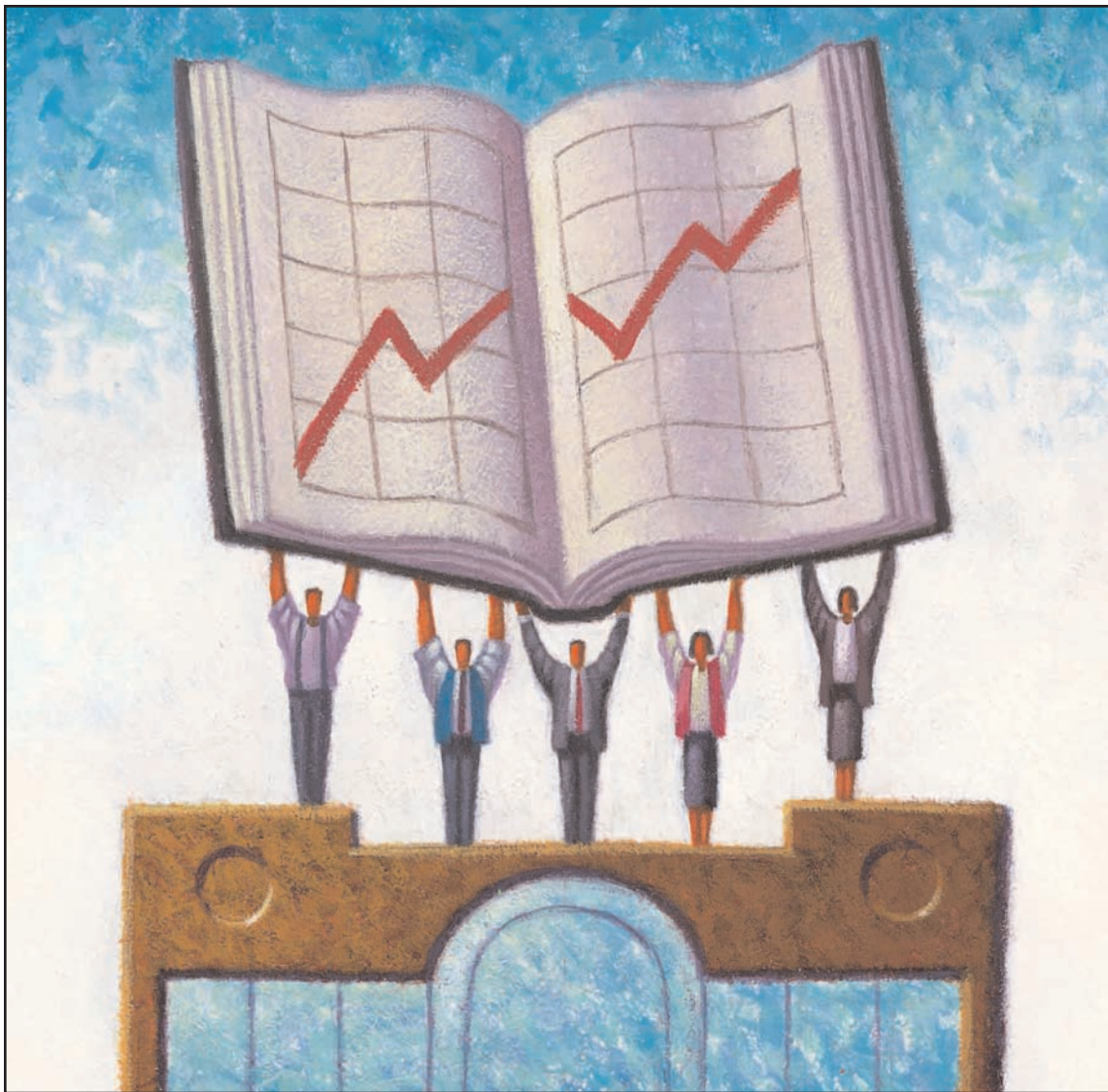
“This is the second time this year that we’ve seen a new daily record for the number of processed equity transactions,” said Thomas Costa, DTCC managing director and general manager for Equity Clearance and Settlement. “The average daily volume for the first three months of 2005 alone is well above last year’s daily average volume – 26.2 million transactions in 2005 versus an average of 22.9 million transactions in 2004.

“But staying ahead of the curve is a high priority at DTCC and we continually expand our capacity to handle unpredictable spikes in volumes as they occur,” he added

In 2004, DTCC for the first time cleared and settled securities trades worth more than \$1 quadrillion (\$1,000,000,000,000).

AT NSCC, each transaction represents either one buy or one sell side of a trade. The 34.8 million transactions on April 15 represented a total of 4.6 billion shares traded that day.

Aside from providing the capacity to process transactions on high volume days, NSCC also reduces the number of trade obligations requiring financial settlement through a process called “netting,” which both minimizes securities movement and reduces risk for the industry. On the peak day of April 15, NSCC reduced financial obligations from \$768.3 billion to \$16.9 billion, a netting factor of 98%. @



Here is a summary of April 15 transactions compared to other record days in 2005 and 2004:

	May 10, 2004	January 4, 2005	April 15, 2005
<b>Transactions</b>	30.2 million	32.2 million	34.8 million
<b>Value of Transactions</b>	\$494.6 billion	\$550.5 billion	768.3 billion
<b>Final Settlement Value</b>	\$12.5 billion	\$11.6 billion	\$16.9 billion
<b>Netting Factor</b>	97%	98%	98%

# Nevada Court Dismisses Nanopierce Lawsuit Against DTCC On Naked Short Selling

Follows series of nine other failed suits *By Steve Letzler*

A Nevada court has dismissed a lawsuit brought by Nanopierce Technologies, Inc. against DTCC and its subsidiaries that sought to hold DTCC responsible for the drop in Nanopierce's stock price.

Nevada's Second Judicial District Court in Reno, Nevada, adopted the argument that DTCC's clearing and settlement functions are subject to the oversight and approval of the U.S. Securities and Exchange Commission (SEC) and therefore, under the U.S. Constitution, cannot be challenged under state law, as Nanopierce sought to do. DTCC demonstrated that Nanopierce's attempt to use state law to forbid DTCC from utilizing this program is barred by an established legal doctrine known as federal preemption.



In dismissing the case, Judge Brent Adams stated that "(S)tate law may not be applied as to impose damages on (DTCC). To do this would be to forbid Defendants from doing what the SEC authorized them to do."

The court's decision came after hearing extensive argument and reviewing voluminous documents regarding the Stock Borrow Program and DTCC's clearing and settlement activities. The judge's decision to dismiss the case against DTCC follows a series of nine

other cases that have been dismissed or withdrawn against DTCC.

Nanopierce had filed the case in May 2004 seeking to hold DTCC responsible for the drop in its stock price and claimed that DTCC's Stock Borrow Program had somehow enabled brokerage firms to engage in "naked short selling" of Nanopierce shares. DTCC responded by demonstrating that its clearing and settling activities are extensively regulated by the federal government and that the specific program challenged by Nanopierce, the Stock Borrow Program, had been approved by the SEC.

"We are extremely gratified that the court agreed with us that neither DTCC nor its subsidiaries are proper defendants here," said Larry Thompson, DTCC's first deputy general counsel. "All of our operations are taken in accord with our SEC-approved rules and subject to strict federal regulatory oversight. The Nevada court agreed with us that plaintiffs like Nanopierce cannot attempt to use the laws of 50 states to challenge DTCC's SEC-approved operations designed to ensure stability and uniformity in clearing and settling the nation's securities transactions.

"Plaintiffs' claims that the Stock Borrow Program results in the manufacture of artificial shares is pure invention," Thompson stated. "Only shares that are actually on deposit in a broker's account can be borrowed. We hope that Judge Adams' decision will be taken to heart and the ill-considered litigation and media campaign against DTCC will come to an end."

**Editor's Note:** For more information on this issue, please see "DTCC Responds on Naked Short Selling" at:

[http://www.dtcc.com/ThoughtLeadership/keyissues/naked\\_short\\_selling.htm](http://www.dtcc.com/ThoughtLeadership/keyissues/naked_short_selling.htm); and an SEC update on short selling and Reg SHO at: <http://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm>. @



*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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