



DTCC Automates Transfer of Funds Linked to Government Securities Trades

By James Conmy

In an effort to lower risk and further streamline the payment of funds linked to securities traded in the multi-trillion-dollar-a-day market for U.S. government securities, DTCC has introduced a new, automated payment service for dealers, traders and other firms involved in the market.

The new service enables DTCC's Fixed Income Clearing Corporation (FICC) subsidiary to use the Federal Reserve [continued on page 2]

DTCC and Industry Set To Tackle Challenges Of Processing Structured Securities

By Edward C. Kelleher

DTCC has proposed a series of initiatives aimed at solving the processing problems of the structured securities market, including collateralized mortgage obligations (CMOs) and other asset-backed securities (ABS). The initiatives are discussed in a new white paper issued by DTCC in June.

The paper is titled *Structured Securities Processing Challenges:*

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DTCC Automates Funds-Only Transfers

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Susan Tysk

Board's National Settlement Service to automatically collect money from or pay funds to the accounts of securities dealers and other firms.

The payments and collections are not used for settling trades, but instead take care of non-trade activities, such as changes in the value of securities when they're marked to market, adjustments to securities trades and the pass-through of bond coupon payments for securities being traded.

Fewer steps

Previously, dealers had to wire their settling bank every day to make arrangements for the delivery or receipt of funds to meet these various non-trade obligations, and then confirm that the transfers had taken place. The new, automated "funds-only" service eliminates all those steps entirely.

"Every trading day, we have to move as much as \$500 million to deal with mark-to-market adjustments and the servicing of the securities involved in the trades," said Susan Tysk, DTCC managing director, Clearance and Settlement Group. "By automating this process, we can eliminate

errors, reduce risk, save our customers time and money, and bring more safety and reliability to the operation of the markets."

Nearly all trades in U.S. government securities are cleared and netted through FICC's Government Securities Division. Final settlement of the trades is completed through the FedWire system, which electronically delivers the securities to the buyers and the payment to the sellers. FICC's new "funds-only" system does not involve or affect these securities movements. Rather, it automates post-trade adjustments and other such "housekeeping" matters related to the securities involved in a trade.

Automatic funds settlement

Under the service, the individual debits or credits of all the trading firms that participate in FICC's Government Securities Division netting process will be totaled every day at the settling banks used by the firms. Then FICC will automatically settle the net debit or credit position at those banks through the National Settlement Service.

"By automating this process, we ease the pressure on our member firms to satisfy their funds-only obligations on a timely basis," explained David Cosgrove, DTCC vice president, Asset Services. "Until now, government securities dealers using our netting service had to check their accounts daily at their settling banks, advise the banks whether

to make or accept a transfer of funds from our account at our settling bank and then confirm the transaction. The new process eliminates these steps entirely, because the funds will move automatically through the National Settlement Service."

Using the Fed system

Cosgrove said FICC would leverage systems and procedures already in place at DTCC's Depository Trust Company and National Securities Clearing Corporation subsidiaries to handle the automated transfer of funds through the National Settlement Service.

Although the Securities and Exchange Commission gave FICC permission last December to initiate the service, Cosgrove said FICC has been running the service in parallel with the existing funds-only settlement process in order to allow ample time for testing with all the settling banks.

"This streamlines and standardizes the



David Cosgrove

collection of funds across clearing corporations," Cosgrove said, "and the automation of the system means our netting customers will no longer face extra charges for late payments." @

Donald F. Donahue Elected President and CEO of DTCC

By Stuart Z. Goldstein

DTCC announced that Donald F. Donahue was elected to become president and chief executive officer (CEO) by DTCC's Board of Directors. The appointment is effective August 1, 2006.

Jill Considine, DTCC's chairman and CEO, recommended Donahue's promotion to the Board, following her decision to relinquish the titles of president and CEO as part of a long-term corporate succession plan that she introduced.

In addition to his new role at the holding company, DTCC, Donahue will become president and CEO of its core subsidiaries, National Securities Clearing Corporation (NSCC), The Depository Trust Company (DTC) and Fixed Income Clearing Corporation (FICC).

Both Considine and Donahue will continue to serve as directors on DTCC's Board.

Planning for the future

"DTCC's role in the financial securities industry is to ensure safety and soundness in the post-trade clearance and settlement of securities transactions. Last year, we settled in excess of \$1.4 quadrillion. Considering the critical nature of what we do, it's prudent to have a succession plan that can be phased in and positions the organization for the future," said Considine.

Donahue is a 20-year veteran of DTCC and previously, DTC. Since May 2003, he has served as DTCC's chief operating officer. Prior to that, Donahue headed DTCC's Customer Marketing and Development Division, with responsibility for strategic planning, product development, relationship management, applications development and technology.



Donald F. Donahue

At DTC, he served as chief information officer from 1997 until 2000, and as head of the depository's Operations Division from 1995 to 1997. He joined DTC in 1986 and has held positions in a variety of areas.

"Since 1999, Don has played a major leadership role in helping us seamlessly integrate and streamline the various clearing corporations and depository functions under the DTCC organizational umbrella, without any disruption in service to our customers," said Considine. "He's been the architect of our Business Continuity Plan, post-9/11, which has reinforced DTCC's highly resilient, self-healing telecom network, created multiple data center redundancy and launched our Southern Business Center, which now shares critical operating responsibility for key functions performed by DTCC subsidiaries. More recently, he has helped guide the launch of major new initiatives at DTCC, including our efforts to automate the over-the-counter derivatives market through DTCC Deriv/SERV.

"He's a talented, hands-on executive, who has the confidence of our Board and can easily move from day-to-day operational details across DTCC's diverse businesses and market segments to an impressive grasp of strategic issues challenging the financial services industry as a whole," Considine added.

Stephen Casper, chairman of the Board's Compensation and Human Resources Committee and president and CEO of Fischer Francis Trees & Watts, Inc., said, "Jill has taken a very proactive approach on the subject of succession planning, that will help us ensure the continuity, quality and reliability that have been the hallmarks of DTCC's service to the industry. We join in supporting Jill's recommendation to appoint Don Donahue as president and CEO. He has the broad knowledge and respect of major industry firms to take on this expanded responsibility."

More on Donahue

In May 2004, Donahue was appointed by the U.S. Secretary of the Treasury to serve as Sector Coordinator and Chairman of the Financial Services Sector Coordinating Council (FSSCC) for Critical Infrastructure Protection and Homeland Security. FSSCC coordinates the private sector's preparation and sharing of best practices across the financial services industry to address events that could disrupt the normal business of the financial sector, such as cyber-attacks, natural disasters and terrorist attacks.

"I appreciate the vote of confidence that is reflected in this decision," said Donahue. "Since 1999, under Jill's leadership, we have successfully

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DTCC Announces New CEO and COO *Continued from page 3*

transformed the culture of DTCC to operate more like a for-profit company with a competitive drive and bottom-line accountability for results, even while we operate on an 'at-cost' basis, returning savings derived from increased efficiencies and excess revenue to our customers in the form of discounts and rebates.

"We've increased the breadth of services and markets we support, expanded the scope of risk-mitigation services we provide, improved overall customer satisfaction survey scores to world-class levels and established a global image for DTCC as a low-cost and high-quality logical solutions provider. However, sustaining this momentum requires that we have the depth of talent and leadership in place for transitions we all know are inevitable," said Donahue.

Prior to joining DTC, Donahue was president of two affiliated companies that developed and marketed credit enhancements for municipal securities from 1985 to 1986. Before that, he worked for the Municipal Rulemaking Board, the self-regulatory organization governing the U.S. municipal securities markets, from 1977 to 1985.

He began his career working for Barr Brothers & Co., Inc. for five years, as a broker/dealer specializing in municipal securities. Donahue has a B.A. degree in History from Columbia University.

William Aimetti becomes COO

DTCC also announced that William Aimetti, a well-known and respected industry veteran, was elected to become DTCC's chief operating officer (COO). Aimetti, a managing director, has been serving as DTCC's chief information officer since April 2003. In addition to his appointment as DTCC's COO, Aimetti will become executive managing director and COO of NSCC and DTC.

He also sits on DTCC's Executive Committee, which is accountable for the corporation's overall performance.

Aimetti joined DTCC in July 2000 as a managing director and chief administrative officer to oversee all operations and quality initiatives of the company's two subsidiaries, NSCC and DTC.

More on Aimetti

Prior to joining DTCC, Aimetti was associated with Nomura Holdings America, Inc./Nomura Securities

International, Inc., where he had been executive managing director – Operations, Technology and Corporate Services. He also served as president and chief executive officer of Nomura International Trust Company, a subsidiary of Nomura Holdings America. He joined Nomura in 1994.

Previously, he was a division executive for Citibank, where he was responsible for all operations and technology for the North American Global Finance Division. In addition, he has served as a key member of the operations divisions of both the Securities Industry Association and the New York Clearing House, and was a board member of Cedel (now Clearstream).

Aimetti is a member of the Advisory Board of Seton Hall University and serves on an affiliated Board of Morristown Memorial Hospital in Morristown, N.J. He also serves on the board of The Relevance Corporation.

Aimetti holds a B.A. degree in psychology from Seton Hall University and a master of science degree from Columbia University's Graduate School of Business. @



SUE LEVINE

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William Aimetti

New Study Quantifies Impact Of Corporate Actions on Trading

By Steve Letzler

Corporate actions can have a significant impact on trading prices, trading volume and trade price volatility, according to a report issued in May by Oxera, an independent economics consultancy in Europe.

The results of this groundbreaking study indicate that a financial services firm's trading activities can be significantly impacted by these announcements. "Oxera's research highlights the need for firms to make sure that their trading desks have access to accurate, timely data on corporate actions in order to execute optimal trading strategies," said James Femia, DTCC managing director, Global Corporate Actions.

The study, titled *Share prices and trading activity over the corporate action processing cycle*, quantifies the impact that five corporate action event types had on share prices and trading activity. DTCC sponsored the research, and both DTCC and Oxera representatives presented the results and discussed the implications at conferences in London and New York.

Key findings

"It is well known that the announcement of a takeover produces a price and trading impact in the securities market," said Dr. Luis Correia da Silva, Oxera managing director. "But this study demonstrates that other corporate actions can also have an impact on share prices and trading activity. In addition, most of the effect occurs in a short period around the announcement of the action, or the event itself, as the market is absorbing the relevant information contained within that corporate action."

The report adds, "Potentially most important, these effects often emerge in a predictable manner around critical corporate action processing dates."

This means that when firms disseminate corporate action information quickly and accurately throughout their operations, the front offices are direct beneficiaries because the data can help trading desks improve trading decisions and strategies.

The event types covered in the report are takeovers, stock splits, spin-offs, rights issues and exchange offers. The research is based primarily on corporate action events related to U.S. securities, although the rights issue events studied involved a wide array of securities from the U.S., Europe and Asia.

"It is well known that the announcement of a takeover produces a price and trading impact in the securities market. But this study demonstrates that other corporate actions can also have an impact on share prices and trading activity."



Luis Correia da Silva, Oxera managing director

According to Oxera:

- Corporate actions have potentially strong effects on share prices and trading activity in the relevant stocks, although these effects depend on the type of corporate action and the particular point in the corporate action processing cycle.
- Within the corporate action types analyzed in this study, takeovers, spin-offs, stock splits and rights issues appear to have the strongest effects, while exchange offers have only a limited impact.
- In general, the strongest effect is observed on the date when the corporate action is

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DTCC Partners with Inter-Dealer Brokers to Launch Front-Office Affirmation Platform for Credit Derivatives

By Lisa Argento

DTCC, working with leading inter-dealer brokers (IDBs), announced in June the launch of AffirmXpress, a single-screen, post-trade affirmation platform that allows traders and front-office staff to affirm credit derivative trades from multiple IDBs.

AffirmXpress, which will improve efficiency and support the growth of the credit derivatives market, marks another milestone in the industry's continuing efforts to automate processing in this market.

DTCC's derivatives services are offered through DTCC Deriv/SERV LLC, a wholly-owned subsidiary of DTCC.

Delivering immediate affirmation after the trade

In the initial pilot, DTCC is partnering with three leading IDBs – GFI Group, ICAP and Tullett Prebon – and will complete testing by the end of June. AffirmXpress will be expanded to include other IDBs next year. Several major dealers have committed to use AffirmXpress, and others are in the pipeline.

“AffirmXpress addresses one of the over-the-counter derivatives markets' biggest challenges – immediate trade affirmation of brokered transactions,” said Gina Ghent, DTCC vice president, Business Development. “AffirmXpress will automate this process, and will soon give trading counterparties the option to submit their affirmed trades directly to Deriv/SERV, DTCC's automated matching and confirmation service. Through this streamlined process, a trade could be legally confirmed within seconds of affirmation.”

Up-front automation

Initially, AffirmXpress will support credit derivatives, including single-name and index credit default swaps (CDS), and tranching index swaps. Future releases will include interest rate and equity derivatives products. AffirmXpress will be offered to the industry at no charge for at least the first year.

“Our goal with AffirmXpress is to encourage automation as early as possible in the post-trade life cycle to reduce operational risk, while giving customers easy access to the tools they need to deal with the growing volume of credit derivatives trades,” said Ghent.

IDB perspective

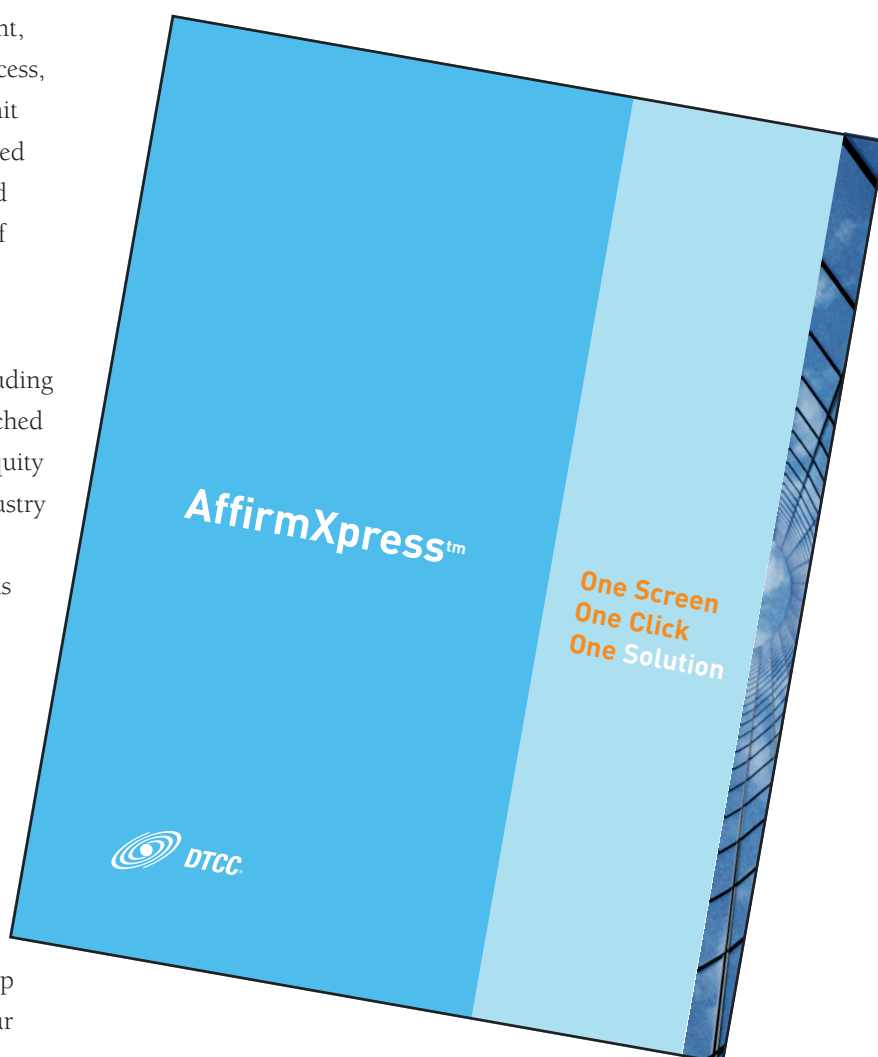
“We're committed to helping our clients improve efficiency, reduce errors and support the growth of this important market,” said Michael Fuhrman, GFI's head of e-trading – North America. “From our perspective, a one-stop affirmation service will result in dramatic time-savings for our

clients by reducing the effort traditionally associated with this front-office process.”

“We stepped forward to work with DTCC and the other IDBs because we strongly believe that this combination of market leaders, and the recognized standard in CDS post-trade matching, delivers the solution for improved trading efficiency in the inter-dealer markets,” said Chris Ferreri, managing director, ICAP. “AffirmXpress is an example of the efforts we make to serve the needs of our customers as new products and challenges enter the market.”

“The collaborative effort means we are quickly delivering a front-end affirmation service to the global credit derivatives market,” said Toby Young, global head of Trading Technology, Tullett Prebon. “AffirmXpress linking with Deriv/SERV for automated confirmation and legal execution further streamlines post-trade processing for our customers.” @

[To learn more about AffirmXpress, contact Gina Ghent, DTCC vice president, Business Development, at 212.855.5624 or gghent@dtcc.com.]



Update on the Trade Information Warehouse *By Lisa Argento*

Development of DTCC's central industry trade information warehouse, which will automate and centralize processing for over-the-counter (OTC) derivatives contracts, is proceeding at a rapid pace on multiple fronts.

Working with an industry group on the business requirements for this global infrastructure solution, DTCC has finalized the overall warehouse service description, along with a plan for the initial release. Simultaneously, market participants have begun reconciling their existing trade portfolios (known as deal books), preparing to load these trades into the warehouse.

DTCC announced in February plans to build the warehouse, which will launch with credit derivatives and later expand to cover other OTC derivatives products.

The game plan

The warehouse will be implemented in multiple phases,

beginning later this year. The initial release will support contract maintenance, including reporting and inquiry capabilities, as well as a facility to "backload" legally confirmed trades into the warehouse. In 2007, the warehouse will expand to



Peter Axilrod

support central payment calculation and netting, and central settlement processing. (Parts of this expansion could begin user acceptance testing in 2006.)

Industry groups working with DTCC on the warehouse are also establishing a plan for the timing and content of subsequent releases, including extensions of the warehouse to other OTC derivatives instruments.

Getting in sync

To jump-start implementation of the warehouse, market participants are now reconciling and revalidating their existing trades with each of their counterparties, according to Peter Axilrod, DTCC managing director, Business Development, who is leading development of the warehouse along with Bill Hodgson,

DTCC vice president, Business Development, in London.

"For the market to realize the full value of the warehouse as quickly as possible, it is necessary for firms to participate in this reconciliation process," said Axilrod. "This will help assure that when warehouse users backload existing trade records into the warehouse, those records will be clean, and the process will be relatively smooth and swift."

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What Is the Trade Information Warehouse?

The creation of a central trade information warehouse marks a significant expansion of DTCC's Deriv/SERV and is critical to the goal of bringing increased accuracy, cost savings and reduced risk to the post-trade processing of OTC derivatives.

Beginning with credit derivatives, this global infrastructure solution will comprise:

- A central trade database with the most up-to-date record of each contract; and
- A central capability to standardize and automate "downstream" processing of payments and other post-trade processes over the life of a contract.

The warehouse addresses two critical problems that continue to plague the industry: maintaining reliable, up-to-date contract records, and efficiently processing the flow of information, payments and other post-trade events associated with contracts.

The warehouse will assign a unique reference number to identify each contract in the database. Counterparties will have two ways to get trades into the warehouse. All new trades that are confirmed through Deriv/SERV automated confirmation and matching will automatically populate the warehouse database on the day it goes live. Firms also can backload into the warehouse existing trades that have been previously legally confirmed (whether through Deriv/SERV or on paper).

Backloading existing trades will constitute a legal redocumentation of the trades, superseding the paper confirmation from the date on which they enter the warehouse, meaning that any disputes are cleanly segregated into "pre-warehouse" and "post-warehouse."

Update on the Trade Warehouse *Continued from page 7*

He added that only firms with small deal books are exempt from this process.

“Deriv/SERV customers with large deal books have already begun this revalidation process,” said Axilrod.

To facilitate the reconciliation, DTCC is providing an additional parallel confirmation system. The system, essentially a clone of the current DTCC Deriv/SERV trade confirmation service, identifies discrepancies in a counterparty’s legal trade records, allowing parties to the trade to make adjustments and resolve differences.

All templates, messaging, affirmation, matching processes and workflow tools in the parallel system correspond with those in Deriv/SERV (with certain limited exceptions).

Transatlantic collaboration

Since February, a global team of senior experts from dealer and buy-side firms (including traditional and alternative investment management firms) has participated in a series of “virtual” meetings with DTCC, in New York and London, to hammer out requirements for the warehouse.

“These meetings involve a tremendous commitment of both time and brainpower on the part of the individuals participating,” said Axilrod. “We are most grateful to the members of this group for contributing their market knowledge and broad experience to this initiative.”

The project is being managed by a Global Senior Oversight Group, established by the OTC Derivatives Operations and Planning Committee of DTCC’s Board as an official DTCC governing body to oversee the development and implementation of the warehouse.

Breaking new ground

“One of the challenges with the warehouse is that we’re not just building a new system,” said Hodgson. “We’re also working with the industry to establish best practices and a common global operating model that reconciles today’s varying market practices.”

Also challenging is that the development effort is taking place in an incredibly dynamic environment. “The credit

derivatives market is complex and experiencing explosive growth in terms of trading volume, secondary market development, new product types and new market participants,” said Hodgson. “That is what makes this such an exciting, vital project.” @



Bill Hodgson

A large graphic with a blue sky background and a grid pattern of black lines that recede into the distance, creating a sense of depth. The text is overlaid on the right side of the graphic.

Here's How It Works Today

Today, counterparties to credit derivatives contracts (and most other OTC derivatives contracts) handle all administration between themselves on a bilateral basis. In other words, each party must continually “sync up” with each of its counterparties over the life of every contract, keeping track of post-trade events such as assignments, amendments, terminations and notional adjustments. This requires considerable manual processing relying on faxes, emails and phone calls. What’s more, reconciliation processes are not standard across the industry. Each trading party is dependent on its counterparties’ internal processing capabilities, which vary – effectively making each trading party only as “good” as its counterparty. This means firms have to rely on different processes to coordinate with different counterparties.

DTC Expands ADR Servicing By Edward C. Kelleher

The Depository Trust Company (DTC) has expanded its servicing of American Depositary Receipts (ADRs) with a new capability to collect and allocate depository service fees for non-dividend-paying ADR issues.

This enhancement streamlines the process for all parties, eliminating the need for agents to mail billing statements and for ADR holders to remit payments to them.

DTC, ADRs and agents

ADRs are receipts for the shares of a foreign-based corporation that a U.S. shareholder holds in lieu of the actual stock. They entitle the shareholder to all dividends and capital gains earned by the underlying stock. For most ADR issues, DTC processes dividends earned and allocates payments to the appropriate customers. Any depository service fees charged for these issues are deducted from the dividend paid by the ADR agent to DTC and passed on to customers.

This new service applies to those ADR issues that do not pay dividends. “A minority of ADRs do not pay dividends but permit the ADR agent to charge a depository service fee,” said Joseph Clemente, DTCC product manager, Asset Services. Some of the largest ADR agents include Citibank, Bank of New York, Deutsche Bank and JPMorganChase.

Until now, DTC has not collected these custody fees from its customers who are ADR holders. Over time, the process of assessing and paying the fees had become increasingly cumbersome and inefficient for both the agents and the ADR holders, according to Marcelo Mejia, DTCC director, Asset Services. “In the past, ADR

agents requested position listings from DTC showing its customers’ ADR holdings at the close of business on the record date,” he said. “Based on that information, agents would assess their depository service fees and then mail invoices to the ADR holders requesting payment.”

Consensus

With the goal of streamlining this process, the largest agents asked if DTC could assist them in collecting these fees.

“We met with the agents and held discussions with several divisions of the Securities Industry Association [SIA], including the Regulatory and Clearance Committee of the SIA’s Securities Operations Division,” said Clemente. “The consensus was that DTC could boost efficiencies for agents and ADR holders alike if we started collecting the depository service fees via our monthly participant bills.”

In April, DTC filed a rule change with the Securities and Exchange Commission on this matter, which was effective on filing. Now, DTC collects the depository service fees from its ADR-holder customers, passing payment through to the ADR agents, all as part of DTC’s monthly billing process.

To cover the cost of this service, DTC retains a percentage of the fees it collects. @

[For more information on ADR custodial fees, contact Joseph Clemente, DTCC product manager, Asset Services, at (212) 855-2425 or jpclemente@dtcc.com]



Joseph Clemente

SUE LEVINE



Federal Court Dismisses Lawsuit Again

DTCC announced that by order entered May 31, 2006, the United States District Court for the District of Nevada, Las Vegas, has dismissed Whistler Investment, Inc.'s lawsuit against DTCC and its subsidiaries. The dismissal was "with prejudice," meaning that Whistler may not seek to amend its complaint.

In granting DTCC's motion to dismiss, the court agreed with DTCC that clearing and settlement rules promulgated by DTCC's subsidiaries and approved by the U.S. Securities and Exchange Commission (SEC) cannot be challenged under state law. Because DTCC's Stock Borrow Program (SBP), the target of the lawsuit, is explicitly approved by and subject to the ongoing oversight of the SEC, the legal challenge is barred by the Supremacy Clause of the U.S. Constitution, on grounds of both "field" and "conflicts" preemption.

'Meritless claims'

This order is the fourth time in the last year a court has ruled that plaintiffs are not permitted to sue DTCC or its subsidiaries for carrying out functions that are regulated and overseen by the SEC.

These are among a number of suits that have been brought, largely by bulletin board traded companies that seek to blame their poor stock performance and failed business models on DTCC and the national market system for clearance and settlement. To date, except for one case where DTCC's dismissal motion is pending, all of the cases either have been dismissed by the courts or withdrawn by the plaintiffs.

"We are very pleased that judges across the country continue to reject these meritless claims," said Larry Thompson, DTCC's general counsel. "Last year, DTCC settled more than \$1.4 quadrillion in securities transactions. We play a pivotal role in the U.S. capital markets by providing the capacity, certainty and reliability required to clear and settle today's enormous trading volumes and maintain the integrity and soundness of the U.S. capital markets. All of our operations and activities are carried out under SEC-approved rules and are subject to strict federal regulatory oversight. This arrangement ensures uniformity and accountability in clearing and settling securities transactions and, in turn, provides the stability that is essential to the efficient functioning of our capital markets."

Dismissing Whistler

In ordering the dismissal of the Whistler case, Judge Robert Jones explicitly adopted the reasoning of Judge Kenneth Ryskamp of the United States District Court for the Southern District of Florida in the case of *Capece v. DTCC*.

In that case, which was dismissed by the court on October 11, 2005, Judge Ryskamp specifically found that, "Allowing Plaintiffs to assert a state law cause of action against Defendants [DTCC and its subsidiaries] would require Defendants to tailor their practices with regard to the SBP [stock borrow program] to satisfy each state's formulation of the standard of care in a negligence action. Such a result would destroy the Congressionally-mandated uniform system governing securities trading."

Thompson concluded, "By dismissing the Whistler case, Judge Jones has reaffirmed the importance and value of



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having clearly delineated authority in the area of market operations. We completely agree with this result, as does the SEC, which has weighed in unequivocally on this issue.”

SEC brief

In February 2006, the SEC filed a “friend of the court” brief in support of DTCC in one of the dismissed cases, *Nanopierce Technologies Inc. v. DTCC*, urging the Supreme Court of Nevada to affirm the lower court decision dismissing the case. The *Nanopierce* case, which makes identical claims to those in the Whistler action, is pending on appeal before the Supreme Court of Nevada. The SEC brief can be accessed at: www.sec.gov/litigation/briefs/nanopiercesecbrief.pdf.

Additionally, in a May 12, 2006, follow-up letter to the Supreme Court of Nevada, the SEC wrote, “Plaintiffs’ claims are preempted because evaluating these claims of alleged defects has been entrusted by Congress to the [SEC], not to state courts.”

In its letter to the Nevada court, the SEC stated, “The [SEC] found that the clearance and settlement system complies with the requirements of the Exchange Act when it approved the system more than twenty years ago, and it has continued to be of that view as it has exercised oversight responsibility ever since.”

The SEC also stated that it “has adopted Regulation SHO for the purpose of preventing abusive naked short selling, and if it concludes that further steps are required, it will take them.”

‘Misguided campaign’

“The court’s decision and the forceful statements made by the SEC underscore what DTCC has been saying since this misguided litigation campaign began,” said Thompson. “Short selling and naked short selling are trading strategies and are not connected to the post-trade clearance and settlement of securities transactions. There is nothing in DTCC’s operating procedures, activities or conduct that justifies these frivolous suits.”

In the Whistler case, DTCC has sought to impose monetary sanctions against the plaintiffs’ counsel for having brought frivolous litigation. That application will be pursued vigorously before Judge Jones. @

Utah Will Require Brokers to Report Fails In Utah Companies

By Steve Letzler

Utah recently passed a law requiring any broker/dealer licensed to do business in the state to report fails in trades involving Utah companies on the “threshold” list to the Utah Securities Commission. It is scheduled to take effect October 1.

The new Utah law has no impact on DTCC, but puts a new responsibility on brokers in terms of reporting to the state of Utah. The law, which requires the reporting within 24 hours of the fail, will impose stiff fines on brokers for failure to comply.

The fails could occur from any account anywhere in the country, as long as the fail involved trades in a Utah-domiciled company, according to the law. And any fail, even if legal, would have to be reported and would be made public by the Utah Securities Commission.

Any broker/dealer that does not provide the information within five days could be liable to the company whose stock had the fail for payment of \$10,000 a day. If the failure to report went six days or more, the liability could be \$10,000 a day or the sum of the sales price for each securities share in the trade that has not been delivered. Under the bill, broker/dealers could also be liable for 12% interest on these amounts, costs and attorneys fees. The money goes to the issuer of the securities, not to the state.

What is required

The law will require the reporting within 24 hours of all fails by any broker/dealer registered in the state that occurred in any Utah-domiciled or -headquartered public company to the Utah Securities Commission. The commission will make the information public. The information will include:

- Name of the company whose shares were the subject of the fail
- Date the trade failed to settle
- Amount of shares not delivered
- Identity of the customer account or broker/dealer account for which the sell transaction was executed, or
- Identity of the account that failed to deliver securities in settlement of the trade (in the case of the purchasing broker/dealer).

Industry reaction

When the bill was passed by the Utah legislature, it immediately drew the attention of broker/dealers in the state and the Securities Industry Association (SIA), which opposed it but were unable to stop it from being signed into law by the governor.

Press reports indicated that some brokerage firms were so displeased by the conditions of the law that they were threatening to withdraw from the state or stop accepting trades in Utah-based companies.

DTCC and JASDEC Create New Link By James Conmy

DTCC and the Japan Securities Depository Center, Inc. (JASDEC), Japan's central securities depository, announced in May the creation of a new international account to facilitate the post-trade processing and custody of U.S. securities listed on Japanese stock markets.

The establishment of this new account is in line with a streamlining initiative recently approved by Japan's Financial Services Agency and Ministry of Justice.

Some 15 U.S. securities, including Dow Chemical, Boeing Co., JPMorganChase, AIG and several country funds, are currently listed and traded on the Tokyo Stock Exchange or the Osaka Securities Exchange.

firms, in turn, can use the JASDEC account to move the same securities to U.S. brokers or custodians.

Agencies shift responsibilities

Until April 28, book-entry transfer and administrative changes reflecting trading in these securities were the responsibility of Japan Securities Settlement & Custody, Inc. (JSSC), which has also operated a National Securities Clearing Corporation-sponsored account at The Depository Trust Company (DTC) since 1988, but as a separate process from the mainstream settlement of Japanese securities – and mainly for stock exchange members.

Now, as part of a longer-term drive to make all securities traded on Japan's markets "paperless" or fully electronic by 2009, Japan's securities regulators are consolidating post-trade responsibility for all issues – both Japanese and non-Japanese – traded on Japan's stock exchanges. JASDEC, which used to manage only Japanese domestic issues, has now assumed responsibility for nearly all of these and other non-Japanese issues.

Account number unchanged

To make it easier to handle both the book-entry and physical delivery of these U.S. securities, JASDEC has entered into a full participation agreement with DTC, a subsidiary of DTCC. In addition, in order to maintain prior custody history for these issues at DTCC's depository and to eliminate any need for a bulk transfer of the issues, JASDEC has assumed Participant Number 5600, which was the number previously assigned to JSSC's sponsored account.

"This is a quick and effective way to create a central securities depository link for specific securities traded in other marketplaces," McGrail said. "It allows firms to automate the delivery of these securities to brokers or custodians in both

Japan and the United States. And it allows us to record, by book-entry, the movement of the securities in both markets."

Standardized cross-border servicing

The new link opens up to JASDEC members the services and activities of DTCC's depository for the specific U.S. securities for which JASDEC now has responsibility. This helps standardize the cross-border servicing of these U.S. issues, as do DTC's links with other securities depositories globally.

"We're very pleased to be part of this new facility aimed at streamlining the trading and handling of U.S. securities in Japan," said Yoshinobu Takeuchi, president and chief executive officer of JASDEC. "We have access to DTCC's depository services and, as more U.S. companies decide to list their securities on Japanese exchanges, we will be fully equipped to handle the post-trade processing."

The main securities movements help to reposition inventory between the two markets, with Japan settling in yen and the United States in U.S. dollars. The movements are all done on a free-of-payment basis, however. Money settlement for trades on Japan's markets will continue to occur in Japan, and any money supporting inventory movements will be handled bilaterally outside DTCC. @



"Together, we've taken steps to integrate settlement and asset servicing for U.S. issues listed on Japan's markets within JASDEC's depository accounts, and to help Japanese brokers trade these U.S. securities and custodians to handle them – without having to leave the ease and familiarity of their domestic markets," said Robert McGrail, DTCC executive managing director, Domestic and International Core Services.

Cross-market securities movements

With this new link, the securities can be traded on Japan's markets and the transactions settled in yen, and any book-entry movement of the securities recorded by JASDEC will also be accounted for within DTCC's depository.

U.S. firms, for example, can move any of the U.S. securities traded on Japan's exchanges to a Japanese broker or custodian through this account. Japanese



Insurance Services' Account Transfer Solution Gains Industry Traction By Nicholas Clarke

DTCC's automated service for transferring annuity account information from one broker/dealer to another is winning a growing number of customers. These include some of the biggest names in insurance and brokerage, such as AIG, Hartford Life, Pacific Life Insurance, A.G. Edwards, Robert W. Baird & Co. and Merrill Lynch.

The service, called ACATS/IPS (Automated Customer Account Transfer Service/Insurance Processing Service), brings greater speed and efficiency to distributors and carriers alike by automating the change of broker/dealer of record, as well as agent and broker identification number (BIN) changes, for annuity contracts. It is provided by Insurance Services, a business unit of National Securities Clearing Corporation, a DTCC subsidiary.

"We've been able to cut our transfer completion time



dramatically by using ACATS/IPS," said Scott Hanson, vice president and account transfer manager at Baird. "What used to take anywhere from 20 days to six months can now be settled in three to four days and, in some cases, the next day, which is outstanding."

Efficiencies all around

Transfer notification and ease of use are other benefits of the service, according to customers.

"Before ACATS/IPS, it was fairly common to be unaware that an annuity transfer had even taken place," said Hanson. "And even when we did receive a statement, processing it required substantial paperwork and multiple sign-off reviews. Now we get automatic notification," he continued. "And once the annuity assets are loaded into the system, all we do is type in a couple of keystrokes, send an electronic confirmation through DTCC to the annuity carrier to make sure the rep and account information matches, and then it settles."

The carrier side of the industry cites similar efficiency gains. "Prior to ACATS/IPS, we had a completely paper process that, at best, lagged the actual customer moving from one broker/dealer to another by at least six weeks," said Frank Norton, e-commerce program director, Annuities & Mutual Funds, Pacific Life Insurance. "Now we're getting almost immediate notification of customer requests to change broker/dealers. This is a huge plus, as it allows us to quickly move contracts to the right representative so commissions are paid accurately and on time, with no back-dating or reversals."

Better customer service, too

Equally important to carriers are the efficiencies that ACATS/IPS generates from a customer service standpoint.

"Because we're getting transactions electronically, our customer service staff no longer has to process them manually," said Norton. "With ACATS/IPS, the broker/dealer submits a transaction to DTCC, which verifies it and automatically creates a transaction that is sent to us electronically. We either accept the transaction, which we process electronically – for example, using imaging technology to capture the transaction for auditing purposes – or we reject it. Since we began using the service, we've processed more than 1,000 annuity changes and achieved significant time and cost savings in processing these transactions straight through without any human intervention."

The reduction in customer service calls is yet another benefit – for carriers and their customers, according to Norton.

"In the past, we'd get calls from clients who would say, 'I switched broker/dealers, but it's not shown on my monthly or quarterly statement.' And we'd say, 'Well, we weren't notified.' That would create customer service issues," said Norton. "With ACATS/IPS, those calls – and issues – are all but eliminated."

Building critical mass

As more customers sign on to ACATS/IPS, its value to the industry will be even greater.

"The more distributors and carriers use ACATS/IPS, the better it will be for all participants," said Lana Macumber, DTCC director, Insurance Services. "Increasing the level of automation for processing annuities is a priority for the industry, as indicated by the Securities Industry Association Insurance Panel, and we're confident that more companies will be taking up the service in the weeks and months ahead as they learn more about it and its benefits." @

DTCC and Industry Set to Tackle Structured Securities Challenges

Continued from cover

A White Paper on the Processing Challenges Posed by Collateralized Mortgage Obligations and Other Asset-Backed Securities.

A fast-growing market

CMOs are bonds backed by a pool of mortgage loans and issued by various organizations, including Fannie Mae, Freddie Mac, investment banks and insurance companies. ABS are structured bonds or notes backed by loan payments or accounts receivables such as credit cards or auto loans.

“CMOs and ABS have shown rapid growth in the last several years,” said James Balbo, DTCC managing director, Asset Services. “The average monthly distribution of principal and interest for these securities by The Depository Trust Company, DTCC’s depository, has grown from \$9.5 billion in 2001 to \$52.5 billion in 2005.”

With this growth, however, comes an increasing number of processing challenges, and late and inaccurate notifications of payment rates for these issues continue to pose a major challenge for the industry.

Outline for streamlining

DTCC first discussed CMO and ABS processing in a white paper issued to the industry in 2003. Although the depository and paying agents – those agents that distribute the monthly principal and interest (P&I) payments – have implemented automation and process improvements in the last two years, little progress has been achieved in improving the accuracy of CMO/ABS payment processing, according to the latest paper.

“Thousands of these transactions fail to be processed in an accurate and timely manner each year. In 2005 alone, more than 5,300 CMO or ABS transactions had to be adjusted or reversed

after payment,” Balbo said. “This paper outlines steps to improve and expedite processing capabilities in 2006 and calls upon the

industry to help resolve this difficult and growing problem.”

Root of the matter

DTCC believes that the problem is structural, involving many different parties who add and forward information on P&I payments. The problem can only be solved through a concerted industry effort to change the terms of the deal structures and the time-frame given to those involved in the payment process, according to the paper.

“Working with leading industry groups, including The Bond Market Association [TBMA] and the American Securitization Forum [ASF], DTCC will form a committee to investigate the root causes of the processing problems affecting structured securities,” said Balbo. “Together we will make industry-wide recommendations and monitor implementation of those recommendations.”

Industry collaboration

“We look forward to working with DTCC on this important industry initiative,” said George Miller, executive director of ASF. “We expect that by working together, our organizations can help develop a solution for processing structured securities that will benefit the marketplace, boosting both the accuracy and

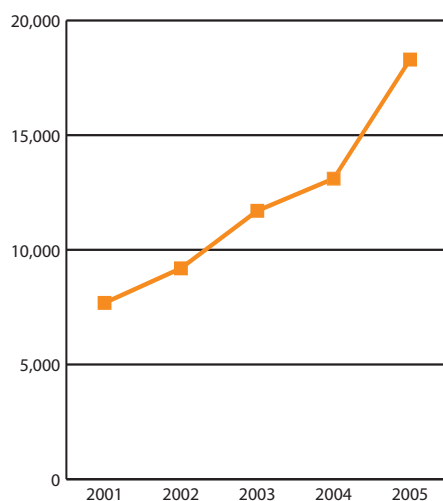
timeliness of structured securities payments.”

“DTCC and the paying agents have worked very hard in the past few years to begin to fix the problems involved in processing structured securities,” said Peter

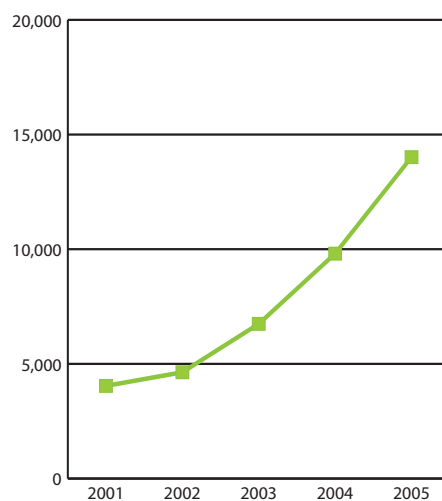
[continued on page 15]

Growth of Structured Securities (CUSIPs)

Collateralized Mortgage Obligations



Asset-Backed Securities



Gleeson, DTCC vice president, Operations. "Wherever we could, we incorporated automated data collection. We introduced a standardized file layout and today more than 90% of the rates are received in that format.

"But there's not too much more that DTCC and the agents can do alone," said Gleeson. "We need the rest of the industry – particularly servicers and issuers – to get involved. And this is where TBMA and ASF will play crucial roles in bringing other industry members to the table."

DTCC said it would also expand the distribution of monthly agent performance "report cards" beyond the agency community. Currently, DTCC works with major paying agents and together they use the report cards to examine processing and performance problems. The data in these cards can be used to



James Balbo

create similar report cards for service providers in other industry segments to help them improve efficiencies and meet new regulatory requirements.

DTCC will also:

- Create a time limit for late adjustment.
- Implement financial disincentives for failure to comply with established industry standards for accuracy and timeliness.
- Explore other recommendations to improve timeliness and accuracy, including establishing best practices for all parties involved in the processing chain. @

[To access the white paper, visit the DTCC Web site at www.dtcc.com. Click "Thought Leadership," then "Structured Securities Processing Challenges: A White Paper on the Processing Challenges Posed by Collateralized Mortgage Obligations and Other Asset-Backed Securities."]

Corporate Actions *Continued from page 5*

announced, although record dates and ex-dates are also often associated with significant increases in share price volatility and trading activity.

A service tailored to traders

The findings of the study could put additional pressure on firms to improve the way they deal with corporate actions.

"One of the things we notice in marketing our corporate actions announcement service is that the trading desks are increasingly pushing for better and more timely data on corporate actions," Femia said. "As a result, we are in the process of developing a new service with an emphasis on speedy delivery of initial announcement information that is customized for trading desks, even if all the data hasn't been verified or completed. Traders and

A Growing Body Of Research on Corporate Actions

The new Oxera study, *Share prices and trading activity over the corporate action processing cycle*, builds on a previous Oxera study published in May 2004 called *Corporate actions processing – what are the risks?*, also sponsored by DTCC.

The earlier report focused on quantifying the operational risks faced by firms in processing a growing volume of increasingly complex corporate action announcements on securities globally.

Oxera is one of Europe's longest-established independent economics consultancies. Based in London, Oxera has an international reputation for integrity and intellectual rigor.

[To access a copy of the earlier report, visit DTCC's Web site at www.dtcc.com/gca and go to "White Papers."]

investors need early visibility of events. They can't necessarily wait until all the details have been validated and verified."

DTCC's Global Corporate Actions Validation (GCA) service provides the largest global coverage of corporate action information in the world. Last year, it provided information on more than 826,000 corporate action events involving 1.2 million securities in more than 150 countries, and has continued to expand in 2006.

The GCA service will feed into the development of the new service, to ensure customers can fully leverage the information supplied. @

[To access a complete copy of this report, visit DTCC's Web site at www.dtcc.com/gca.]

Deriv/SERV Wins Operational Risk & Compliance Award

By Lisa Argento

DTCC Deriv/SERV was selected as winner of the 2006 Operational Risk & Compliance Achievement Award for “Best Back Office Risk Reduction” by *OpRisk & Compliance* magazine, specifically for its role in automating the processing of over-the-counter derivatives. The award recognizes excellence and innovation in the development of technology and tools that help firms manage operational risk and mitigate potential loss events.

OpRisk & Compliance is a monthly publication based in London and distributed to more than 6,600 executives at banks, asset managers and insurance companies worldwide.

And the Winner Is . . .

Here is an excerpt from the *OpRisk & Compliance* article that explains why DTCC Deriv/SERV was selected winner of the 2006 Operational Risk & Compliance Achievement Award for “Best Back Office Risk Reduction.”

“What better judgement of a product could there be, than when customers vote with their feet?”

“In the last few years, it’s been hard to ignore the flurry of activity taking place at The Depository Trust & Clearing Corporation. In late 2003, the world’s largest post-trade clearing organisation launched its Deriv/SERV platform, to automate the matching, confirming and streamlining of business processes in the over-the-counter derivatives market. Since then, clients have been quickly signing on. According to Janet Wynn, managing director and general manager of Deriv/SERV, the DTCC, having started with 10 clients, now has over 400.

[NB: Since *OpRisk & Compliance* published

“We’re delighted to be honored by *OpRisk & Compliance* and our peers with this award,” said Janet Wynn, DTCC managing director and general manager, Deriv/SERV. “With the credit derivatives market growing exponentially, our goal is to facilitate certainty and deliver efficiency through a one-stop, centralized, automated environment for the entire life cycle of these instruments.”

Peter Axilrod, DTCC managing director, Business Development, thanked customers for their role in the service’s success. “We thank our Deriv/SERV customers, both dealers and buy-side firms, for their commitment to working with DTCC to expand and enhance Deriv/SERV,” he said. @

this article, the number of customers has reached 500.]

“Back-office operations can be one of the biggest sources of operational risk. By increasing automated processing rates, the recently overhauled Deriv/SERV is assisting clients to reduce the risk and cost of time-consuming and error-prone manual processing. Wynn reports that clients, including buy-side and sell-side firms, report that automated confirmation of credit derivatives trades grew to more than 60% in early 2006 – an increase from a mere 6% at the beginning of 2004.

[NB: The number of automated confirmations has now reached 70%.]

“The DTCC has also addressed trade backlogs through its partnership with Markit Red, (the market-standard database for confirming reference entities in the credit derivatives market). Markit Red’s 9-digit Clips (codes) are now required to aid the reduction in mismatches for dealers on the DTCC.” @



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

DTCC's 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.

The Depository Trust & Clearing Corporation (DTCC) is the holding company for the following subsidiaries:

- **National Securities Clearing Corporation (NSCC):** Clearance and settlement of broker-to-broker trades; mutual fund services; insurance services.
- **The Depository Trust Company (DTC):** Underwriting, custody and asset services, as well as settlement services for money-market and institutional trades.
- **Fixed Income Clearing Corporation (FICC):** Clearance and settlement for U.S. government securities and mortgage-backed securities.
- **DTCC Deriv/SERV:** Automated post-trade services for the global over-the-counter derivatives market.
- **DTCC Solutions:** Global corporate action services and restricted securities services.

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

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Printed by
DTCC Print Department