



FICC Sets Timetable to Build Central Counterparty For Mortgage-Backed Securities Trading by James Conmy

As part of its long-planned effort to create comprehensive central counterparty capabilities that include guaranteeing the settlement of trades in the \$300 billion-a-day mortgage-backed securities market, Fixed Income Clearing Corporation (FICC) announced in April plans to develop new services that will underpin the proposed central counterparty. FICC is a subsidiary of DTCC.

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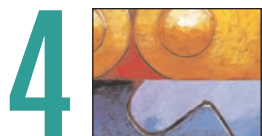
Business Continuity: Customer Connectivity

By Helen Cunningham

A key component of DTCC's business continuity plan entails testing connectivity between certain customers' back-up sites and DTCC's multiple data centers. These tests are conducted at least once a year for three DTCC subsidiaries: The Depository Trust Company (DTC), National Securities Clearing Corporation (NSCC) and Fixed Income

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Retransmittal Capability For CNS Buy-Ins



Screening Physical Securities



New Compliance Solution For Fund Industry

Central Counterparty for Mortgage-Backeds

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Its goal, the corporation said, is to begin phasing in new services now so that it can have full central counterparty capabilities up and running within two years.

FICC, which cleared \$75.6 trillion in mortgage-backed securities transactions last year, laid out its plans for building the new services in a paper called “A Central Counterparty for Mortgage-Backed Securities: Paving the Way.”

“When we get the central counterparty fully operational, we expect to lower clearing costs, reduce operational and counterparty risk, decrease our customers’ capital charges and bring down the fail and financing expenses of our clearing members,” said Thomas Costa, managing director of DTCC Clearance and Settlement and head of FICC. “After several years of planning, extensive discussions with our customers and a thorough analysis of required systems capabilities, we’re primed to get started,” Costa said.

In trading mortgage-backed securities, financial institutions use the Electronic Pool Notification service operated by FICC’s Mortgage-Backed Securities Division to allocate pools of mortgages to their trading positions. Because FICC does not function as a central counterparty for these trades, however, every obligation remaining after completion of the netting process must be allocated and then subsequently settled separately with each individual counterparty, which results in a series of disconnected processes.

Phased transition

In order to help the industry transition to a more efficient “straight-through” central counterparty model, FICC plans to phase in implementation of the services necessary to support the new central counterparty in three separate steps.

• **Phase I:** FICC will allow for the

matching of specified pool trades via its real-time trade matching (RTTM) service. Scheduled for customer testing in the fourth quarter of 2006, “specified pool trade matching” will enable mortgage-backed securities trades to be submitted into FICC’s real-time trade matching service for bilateral matching when both parties to the trade agree – at the time the trade is executed – exactly which pool number needs to be delivered on settlement date.

- **Phase II:** This phase involves simplifying and automating the routines for substituting the mortgages allocated to a pool. This step is scheduled for customer testing during the first quarter of 2007, with production roll-out to members during the second quarter.
- **Phase III:** This phase will allow for central counterparty netting – and guaranteed settlement – of specified pool trades, as well as pools allocated to a trade position. Tentatively scheduled for introduction by year-end 2007, this will eventually allow for full, multilateral pool netting and means that FICC will step in as a central counterparty to net pool obligations.

Costa noted that FICC has been in discussion with its customers who trade mortgage-backed securities since the publication of a white paper in 2003 that first broached the idea of creating a central counterparty. The creation of an industry working group in 2004 helped move the project along, he said.

The schedule to complete the project is ambitious, according to Susan Tysk, managing director for Product Management in DTCC’s Clearance and

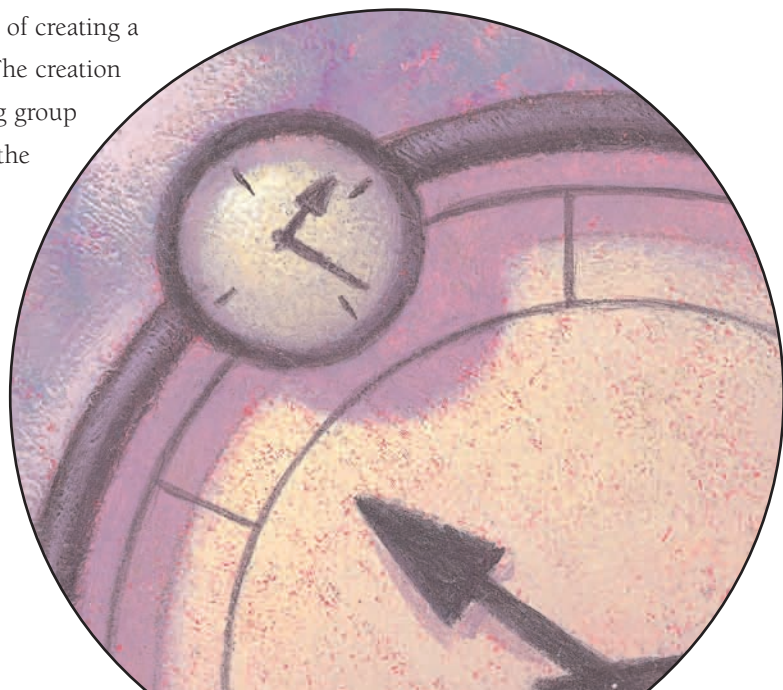


Thomas Costa, managing director, DTCC Clearance and Settlement and head of FICC

Settlement Group. “We’ll be working closely with market participants to review outstanding issues, clarify business requirements critical to implementing the three phases, and define new industry practices or processes that may need to be adopted,” said Tysk.

FICC’s Government Services Division currently provides central counterparty services for trades in U.S. government securities, while another DTCC subsidiary, National Securities Clearing Corporation, supplies central counterparty services for trading obligations in equities, corporate bonds and municipal bonds. @

[To obtain a copy of the position paper, visit www.dtcc.com; under Thought Leadership, click White Papers.]



DTCC Completes Change in Share Ownership By Steve Letzler

DTCC recently completed a major change in the organization's ownership structure through a redistribution of common shares. At the end of March, the first annual share redistribution under the new arrangement was completed.

The new structure, approved by DTCC's shareholders in November 2005 and the Securities and Exchange Commission (SEC) in December 2005, for the first time made it mandatory for many participant firms to purchase DTCC stock. The redistribution involved the sale of DTCC common stock by the New York Stock Exchange (NYSE), the NASD and the American Stock Exchange, which altogether had held 36.4% of common shares. Both the NASD and NYSE will continue to hold preferred shares in DTCC, which gives each the right to name a director to the DTCC board.

"The DTCC Board felt the time was right for participants to take steps to ensure that DTCC remains a user-owned and user-governed organization," said Richard Nesson, DTCC executive managing director for Legal, Regulatory and Compliance, and corporate secretary of the organization.

Nesson added that ownership of DTCC common shares is not a financial investment, but a vehicle for supporting DTCC and influencing its policies and operations through the election of directors. "It is only through such ownership and participation in DTCC's governance that users can assure DTCC's clearing agencies continue to operate 'at cost,' providing users with monthly discounts and/or other refunds of excess revenues."

Specifics of the new structure

The DTCC Board of Directors voted to change the organization's ownership structure at its August 2005 meeting. DTCC subsequently asked shareholders to approve the proposed requirement for mandatory share purchases. Holders owning in excess of 86% of DTCC's common shares voted in favor of the proposal. That was followed by the submission to the SEC of related rule filings by The Depository Trust Company (DTC), National Securities Clearing Corporation (NSCC) and Fixed Income Clearing Corporation (FICC).

Previously, DTCC common shares were allocated and made available for participants to purchase, although no firm was required to purchase shares. Participant firms were given

the option to purchase shares on a pro-rata basis up to a maximum, commensurate with their use of DTCC's services. Under this arrangement, about 190 firms were shareholders of common stock.

Under the new structure, certain firms are required to purchase shares, while others have the option but are not required to do so. DTCC's total of 23,655 shares outstanding remains the same.

Under the terms of the clearing agencies' rules, firms required to purchase DTCC stock are: all participants of DTC except for "limited participants," and all participants of NSCC and FICC that receive a trade guarantee.

Voluntary shareholders are firms that do not make full use of the services of the operating subsidiaries. These include "limited participants" of DTC (mostly transfer agents); mutual fund and/or insurance services only members and "municipal comparison only" members of NSCC; "comparison only" members of the Government Securities Division of FICC; and participants or limited-purpose participants of the Mortgage-Backed Securities Division of FICC.

Firms that are not either mandatory or voluntary participants and do not have the option to own DTCC common shares are participants of NSCC that are "data service only" members or "third-party administrators," and "sponsored members" of FICC.

Mandatory purchaser participants were required to buy shares up to their allocated amounts of share entitlements, as well any DTCC common shares that voluntary purchaser participants elected not to buy. @



DTCC Adds Retransmittal Capability to CNS Buy-Ins By Steve Letzler

DTCC has added a 24-hour Continuous Net Settlement (CNS) buy-in retransmittal capability to its new SMART/Track for Buy-Ins service, the latest move in a multi-step rollout of the service.

In February, DTCC began full-scale operation of the new Web-based system that standardizes and automates the creation, delivery and tracking of buy-in notices. This first phase provides the ability to submit intentions, orders and executions of buy-in notices done through National Securities Clearing Corporation's (NSCC's) CNS system.

At the end of March, following approval by the Securities and Exchange Commission, DTCC added a new feature that allows a long participant (the broker purchasing the shares) who is receiving a buy-in initiated outside of CNS to retransmit it to CNS, with as many as five parties in the chain.

"The Ad Hoc Buy-In Committee of the Securities Industry Association and the industry were critical players in the development of this feature," said Margaret Koontz, DTCC director, Product Marketing and Development. "The industry requested this feature, since it will help reduce risk to the long participant by allowing that firm to retransmit the buy-in to CNS, which will, in turn, pass the liability to the short participant. This required a modification to the CNS buy-in system to receive same-day buy-ins and to pass the same-day liability to short participants."

Coming in May

DTCC plans to launch a multiple-entry screen feature on SMART/Track for Buy-Ins for CNS buy-in intents and orders in May, according to Koontz.

"One of the immediate issues we heard about from our customers entering CNS

intents and orders was that they wanted to be able to enter multiple CNS buy-ins at one time, rather than entering each one individually, as the current system requires," Koontz said. "We decided this capability was sufficiently important to be introduced before we added non-CNS buy-in capability to our system. As a result, the non-CNS capability will be postponed from our original schedule of mid-year; we now plan to have it

operational in late summer/early fall."

The multiple-entry screen feature will allow the 267 firms now using SMART/Track for CNS Buy-Ins to enter up to 15 buy-in entries at a time, with defaults added in certain required fields that participants will be able to override.

Koontz noted that currently between 2,500 and 2,800 CNS buy-in intent notices are being submitted daily through the SMART/Track for Buy-In system. @



Overview of SMART/Track for Buy-Ins

Buy-ins are generated by a long broker to close out an open fail with a counterparty. The long broker that is expecting delivery of the securities sends a buy-in notice to the delivering broker saying that it plans to go to the market to buy the securities if they are not delivered by a specified date and will hold the delivering broker liable for any price variation or difference. In other words, if the stock was first promised at \$10 a share by the broker, and now sells for \$12 a share, the long broker will hold the sell-side broker accountable for the \$2-a-share difference.

SMART/Track for Buy-Ins provides a central information point that enables participants to create and send buy-in notices and, in the case of a CNS buy-in, to execute it if necessary. The system also tracks the life of a buy-in notice. It will retain data for seven years for both CNS buy-in notices and broker-to-broker or non-CNS buy-in notices. The system is browser-based and will replace the Participant Exchange (PEX) service, which currently serves as a messaging facility for buy-ins, when the non-CNS functions are added later in the year.

Depository Strengthens Program For Screening Securities

By Karen Bray

The Depository Trust Company (DTC) has implemented new procedures for the handling of physical securities to ensure full compliance with regulations of the Office of Foreign Assets Control (OFAC), a division of the U.S. Department of Treasury.

For any physical security transaction that is processed through DTC, OFAC requires the industry to perform multiple checks of the security's registration from the point of initiation to the point of completing the transaction. That means DTC, participants (and possibly their institutional clients) and transfer agents are all obliged to scan registrations against the OFAC database.

"Essentially, OFAC requires each organization in the transaction's chain to perform OFAC checks of the individuals and organizations they are doing business with," said Joseph Clemente, DTCC product manager, Asset Services. "DTCC is also required to screen these transactions, even though DTCC plays an intermediary role by passing along the transaction to the transfer agent for processing."

The regulatory environment

OFAC has tightened its expectations for all U.S. financial institutions as part of the government's ongoing efforts to track foreign countries, organizations and individuals that may be engaged in terrorism, narcotics trafficking and other prohibited activities. Firms that process OFAC-prohibited transactions are subject to fines.

"Like the entire industry, DTCC is operating in an increasingly stringent regulatory and compliance environment," said James Balbo, DTCC managing director, Asset Services. "To ensure we

meet the highest compliance standards for the physical securities we hold in safekeeping, we have expanded our procedures for screening certificates."

The OFAC database

OFAC's origins date back to the War of 1812, when the U.S. government administered sanctions imposed against Great Britain for the harassment of American soldiers. OFAC was formally created in 1950 during the Korean War to administer enforcement of the U.S. government's economic and trade sanctions. Today it maintains a database of banned "entities" – including countries, people, corporations and ships – that U.S. companies cannot do business with. This database is constantly updated, as entities are added to or deleted from the banned list.

In the post-9/11 world, OFAC's oversight is increasingly rigorous, and its banned list now includes entities linked to, or supporting, terrorism.

Ramping up

DTC has used an industry-standard software package for periodic OFAC scanning since 2002, according to Patrick Mapp, DTCC compliance director, Office of Corporate and Regulatory Compliance. Now the depository is taking this program to a new level.

"On a regular basis, we are screening DTCC's masterfiles, which contain information on our subsidiaries' customers and securities, against the OFAC database," Mapp said. "In the security masterfile alone,

we are scanning 2.6 million issues for keywords."

What's more, the company has expanded its screening beyond registrations of securities held in DTC's custody safekeeping program to include those involved in securities transfer transactions, whereby DTC re-registers securities per instructions from a participant.

To meet the new requirements for safekeeping securities and processing transfer requests, DTC has fully implemented improved security screening processes over the past six months. Now the company is identifying and prioritizing

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Screening

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additional areas of the depository that require focus, including Deposits and Underwriting, both of which already have compliance enhancement plans in the works.

The screening process

When a scan for certificates in the vaults gets a potential OFAC match, or “hit,” DTC compares the registration details against the information on the OFAC list. For example, if a person’s name on a certificate comes up as a hit, a review is performed to determine if it is a quality match of the person’s first and last name(s). If it is not a quality match, the hit is designated as a false positive.

If it is a quality match, DTC will request additional information from the presenting firm via the Participant Terminal System (PTS). For DTC to determine whether a quality match is valid, customers must provide the necessary data. In most cases, firms will be required to provide the customer’s date of birth, citizenship, residency or passport number to confirm or negate the information on the OFAC file. “This entire process is electronically linked,” said Clemente, which means participants can transmit the information back to DTC via PTS.

A similar process takes place for securities transfer instructions, which participants send DTC seeking to transfer and re-register securities. DTC checks the new registration instructions and, if there is a hit that DTC cannot validate as false, for the transaction to be completed, the participant must provide the required information.

“It’s important for participants to respond to the transfer requests before the established cutoff times, otherwise we will reject the instructions,” said Clemente. “Since our customers are running their own OFAC screening processes, the required information should be readily available and can be easily sent to us via PTS. In fact, we’re asking participants to be proactive about passing along any information they have from their own screenings in order to avoid unnecessary bottlenecks. With the right information, we can resolve issues swiftly.”

Proactive collaboration

Balbo summed up DTCC’s collaborative approach to OFAC screening this way: “We are committed to striking the right balance between meeting our standards for compliance and implementing compliance processes that are as thorough, seamless and efficient as possible for our customers.” @

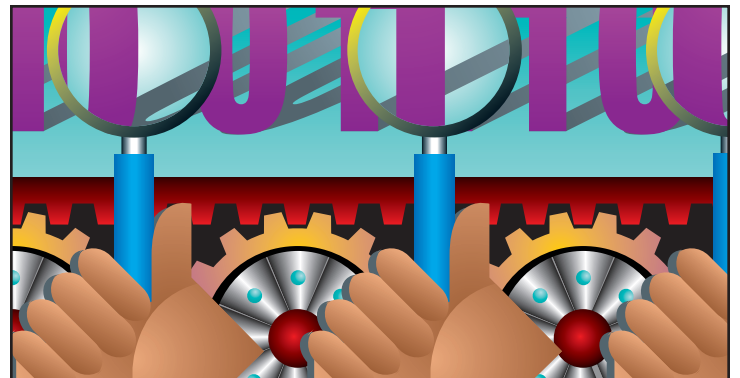
[For more information on DTCC’s OFAC screening program, contact Joseph Clemente at 212.855.2425 or jclemente@dtcc.com.]

DTCC Delivers Another Comp

DTCC is helping to move the mutual fund industry toward compliance with a new Securities and Exchange Commission rule designed to combat short-term trading and market timing.

The solution will expand the functionality of Networking, a core mutual fund service provided by National Securities Clearing Corporation (NSCC), a subsidiary of DTCC, and support the operational needs of industry members that are required to comply with SEC Rule 22c-2, which goes into effect Oct. 16, 2006.

By creating a robust data stream within Networking for fund companies to request and obtain shareholder identity and trading information from intermediaries, Networking will help fund companies better monitor trading frequency by investors whose transactions are housed in omnibus accounts (a pool of individual accounts combined into one account, usually in the name of an intermediary). This will also help ensure that a fund’s market-timing policies are being enforced.



What Rule 22c-2 Requires

SEC Rule 22c-2 requires mutual fund companies to enter into written agreements with their distribution intermediaries whereby the intermediaries, on request, must provide funds with certain shareholder identity information, such as taxpayer identification number, and trading information for positions held in omnibus accounts.

The rule also states that each fund’s Board of Directors approve a redemption fee or determine that imposition of a redemption fee is either not necessary or not appropriate. In either case, a written agreement between trading partners is required.

The rule applies to all funds except money-market funds, exchange-traded funds and funds that permit market timing of fund shares.

Compliance Solution for Fund Industry

By Karen Gregory

“This is an extraordinarily efficient and cost-effective way for the industry to gain access to a level of transparency necessary to ensure compliance with funds’ market timing policies,” said Kathy Joaquin, director of Operations & Distribution, Investment Company Institute. “And a key benefit is that funds and intermediaries can use technology that already exists to request and transmit data needed in standardized formats through a secure industry facility.”

Two levels of information: summary and detail

Intermediaries can pass information in two stages. “The first is at the summary data level where information will be passed for super-omnibus accounts, those composed of multiple plans, trusts and/or investor omnibus accounts,” explained Paul Bucaoto, DTCC director, Product Management. This information may include account numbers, dollar amount and number of buys and sells, and it will help fund companies identify where trading is occurring frequently.

The second stage is at the detail data level, where the fund company may use the data from the summary level to request more specific information. “That would narrow an inquiry to additional details on shareholders in a particular 401(k) or retirement plan, for example, or to information on a financial rep, or to Fund/SERV control numbers,” Bucaoto added. (Fund/SERV is the industry standard for fund purchases, redemptions, exchanges and money settlement.)

Established in 1988, Networking is recognized as the industry standard for automating and centralizing customer account information, allowing for full reconciliation of this information on the records and customer statements of both fund companies and intermediaries.

“The development of this enhancement was a major undertaking in terms of industry coordination aimed at solving one aspect of a significant industry issue,” explained Barbara Simon, DTCC vice president, Product Management. “The regulators have pressed for a solution and we are pleased that we have the technology to be able to develop a solution to meet the October timetable.”

In designing the changes to Networking, DTCC worked in partnership with the Investment Company Institute’s Standardized Data Reporting Working Group and several task forces on the technical design of the processing flow, data elements and data definitions, and also to ensure that the design met industry best practices. “Our goal was to create a solution, within Networking, that meets the requirements of the industry head-on, but also has the

flexibility to be expanded in the future,” Simon added.

Earlier enhancements

Last September, DTCC went live with an initial set of enhancements to Networking and Fund/SERV that automated the processing of short-term redemption fees, charges to investors who rapidly roll in and out of funds before a predetermined holding period has elapsed.

New fields were added to Fund/SERV to allow customers to process and settle the actual fees, as well as identify redemptions that are subject to fees and those where the fee is to be waived.

Enhancements made to Networking enable funds to indicate fees applied to short-term redemptions, and send to firms detailed information on direct redemptions, which are intermediary transactions handled with the fund using communication methods other than Fund/SERV. @



Barbara Simon, DTCC vice president, Product Management

Key Definitions

Here’s a refresher for keeping up with terminology in the mutual fund industry.

Late trading: Buying and selling of mutual fund shares after the official 4:00 p.m. close of the stock market based on the price established by the fund at market close; it is illegal.

Market timing: While trading in and out of mutual fund shares in an attempt to make quick profits is not illegal, it is restricted based on a fund company’s policy. It can harm long-term investors by increasing transaction costs and lowering fund returns.

Omnibus account: Consists of a pool of individual accounts that are combined into one account, usually in the name of an intermediary (such as a broker/dealer, bank, insurance company or retirement plan administrator); the underlying shareholder account information is not disclosed to the fund or its transfer agent.

In recent years, regulators working to curb practices that are illegal or are not in the best interests of investors have focused on omnibus accounts because of their non-transparent structure. Approximately 35% of all mutual funds holding are in these types of accounts, according to The Tower Group, Inc.

New Report Highlights Industry Achievements On Infrastructure Protection

By Nicholas Clarke

From supporting hurricane recovery to combating online fraud to planning for a potential avian flu pandemic, the Financial Services Sector Coordinating Council (FSSCC) for Critical Infrastructure Protection and Homeland Security delivered on a number of key initiatives in 2005 aimed at ensuring the safety and soundness of the nation's financial markets. These and other accomplishments are detailed in FSSCC's 2005 annual report, "Protecting the U.S. Critical Financial Infrastructure," published in March.

"The financial sector continues to make significant progress to ensure its resiliency to withstand both man-made and natural disasters," said Donald F. Donahue, DTCC's chief operating officer, who is also chairman of FSSCC and National Sector Coordinator for Infrastructure Protection in Banking and Finance.

"Since the September 11 attacks, the sector has been challenged by a number of events, including the Northeast power outage in 2003, the elevation of the threat level for financial institutions in 2004 and,

most recently, Hurricane Katrina," said Donahue. "In each case, the sector has demonstrated its capacity to withstand such disruptions and preserve the ability of individuals, businesses and others to conduct their financial affairs."

A shared commitment

"As this report shows, 2005 was a year of both challenge and accomplishment for the financial services sector," said D. Scott Parsons, deputy assistant secretary for Critical Infrastructure Protection and Compliance Policy of the Treasury Department. "The FSSCC is vitally important to our efforts to coordinate infrastructure protection efforts across the financial sector and is rooted in the President's goals and vision for the Treasury Department – a vision that is based on a shared commitment by the federal government, the financial services sector, and state and local authorities."

Among the 2005 accomplishments of FSSCC and its members were:

- Meeting the business continuity standards spelled out in the

2003 "Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System," issued by the U.S. Federal Reserve Board, Office of the Comptroller of the Currency, and the Securities and Exchange Commission.

- Increasing membership by 200% in the Financial Services Information Sharing and Analysis Center, a private-sector group that delivers integrated physical and cyber-alert information to thousands of financial institutions.
- Conducting the sector's largest business recovery test ever – involving more than 150 financial institutions – and participating in Homeland Security's TopOff3 exercise in Connecticut and New Jersey, demonstrating the sector's ability to continue operations in times of crisis.
- Assisting in the creation of FloridaFIRST, a partnership of public and private organizations to strengthen the sector's resiliency against hurricanes and other statewide emergencies.
- Establishing a financial services Research and Development Committee, which will work principally with the Treasury Department and Homeland Security's Science and Technology Division to promote new technologies, policies and procedures to further enhance the sector's resiliency.

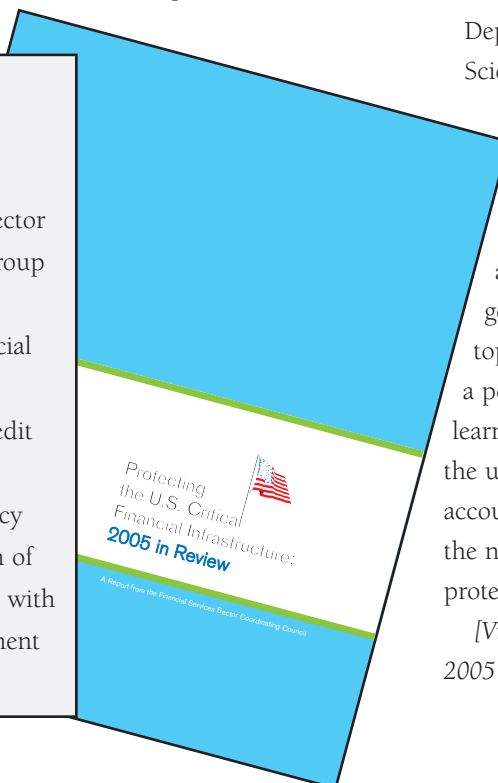
Also in 2005, FSSCC made available to its members and the general public reports dealing with topics including sector preparations for a possible avian flu pandemic, lessons learned from phishing attacks (phishing is the use of fraudulent e-mails to obtain account information from consumers) and the need for regional infrastructure protection coalitions. @

[Visit www.fsscc.org to access FSSCC's 2005 annual report and other materials.]

What Is FSSCC?

Created in 2002 in the wake of 9/11 under presidential directive, the Financial Services Sector Coordinating Council (FSSCC) is a private-sector group of financial institutions and industry associations representing virtually every aspect of the U.S. financial services sector – from clearing and settlement organizations to banks, securities exchanges and credit unions.

The council develops and coordinates major policy issues for the private sector regarding the protection of the critical financial infrastructure, working directly with the U.S. Treasury Department and the U.S. Department of Homeland Security.



Customer Satisfaction: Strengthening Relationship Management

By Helen Cunningham

DTCC's response to the 2005 customer survey included the formation of cross-organizational action teams charged with implementing strategies to improve customer service. These teams are focused on three attributes that drive customer satisfaction: problem resolution, overall customer service and how Relationship Management staffs meet customer needs.

The article that follows provides a progress report on the team focused on Relationship Management. Future articles will cover other teams' activities.

Focal points

"One message that came through loud and clear from the customer survey data was the need for DTCC's relationship managers to spend more time with customers," said Paula Arthus, DTCC managing director, Mutual Fund Services. "Another theme was that customers wanted us to know their businesses better."

To strengthen these aspects of the customer experience, DTCC assembled a team of executives who manage customer relationships from the Deriv/SERV, Insurance Services and Mutual Fund Services business units, along with members of DTCC's Core Relationship Management group, who cover the Clearance and Settlement, Asset Services and Fixed Income businesses.

The team reviewed the customer satisfaction action plans that had been developed by each individual business unit. "We identified best practices and synergies that could be leveraged

across the entire organization," noted Arthus.

"We also wanted to introduce a degree of standardization to our practices, so that all our Relationship Management organizations operate with consistency," said Ann Vece, vice president, Core Relationship Management. "We have customers who use a number of our products and services, and a common approach to relationship management is fundamental."

Customer outreach

To focus DTCC relationship managers on discovering more about their customers, each relationship management team developed detailed account plans for certain customers. These plans serve as a single, centralized source of information on the firm and its relationship with DTCC.

By the end of the first quarter, DTCC had met with and completed action plans for more than 90% of targeted customers. "We're getting good feedback on our outreach," said Arthus, "Our customers believe that when we better understand their businesses – and pain points – we are in a stronger position to anticipate and meet their needs."

The account plans include a business profile of the customer, as well as an overview of its strategic priorities. "This information is a valuable resource for helping DTCC executive management and our business units identify potential opportunities for solutions at an individual customer, market segment or industry level," said Arthus.

Also in the plans is an overview of the customer's relationship with DTCC. This covers services used across DTCC's subsidiaries and targeted joint initiatives – such as testing for business continuity or implementation for Canadian dollar settlement – along with action steps and timelines for achieving them.

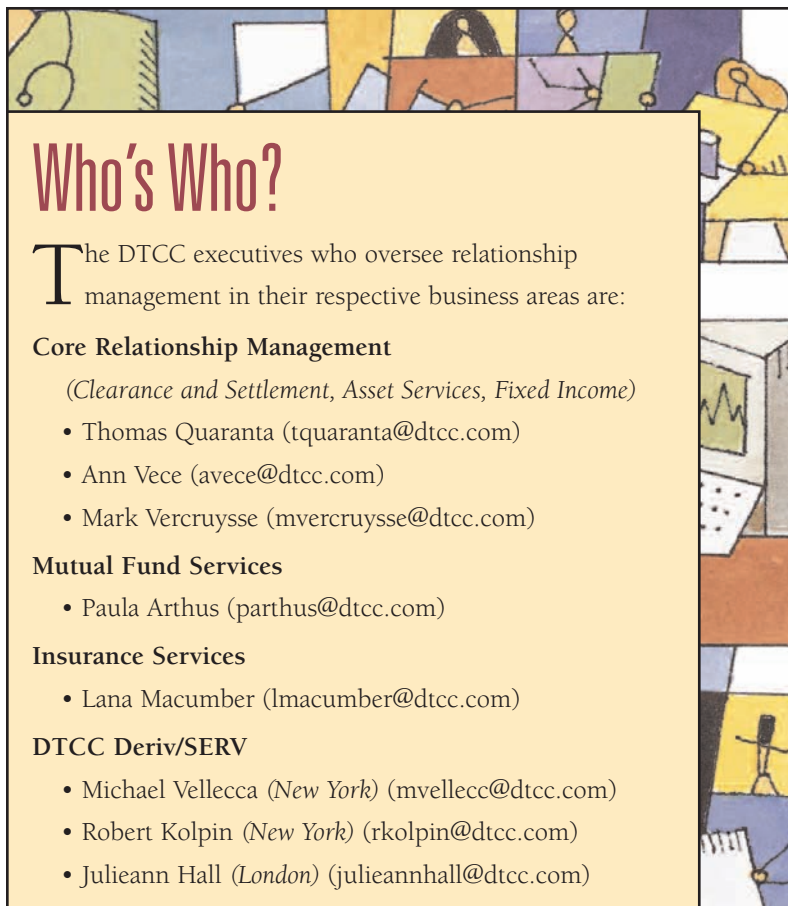
This account planning process emphasizes customer dialogue that is strategically oriented. "We're making it a priority to schedule high-level discussions at least once a year to focus on the big-picture issues facing both the customer and the industry," said Vece. "Given the multiple corporate initiatives DTCC has been working with customers to implement over the last few years, many of our interactions tended to be more tactical in nature."

Better follow-up

A more structured approach to follow-up on customer calls and meetings is another area of focus. "We are formalizing our guidelines for relationship managers to document all customer discussions, including action items and due dates," said Vece.

In addition to ensuring customer action items receive the necessary follow-up and attention, this effort will help keep all DTCC relationship managers up to speed on their customers. It will also raise the bar on existing customer reporting practices, which

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Who's Who?

The DTCC executives who oversee relationship management in their respective business areas are:

Core Relationship Management
(Clearance and Settlement, Asset Services, Fixed Income)

- Thomas Quaranta (tquaranta@dtcc.com)
- Ann Vece (avece@dtcc.com)
- Mark Vercruyse (mvercruyse@dtcc.com)

Mutual Fund Services

- Paula Arthus (parthus@dtcc.com)

Insurance Services

- Lana Macumber (lmacumber@dtcc.com)

DTCC Deriv/SERV

- Michael Vellecca (New York) (mvellecca@dtcc.com)
- Robert Kolpin (New York) (rkolpin@dtcc.com)
- Julieann Hall (London) (julieannhall@dtcc.com)

Deriv/SERV Signs 400th Customer

By Lisa Argento

DTCC signed its 400th customer onto Deriv/SERV in April. This development underscores Deriv/SERV's growing prominence as the largest post-trade service provider in the over-the-counter (OTC) derivatives marketplace. Today, according to major market participants, more than 60% of credit derivatives traded globally are electronically confirmed through Deriv/SERV, up from 15% in 2004.

"Reaching our 400th customer is a significant milestone because it demonstrates strong market commitment to having a single service provider automate the OTC derivatives marketplace," said Janet Wynn, DTCC managing director and general manager, Deriv/SERV. "We expect that before yearend, Deriv/SERV will add at least another 150 firms, primarily from the buy side, to its current customer base."

Deriv/SERV's customers include all of the major derivatives dealers globally, as well as a rapidly expanding base of leading buy-side firms, such as hedge funds, investment managers and insurance companies.

Customer perspective

One of Deriv/SERV's newer customers is Robeco, a buy-side global asset manager headquartered in the Netherlands with offices in Europe, the United States and elsewhere. Robeco provides investment products and services to around 700 institutional and 1.5 million private clients worldwide.

"Deriv/SERV is providing important improvements in the fast-growing OTC derivatives market for instruments like

CDS, CDX, iTraxx and swaps," said Erik van Leeuwen, senior vice president, Business Development – Fixed Income at Robeco. "The growing usage by both the buy side and the sell side to use this platform for legal matching of trades is diminishing the workload and decreasing the risk of errors. Deriv/SERV is giving a boost to further professionalize this market."

'One-stop' servicing

"Deriv/SERV's success to date is only one step in a larger effort by DTCC to automate the OTC derivatives market," said Peter Axilrod, DTCC managing

director, New Business Development. "Our vision is to offer 'one-stop' servicing for OTC derivatives, from affirmation of the trade at the trader's desk to confirmation and matching, payment processing, and a trade information warehouse and 'downstream' processing infrastructure."

Prior to Deriv/SERV's entry into this market, confirmations for credit derivatives trades were processed manually, involving labor-intensive, paper-based processing by fax and telephone. Deriv/SERV fosters a fully automated straight-through process, which allows dealers and buy-side firms to process trades in a timely and efficient manner. @

"The growing usage by both the buy side and the sell side to use this platform for legal matching of trades is diminishing the workload and

decreasing the risk of errors. Deriv/SERV is giving a boost to further professionalize this market."



Erik van Leeuwen, senior vice president, Business Development – Fixed Income, Robeco

Deriv/SERV: On the Menu

Deriv/SERV provides a growing range of services for credit derivatives and other over-the-counter (OTC) derivatives. Here is a round-up of key services offered and in development.

Matching and Confirmation:

Automated matching and confirmation for OTC derivatives contracts, including credit, equity and interest rate derivatives.

Payments:

Payment matching and bilateral netting services, which speed the submission and processing of payments for credit default swaps and other OTC derivatives, providing greater accuracy and straight-through processing.

Affirmation:

DTCC has teamed with leading inter-dealer brokers (IDBs) to develop a single-screen affirmation platform. With a pilot planned for later in 2006, the service will provide a centralized hub for dealers to review and affirm broker-executed credit derivatives transactions. Dealers also will have the option of automatically submitting electronically verified transactions to Deriv/SERV, resulting in legal confirmation within seconds of trade affirmation.

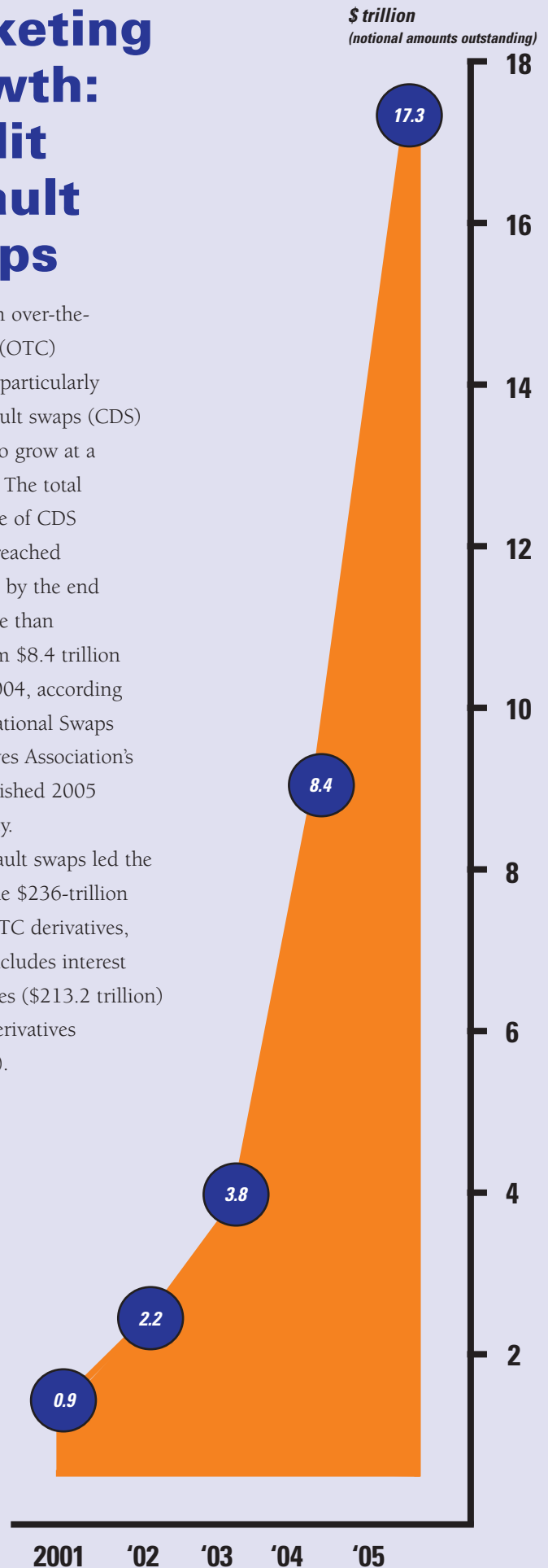
Trade Information Warehouse:

The warehouse will comprise a comprehensive database containing the “golden copy” of trades, and a processing component that will standardize and automate “downstream” processing over a contract’s life cycle. Beginning with credit derivatives, this global infrastructure solution, which is being developed in close collaboration with leading dealers and buy-side firms for launch later this year, will eventually accommodate interest rates, equities and other OTC derivatives. @

Rocketing Growth: Credit Default Swaps

Trading in over-the-counter (OTC) derivatives – particularly in credit default swaps (CDS) – continues to grow at a blazing pace. The total notional value of CDS outstanding reached \$17.3 trillion by the end of 2005, more than doubling from \$8.4 trillion at yearend 2004, according to the International Swaps and Derivatives Association’s recently published 2005 Market Survey.

Credit default swaps led the increase in the \$236-trillion market for OTC derivatives, which also includes interest rate derivatives (\$213.2 trillion) and equity derivatives (\$5.6 trillion).



Source: International Swaps and Derivatives Association, Inc.

Tax Relief for Customers Breaks the \$1 Billion Mark By Edward C. Kelleher

DTCC's TaxRelief Service delivered benefits to customers totaling a record \$1.3 billion in 2005, an increase of 38% from 2004 and the first time the billion-dollar mark was surpassed.

The service, offered by DTCC's Global Tax Services through the company's Depository Trust Company (DTC) subsidiary, enables customers to secure relief from international withholding taxes for themselves and their customers. This comes either up front when a non-U.S. income payment is due – called “at-source” relief – or subsequently through accelerated refunds.

For international investors

The service, launched in 1988, is based on the depository's individual negotiations with tax authorities and securities' issuers in 15 countries (see box below). It applies to various depository-eligible international security types, including ordinary equities and fixed income securities, as well as American Depositary Receipts (ADRs) – receipts for the shares of a foreign-based company held in custody in the United States.

Over the past decade, TaxRelief has steadily expanded its reach, striking agreements with new markets and leveraging changes made to tax treaties.

In 2005, an increased level of investment in ADRs and other non-U.S. securities, coupled with a rise in dividend payouts, contributed to the record amount of relief, according to William Salva, DTCC group director for Global Tax Services.

“We were also able to take advantage of expanded tax treaty benefits in countries such as Switzerland and Japan,” he said. “And there were a number of new Elective Dividend Service [EDS] programs, including

those in Spain and the Netherlands.”

TaxRelief customers use the EDS function on the depository's systems to electronically submit certifications for tax relief, known as “elections.” This enables them to receive income payments that are either exempt from international tax or due at some reduced withholding tax rate for DTC-eligible securities.

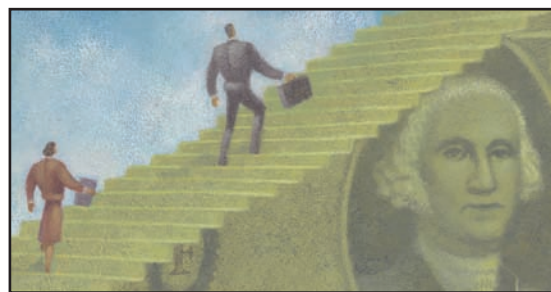
At the source

At-source relief enables customers to pay the lower tax rate at the time of a dividend payment rather than a higher rate, which would require a tax reclaim to recover the over-withheld amount. This allows investors to eliminate the expensive and time-consuming manual processing associated with cross-border hard-copy tax reclamation.

“More than 500 DTCC clients use TaxRelief, including many of the largest investment banks and broker/dealers,” said Salva. “Customers prefer not to incur the time and expense of filing tax reclaims, but if local regulations don't allow for at-source relief, we can often offer accelerated refunds.”

Smoothing access to U.S. markets

Banco Santander, a Spanish bank that is one of the world's largest financial institutions, has leveraged DTCC's tax services to tap the U.S. debt market for



approximately \$8 billion.

When Banco Santander came to the United States looking for new funding opportunities in 2005, TaxRelief played a crucial role in its debt offering because, under a law Spain enacted in 2003, Spanish borrowers must collect and file detailed information on the identity of beneficial holders eligible for at-source tax relief. Until Banco Santander teamed up with DTCC and a vendor that facilitated the collection of the information, no Spanish borrower had sold debt in the U.S. market for two years because data collection was difficult and investors would have had to pay withholding taxes of 15% immediately.

Banco Santander raised \$4 billion in the first offering and has since been back twice to the U.S. market, raising approximately \$2 billion in late 2005 and another \$2 billion in 2006, both times relying on TaxRelief to help facilitate the deals. @

[For more information on DTCC's Global Tax Services, contact William Salva at 212.855.5314 or wsalva@dtcc.com, or visit the DTCC Web site at www.dtcc.com.]

Where to Find Tax Relief

DTCC's TaxRelief provides at-source or accelerated tax relief for depository-eligible securities from the following 15 countries and territories: Canada, Finland, France, Germany, Israel, Indonesia, Ireland, Japan, Korea, Netherlands, Norway, Puerto Rico, Spain, Sweden and Switzerland.

DTCC continues to investigate new markets to expand the list of securities that can qualify for tax relief. In 2005, the service added equities for Japan when a new income tax treaty between Japan and the United States extended tax relief benefits to U.S. pension fund investors.

Central Counterparties and the Future Development Of Financial Market Clearing and Settlement

DTCC Chairman and Chief Executive Officer Jill Considine spoke at the joint European Central Bank/ Federal Reserve Bank of Chicago Conference on “Issues Related to Central Counterparty Clearing” in Frankfurt, Germany, on April 4. Below are excerpts from her remarks.

Our experience since 1999, when we began creating DTCC, may not necessarily be a model for Europe. The industry here, as well as the regulatory environment and the challenges you face, are hardly the same. But I'd like to think that, as Europe considers consolidation options for its infrastructure, there might be some value in our experience.

Consolidation rationale

Many of the reasons behind the consolidation are fairly obvious. We wanted to improve operations, reduce costs, build economies of scale, increase efficiency, lower risks, and create new products and services. And most of our customers didn't want to deal with three or four separate clearing and settlement companies.

We began by bringing under one roof The Depository Trust Company, or DTC, and National Securities Clearing Corporation, or NSCC, which clears and settles trades in equities, corporate bonds, municipal bonds, unit investment trusts and exchange-traded funds. A few years later we brought in two more clearing corporations. One clears trades in the vast market for U.S. government securities, including repos and agency paper. The other clears trades in the expanding market for mortgage-backed securities.

As a result, we have become the largest post-trade infrastructure organization in the world. Last year, just to give you some idea of the scale of our operations, the value of securities settled through DTCC was over \$1.4 quadrillion.

Benefits of consolidation

The question is, of course, have we been successful? Has the consolidation brought our customers benefits? Are costs down? Are service offerings up? Is our technology better? Are we a more responsive organization? My answer to all of these is yes, absolutely – and I think there are a number of ways to measure this.

One, obviously, is in operating and service costs. We have been able to build a reputation among our customers for efficiency, reliability and low costs. As you may know, while we operate on an “at-cost” basis, our transaction fees are among the lowest in the world. And if we generate fees beyond what we need to sustain our business, we give the excess back to our customers. As an example, just last month, reflecting the unprecedented high

volumes we processed last year, we returned a historic \$528 million to our participants in rebates, discounts and interest for 2005. This follows on the heels of our reduction of \$161 million in transaction fees for services for the current year.

But equally important, it seems to me, is that the consolidation and reworking of our clearing and settlement companies has brought industry-wide economies of scale and improvements in the key area of how we interact with our customers, particularly at the technology level. In our experience, the consolidation has created substantial benefits for the entire industry in terms of:

- Increased technology efficiency
- Improved business continuity
- New business opportunities
- Clearing fund operation and cross-margining
- Standardized risk measurement and mitigation
- The potential for extending the safety and efficiency of clearing services without necessarily extending their credit risk role.



Jill Considine, DTCC chairman and CEO

Responding to customers

By combining the resources of all our central counterparties and our depository within one company, we've also found it easier to focus our attention on and respond to customer needs and regulatory direction. I think a good example of this is our response to the amazing growth, the rapid change and the new instruments emerging in the OTC [over-the-counter] derivatives market, especially in the credit derivatives market.

Today, asset managers, hedge funds, pension funds, insurance

[continued on page 14]

Customer Connectivity *Continued from cover*

Clearing Corporation (FICC).

“Our goal is to ensure that the customers who account for the bulk of our business can always connect to us,” said Ken Wright, DTCC’s director of Corporate Business Continuity, who oversees this program.

Why test?

A major concern for the industry during the recovery from 9/11 was communication connectivity between organizations. To address this vulnerability, DTCC’s post-9/11 strategy for strengthening the industry’s resiliency included the implementation of a customer connectivity testing program.

Since its inception in 2002, this program has expanded from 50 customers to approximately 100 today. “At the beginning of each year, we create a list of the firms that account for the bulk of the business across our three subsidiaries,” said Wright. “We require these firms to test connectivity with us at least once a year, from their back-up sites to our data centers.”

Wright explained that it is not necessary to conduct tests from customers’ primary sites because this occurs during the normal

course of business.

“Although customers don’t see where their traffic is routed, we regularly route their data among all our sites,” he said, adding that DTCC’s entire network of data centers is alive all the time. “This ensures that customers’ primary sites are testing with all our sites throughout the year.”



Ken Wright, DTCC director, Corporate Business Continuity

Although customers are only required to test once a year, many opt to test more frequently to ensure that their back-up sites are fully operational. In 2005, DTCC conducted more than 300 connectivity and applications tests for customers.

Keeping regulators informed

While industry regulators do not mandate these tests, DTCC keeps them fully apprised. “We are **[continued on page 15]**

Central Counterparties and the Future...

Continued from page 13

companies and many other buy-side firms are actively trading in this very new market. According to the International Swaps and Derivatives Association, the total notional value of credit default swaps outstanding increased to \$17.3 trillion at the end of 2005 – more than doubling from \$8.4 trillion the previous year. This is remarkable growth for a market that hardly existed in 2000.

With this fast-paced market evolution, regulators and market participants alike have expressed the need to reduce operational risk and increase operational efficiency. We listened. And we responded.

Working closely with our customers, we were able to leverage our experience and technology to create a confirmation and matching service, called Deriv/SERV – for automation and risk mitigation in the processing of credit default swaps and other OTC derivative instruments.

All of the largest derivatives dealers globally and more than 350 buy-side firms are now Deriv/SERV customers. Today, well over 60% of all credit derivatives traded globally are electronically confirmed through Deriv/SERV, up from just 15% in 2004. These improvements have been welcomed by regulators and supervisors including the Federal Reserve, all of which continue to monitor progress in the credit derivatives market.

Our vision for this market, however, is much broader than

simply handling confirmations. Our goal is to create a one-stop, centralized and automated environment for the entire lifecycle of OTC derivatives. We want to take the trade from affirmation at the trader’s desk, to confirmation and matching, and on to payment processing. We also want to build a trade information warehouse, or repository, where the “golden copy” of the trades is retained to support the downstream processing and servicing of these instruments over their life, which can be five years or more.

Our customers – the major market dealers and buy-side firms – are fully committed to this initiative. In March, in a letter to the Federal Reserve about improvements for credit derivatives practices, dealers said they view the warehouse as “a material step forward in reducing operational risk and increasing operational efficiency in the credit derivatives market.”

We appreciate this vote of confidence, and we too believe that a single trade warehouse and a central infrastructure are critically important to the growth of this global market. As we develop the systems, however, one of our core design principles is open architecture – to facilitate integration with other value-added service providers in this space. We want, in other words, to build a derivative contract library and processing resources that are open to everyone who gets a library card. @

Continued from page 14

required to maintain a record of customers that have successfully tested connectivity from their back-up sites and we report these results to regulators at the end of the year,” said Wright.

In 2005, the Securities and Exchange Commission authorized each of DTCC’s clearing agency subsidiaries to issue fines of \$10,000 for firms that fail to meet the annual testing requirement. Noting that this rule went into effect in mid-2005, Wright said, “We did not impose any fines in 2005, thanks to the full cooperation of our customers.”

Getting scheduled

“Every year, we publish Important Notices from each subsidiary telling the industry that we require higher-volume customers to test with us annually,” said Wright. At the beginning of the year, DTCC contacts all the customers that must test to ensure they understand the requirements, following up with reminders throughout the year until the test is successfully completed. If a customer fails the test, then it must be run again.

To schedule a test, customers get in touch with DTCC’s Participant Interface Planning (PIP) group. “Customers complete a form, give us all their circuit information and tell us the time and date they want to test,” said Clifford Testa, the DTCC director who coordinates the online calendar. “We schedule tests at times that do not impact our production environment, mostly on the weekends.”

Mechanics of the test

DTCC’s Network Communications’ group executes the tests, which generally take from 1 to 3 hours. “The customers activate their back-up site; we shut down connectivity to their primary

site; activate connectivity to their back-up site; and then they submit their data,” said James Sideli, DTCC manager in Network Communications.

The test requires firms to successfully connect with at least two of DTCC’s data centers: one in-region and one out-of-region. (DTCC handles the rerouting of data from one site to another, so it is transparent to the customers.)

If customers use the same circuits for all three DTCC subsidiaries, then one test is sufficient for all three.

Likewise, a single test will cover all of a customer’s subsidiaries if all the subsidiaries are using the same circuits to connect to DTCC, which is frequently the case.

Adding on apps

At times, firms choose to expand the test beyond connectivity to include applications, according to Sideli. “Some customers want to test all the applications they run on their primary site at their back-up site, so they have their people submit jobs across all their applications,” he said, noting that this part of the test is customer-driven.

“Once connectivity to the back-up site is established, DTCC disengages and lets the customers test their applications,” Sideli said, adding that if they run into problems, DTCC works with them to troubleshoot. @



Centralized Connections

DTCC’s end-to-end management of its Securely Managed and Reliable Technology (SMART) network affords multiple levels of resilience, including centralized emergency management and recovery. The entire SMART network is fully redundant, self-healing and can be controlled from any of DTCC’s multiple data processing locations. All elements in the communications path are registered with the Department of Homeland Security for high-priority restoration in the event of outage.

Working with multiple telecom providers, DTCC orders, owns and manages all the lines and routers that enable customers to connect to its SMART network. This centralization not only makes for a tightly managed network, it also helps ensure DTCC has a flexible and secure recovery capability, according to Ken Wright, DTCC’s director, Corporate

Business Continuity. “We know exactly where customers’ sites are, but they never see where we are routing their data,” he said.

DTCC further centralized management of the industry’s connections to its network with the completion of an insourcing project with the Securities Industry Automation Corporation (SIAC). This initiative, which is reducing overall cost and risk for the industry, was carried out in two phases. The first insourced certain applications from SIAC to DTCC, while the second insourced network connections.

“Now that the network insourcing is complete, we are looking at the number of circuits per customer and assessing with customers whether they can consolidate circuits to reduce their monthly expenses,” said Wright.

DTCC expects to complete these assessments in 2006 for its larger participants.

James Femia, DTCC's managing director and head of the Global Corporate Actions business, published an article in *STP Magazine* titled "Trading Desks Show the Way in Corporate Actions Automation." It appeared in the 1Q2006 issue.

"In their efforts to achieve greater STP [straight-through processing] of corporate actions, major firms like UBS and Merrill Lynch are giving their trading desks, as well as back-office staffs, access to timely, accurate announcement information," writes Femia.

STP Magazine is a U.K.-based publication that targets asset management, brokerage and banking professionals who have responsibility for front-, middle- and back-office operations.

Lorraine Morrison, DTCC director, Product Management/Asset Services, published an article in *Global Custody Review* titled "Corporate Actions Meet Straight-Through Processing: Challenges for 2006 and Beyond." It appeared in the April issue.

"A key aspect of DTCC's effort to manufacture accurate announcements at the outset of the corporate action chain will be the pursuit of information 'at-source,' which means obtaining and verifying the announcement information directly from the initial source as early as possible in the corporate action lifecycle," Morrison writes.

Global Custody Review is a bimonthly publication that provides news and information for professionals in the global custody and related markets. @

Customer Satisfaction *Continued from page 9*

differ across DTCC and rely on various databases to capture information.

To address the issue of multiple databases, DTCC will be developing a system that will integrate customer data from across the organization. Among its many benefits, this capability will give DTCC a stronger customer relationship management platform. "It will integrate customer and contact information to provide a comprehensive, up-to-date view of each organization that can be leveraged by our business units to identify opportunities to deliver further efficiencies and capabilities," said Vece.

Industry leadership

While providing product and service solutions for industry initiatives, DTCC is also working to be a catalyst for broadening customer education and awareness about industry and regulatory issues.

"The changes taking place in financial services are often complex, calling for solutions with short implementation times, so help with navigating the details is invaluable to many of our customers," said Arthus, who gave an example from the mutual funds industry.

"For certain regulatory changes being mandated by the Securities and Exchange Commission, we are not only upgrading

our services to facilitate compliance, we are also hosting Webcasts with industry experts from our customer base to increase understanding of the issues," she said. "These Web forums take clients through our service enhancements and provide a question-and-answer format to discuss any questions they have about the broader topic."

In the insurance sector, DTCC is building two new services that will help automate regulatory supervision for both insurance carriers and distributors. To bring customers up to speed on compliance issues and DTCC's solutions, the Insurance Services staff will offer in-person training sessions for first movers, as well as e-learning modules for self-help training.

In the derivatives space, DTCC Deriv/SERV staff have expanded the use of global Webcasts to meet the increasing demand of prospective customers. These events are now offered at least twice a week, one out of New York and another out of London.

Customers first

"The true measure of DTCC's success is how well we listen to, know and serve our customers," summed up Arthus. "The Relationship Management team's initiatives are just one example of customer-focused activities across DTCC that are intended to strengthen our understanding of customers and keep them at the center of all we do." @



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

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

@dtcc is published by Corporate Communications and available online at www.dtcc.com under Newsletters.

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Printed by
DTCC Print Department

@dtcc thanks the following individuals for their contributions to this issue:

Paula Arthus, Peter Axilrod, James Balbo, Ann Bergin, Joseph Clemente, Jill Considine, Donald F. Donahue, James Femia, Jeff Ingber, Carol Jameson, Art Kleiner, Margaret Koontz, James Koster, Richard Lanning, Nancy Leo, Patrick Mapp, Vincent McDevitt, Richard Nesson, George Perretti, William Salva, James Sideli, Barbara Simon, Clifford Testa, Larry Thompson, Joseph Trezza, Susan Tysk, Ann Vece, Jeff Waddle, Ken Wright, Janet Wynn