

Customers Rate DTCC: 91% Overall Satisfaction

by Helen Cunningham

For the third consecutive year, overall customer satisfaction with DTCC in 2006 remained at a world-class level, reaching 91% in this year's annual customer satisfaction survey. This is 2 percentage points higher than the 2005 score of 89%.

The rating, according to survey respondents, is attributable in large part to DTCC's ability to meet customers' needs consistently over time and to DTCC's responsiveness and customer-

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2007 Is Just Around the Corner For Underwriting Customers

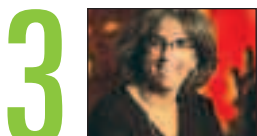
by Edward C. Kelleher

Urgent is the word Denise Russo uses when speaking about customers and the reengineering of DTCC's underwriting system. It's urgent that customers plan and prepare for the new platform, and it's urgent to begin now.

"The reengineering is not something firms can prepare for in a week or a month," said Russo, DTCC director,

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Is Your Transfer Agent DRS-Eligible?



Market Response to New Managed Account Service



Plans for New Alternative Investment Service

2007 Is Just Around the Corner *Continued from cover*

Asset Services. “We’re implementing a unified, end-to-end platform from issuance through the entire asset servicing life cycle, so the changes are enormous. This means our customers need to prepare their front and back offices and their systems for the new platform.”

SOURCE of efficiency

DTCC’s reengineering project, which will bring significant new efficiencies to the industry, is one of the most ambitious undertakings in the organization’s history. It entails redesigning the core systems for securities underwriting and corporate actions with a single new platform called the DTCC SOURCE – Securities Origination Underwriting & Reliable Corporate Actions Environment.

SOURCE will be rolled out in phases beginning next year. Underwriting will be the first system to launch, in mid-2007, followed by the corporate action system in 2009.

Connectivity decisions

Over the past several months, DTCC has been conducting customer outreach programs and meeting with industry associations to discuss the underwriting platform and distribute information and checklists for the project.

Some of the major decisions customers face deal with connectivity. Underwriters need to decide which electronic communication method they will use to connect to DTCC’s depository for each asset class, such as certificates of deposit, various forms of corporate debt, equities, municipal bonds and securitized debt.

“All of our underwriting customers must determine how they want to communicate deal information to the depository,” said Russo, noting that this decision will be influenced partly by whether the underwriter is global, national or regional. “Will they use an external bookbuilding/running system such as Bondesk Syndicate or Dealogic? Will they use a direct connection to the depository? Or will they use the new platform’s Web-based screens?”

Once firms make this decision, a host of other issues arise. For instance, if customers select an external system, they must ensure

the supplier understands the business requirements and the timing involved in testing and implementing the new connection.

An underwriter that opts for a direct connection to the depository will need to obtain and understand file layout specifications, establish connectivity with DTCC’s SMART network and schedule testing, training and implementation with the depository.

Some of the changes

The new underwriting system will include a centralized, automated system that will gather information from underwriters on new bond and securities issues and distribute it electronically in real-time to bond market participants. It will make trade confirmation, clearing and reporting easier, faster and more accurate.

“We still have customers who make phone calls and fax hard copies when

making an issue eligible. This new system will completely change the way they do business, doing away with paper and moving the customer into real time,” said Russo. “It’s a bit like stepping out of the 19th century into the 21st.”

The implementation of SOURCE will require firms to make many other changes. For example, to accelerate and streamline the underwriting process, and to support regulatory requirements, customers will have to give the depository their underwriting information earlier and in greater detail. In addition, offering documents will need to be digitized for ease of handling.

Time is the scarcest resource

Earlier this year, a senior vice president of operations at a financial services firm said, “One of the great challenges DTCC faces with the

reengineering project is the fact that the deliverables are quite a ways off. It’s hard to get people in our industry to worry about something that going to happen next year or in 2008.”

This is a challenge that DTCC has to meet, said Russo. Which gets back to the word “urgent.” @



SUE LEVINE

Denise Russo, DTCC director, Asset Services

The DTCC SOURCE: Where to Learn More

DTCC has developed a package of materials for customers with information about the reengineering project, how customers and the industry will be impacted and what customers need to know and do in the coming months.

For underwriting customers, the materials include a rundown of major system and process-flow changes; new procedures; a checklist for planning for the changes; and examples of asset classes and communications methods.

To access these and other materials about this initiative, visit DTCC’s reengineering Website at www.dtcc.com/reengineering or contact Denise Russo, DTCC director, Asset Services, at drusso@dtcc.com or 212.855.3731.

Attention All Underwriters: Is Your Transfer Agent DRS-Eligible?

by Edward C. Kelleher

Underwriters planning to offer new listed issues on the New York Stock Exchange, NYSE Arca, the American Stock Exchange or Nasdaq on or after January 1, 2007, must have a transfer agent that participates in DTCC's Direct Registration System (DRS).

This is due to new exchange rules recently approved by the Securities and Exchange Commission (SEC), which specify that newly listed issues coming to market on or after the January 1 deadline must be DRS-eligible on the first day of trading. (Existing listed issues will have to

become DRS-eligible by January 1, 2008.)

"Under the rule changes, if the issue has a transfer agent that is not DRS-qualified, it will violate the exchange rules," said Joseph Trezza, DTCC vice president, Asset Services. "This is why we're urging underwriters to look at the new processing paradigm sooner rather than later."

Make it FAST

DRS provides for electronic direct registration of eligible securities in a registered holder's name on the books of a transfer agent or issuer, and allows transfer agents and brokers to transfer shares between each other electronically. DRS is just one way an investor can elect to hold assets; shares also can be held electronically in street name through a broker.

DTCC is also telling underwriters to pick a transfer agent that is a FAST agent because agents must qualify as FAST in order to become DRS-eligible. FAST is DTCC's Fast Automated Securities Transfer service that enables agents to provide electronic custody, transfer, deposit and withdrawal services quickly and efficiently.

Spreading the word

When the SEC approved the rule changes, the response from the industry

was enthusiastic. "It was exciting news and a major advance for the industry," said AnnaMaria Freeman, director, Merrill Lynch & Co., and secretary of the Syndicate Operations Association, the industry trade organization that represents underwriters.

"DRS will help streamline and bring new efficiencies to the underwriting process," she said. "Now we just have to make sure everyone is aware of the change and ready to meet the January 1, 2007, deadline."

DTCC recently sent letters to all underwriters alerting them to the rule changes and providing a list of current DRS-eligible transfer agents. Trezza said DTCC will continue to work with the Syndicate Operations Association to ensure underwriters are up to speed on what the rule changes require.

The number of issues that are DRS-eligible has grown in recent years to 1,234, and the rule changes will add more than 9,000 listed issues to the DRS program by January 1, 2008. @

[For more information on requirements related to the rule changes, contact Joseph Clemente, DTCC manager, Asset Services, at 212.855.2425 or jclemente@dtcc.com.]



AnnaMaria Freeman, director, Merrill Lynch & Co., and secretary of the Syndicate Operations Association

To Learn About Losing Paper, Use the Web

Need to get up to speed on electronic share registration? One place to get your questions answered and to tap into a reservoir of information is the appropriately named "No-More-Paper" section on DTCC's Website, www.dtcc.com/nomorepaper.

The site offers separate sections for industry professionals, issuers and investors, and provides answers to a long list of frequently asked questions (FAQs) about how to jettison paper share certificates and begin using the Direct Registration System (DRS).

Readers can also find out what it costs to issue paper certificates, which companies have already sworn off paper certificates and which countries no longer allow issuers to put out paper securities.

"Now that the major exchanges require issuers to switch to DRS, and the Securities and Exchange Commission has approved, broker/dealers and others need to tell their investor clients about the changes coming – and this Website provides lots of useful background information to help with that communication task," said Joseph Trezza, DTCC vice president, Asset Services.



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centric orientation. Here's how one customer summed up his view of DTCC: "They provide tremendous value to the marketplace and the investing public."

The Melior Group, which DTCC contracted to conduct the survey, noted that measured against its index of survey results for similar organizations, including some Fortune 500 companies, "DTCC scores above the industry average on virtually all key metrics."

Dialogue pays off

The survey data indicate DTCC strengthened its performance across a range of criteria that

are important to both customers and the company in achieving its goals.

"Customer satisfaction is an enterprise-wide priority at DTCC and it is based on ongoing dialogue with our customers," said Donald F. Donahue, DTCC's president and CEO. "Over the past several years, we've extensively implemented the Six Sigma program throughout the company to raise quality awareness among all employees, and the constant across all these quality initiatives is that they must be customer- and metrics-driven."

Four drivers

Four variables serve as the primary drivers of overall satisfaction with DTCC, according to The Melior Group's analysis of the data: transaction-processing capabilities, customer service, commitment to quality and customer-centric focus.

DTCC received a 95% satisfaction rating for its transaction-processing capabilities, a 5-point increase over last year's 90%.

"DTCC processes an extremely high volume of transactions with very high efficiency," said one customer. "Daily processing is generally seamless," noted another.

For customer service, the satisfaction rating was 81%, up 9 points from 72% in 2005. "Customers were most satisfied with the courteousness and helpfulness of service personnel," noted The Melior Group. Areas in which customers are looking for stronger service include innovation and communications. Customers are least satisfied with the process for escalating unresolved problems to a more senior level.

When it came to rating their individual relationship managers, 91% of survey respondents were satisfied, giving high marks for knowledge, attentiveness, sense of urgency and accessibility.

Customers also indicated satisfaction with DTCC's commitment to quality in

In the Customers' Words

Here are some of the write-in comments customers included in their 2006 survey responses.

- DTCC has done a good job providing industry solutions while continuing to drive down cost.
- Be more timely with explanation and causes of issues with the systems.
- We have a great partnership and DTCC does a very effective job balancing the best interests of the industry.
- Become more global.
- There is room for improvement, particularly in reducing the time it takes to get to the right person to answer questions regarding operations.
- From a day-to-day operations perspective, while not perfect, I think DTCC performs admirably. I am also pleased with DTCC's thought leadership and responsiveness on industry issues.

2006, which received a 91% rating, up 6 points over last year's 85% score.

For being customer-centric, survey respondents gave DTCC a 76% satisfaction rating, up 13 points from 2005. "We've made progress in terms of being perceived as customer-centric, but this is an area we'll remain focused on in 2007," said James Koster, DTCC managing director, Relationship Management. "We'll be looking to deepen our knowledge of our customers' businesses and to be more innovative, proactive and creative. We'll also improve the transition process when relationship managers change, which is a topic that received comments in this year's survey."

Ensuring responsiveness

DTCC formulated its 2006 customer strategies and action plans after a thorough analysis of the 2005 survey data and other feedback, according to Koster. "That means we have our customers to thank for this year's strong survey results, which will now serve as the basis for further improvements in the coming year."

DTCC has taken other steps in recent years to ensure responsiveness to customers. For instance, customer satisfaction action plans are metrics-driven so that progress can be tracked and measured. In addition, the senior management team reviews these plans and monitors them throughout the year. And to leverage success, business units now share best practices across the organization.

What's more, DTCC restructured the Relationship Management and Customer Service functions for several business units in 2005, based on customer feedback.

Also significant, said Koster, is that, "All employees take responsibility for customer service and all employees share the credit when the results are positive."

Other leading indicators

For integrity, DTCC received a 94% satisfaction rating, up 4 points from 2005.

The 2006 Survey Process

The marketing research firm The Melior Group, which specializes in the financial services industry, conducted DTCC's customer survey for the third year in a row. With input from DTCC executives, Melior updated the questions for 2006 and streamlined the entire survey to focus on key areas of concern for DTCC and its customers.

Melior surveyed a total of 2,551 customer contacts. Of these, 738 participated, for an overall response rate of 29% (up from 21% in 2005). Based on industry benchmarks, this response rate is "a strong showing," according to Melior.

"Integrity and trust are intangible, yet absolutely critical, assets that a corporation must bring to its customers," said Donahue. "Given DTCC's role at the center of the industry's infrastructure, we have always made integrity a cornerstone of our corporate culture and the 94% rating on this measure tells us customers strongly associate DTCC with integrity."

Communications, specifically DTCC's ability to keep customers informed, posted a 10-point gain in satisfaction for 2006, rising to 85% overall. "In terms of the specific communications attributes evaluated, customers were most satisfied with the reliability/credibility of information offered and least satisfied with the presentation of complex topics in an easy-to-read manner," said The Melior Group.

Focus on problem resolution

Most customers surveyed (72%) did not experience a problem with DTCC in 2006, which compares with 65% last year. That means 28% of customers had a problem, an incident rate that is "fairly typical for major players in the financial services industry," according to The Melior Group.

Overall, half of survey respondents expressed satisfaction with DTCC's ability to resolve their problems. However, the more severe the issue, the less satisfied customers were with DTCC's ability to resolve it.



James Koster, DTCC managing director, Relationship Management

"While we've made progress, customers continue to express concerns about how we handle their problems, including how we communicate about them, how quickly we resolve them and the time it takes to escalate problems to a more senior level within DTCC," said Koster. "So we have our work cut out for us on this front, and it will remain a key area of focus in the coming year."

Overview of technology

Another area of the business that posted strong gains over 2005 was satisfaction with DTCC's technology. "Improvements were noted on all factors," said The Melior Group.

Customer satisfaction with connectivity climbed 12 points to 86% in 2006 while satisfaction with DTCC's hardware and software increased to 81%, up 7 points from the previous year. "I find the infrastructure to be scalable, reliable,

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problem-free,” said one customer. “Apps are designed well and meet most needs,” said another.

With regard to reliability, customer satisfaction rose to 93% in 2006, up 7 points over last year. “DTCC provides a stable environment,” noted one survey respondent.

For leveraging the Internet, customers gave DTCC a 72% satisfaction rating, which is 13 points higher than last year, but still leaves ample room for improvement.

Suggestions for improving technology included:

- Make the systems easier to use. “Some of the systems are not very user-friendly, but they get the job done,” noted one customer.
- Enhance/expand systems (especially Internet-based services). “DTCC could be a bit more creative with industry solutions – more technology is needed,” said one customer.

Satisfaction with products

For the breadth of its product/service line, DTCC received a 90% satisfaction rating, 7 points higher than last year.

In addition, customers indicated substantial or moderate increases in satisfaction for all products and services evaluated. What’s more, 16 of the 18 products surpassed or met DTCC’s corporate goal of 80% satisfaction and many services posted double-digit improvements from 2005.

Issues of strategic interest

Customer satisfaction with DTCC’s industry leadership reached 80% in 2006, up 12 points over last year. When asked how DTCC could strengthen its performance, one senior executive said the organization should, “Continue to leverage their position and knowledge in the thought leadership area.”

To gain a better understanding of strategic issues impacting customers’ organizations and the industry, the 2006 survey posed a series of questions to senior contacts, asking them to discuss issues related to DTCC’s current role and future positioning in the industry.

Risk management, in particular settlement, processing and system risk, was one concern of the executives surveyed. DTCC received an 84% satisfaction rating for its effectiveness in reducing risk in the 2006 survey, an 8-point increase over 2005.

In terms of addressing industry issues, 94% of senior contacts view DTCC as the “go-to” solutions provider. In addition, the survey respondents cited issues they would like DTCC to focus on in the coming years, including globalization, customer service, bringing the investment community together and standardization.

DTCC is regarded as a partner by 90% of senior contacts, with the remainder indicating they would like DTCC to strengthen its efforts to partner with them. “Partnering means better, more holistic cost-effective solutions,” said one customer. @

Customer Survey Results: Next Steps

In September and October, The Melior Group presented a summary of the 2006 customer survey results to DTCC’s Board of Directors, the Quality Council and to DTCC officers.

In the coming months, DTCC will implement a series of initiatives to address the customer feedback received, with a strong emphasis on metrics-based methodologies to achieve results and improve the customer experience.

All business managers and relationship managers received a detailed overview report of the survey, along with access to the complete survey results. They have reviewed their survey responses to identify concerns that required immediate follow-up with specific customers.

The business units also have analyzed their data to identify key themes that surfaced in the survey and, based on these data along with other measures of customer satisfaction (such as advisory boards, call volumes, etc.), developed action plans. These plans will be presented to senior management for review and approval, and then incorporated into DTCC’s goal-setting process at both the corporate and departmental levels.



DTCC Adds New Stock Exchange To Clearance and Settlement

by Michael Bellini

For the first time in nearly a decade, DTCC's National Securities Clearing Corporation (NSCC) has added a new exchange to its clearance and settlement applications: the International Securities Exchange (ISE). The addition of ISE, which went live September 8, gives NSCC customers an additional platform for trading equities.

Implementation of the ISE was transparent to the industry and required minimal systems changes for NSCC members other than recognizing the new exchange. NSCC last added an exchange when ArcaEx, now part of NYSE Arca, launched in 1997.

Built-in flexibility

The New York-based ISE, which introduced the first fully electronic U.S. options exchange in May 2000, received approval from the Securities and Exchange Commission (SEC) to trade equities in September.

"Last year, the people at ISE approached us about adding equities trading to their exchange," said Hank Belusa, DTCC vice president, Equity Clearance and Settlement, noting it took about four months to get the ISE up and running on NSCC systems. "We pre-implemented our software in July of this year, anticipating the eventual SEC approval." The implementation included a thorough testing process to ensure proper connectivity, functionality, speed and reliability.

NSCC's timely response was due in large part to the way its clearance and settlement systems are built and maintained. "We designed the systems with the flexibility to handle these requests with minimal development work on the part of our customers and new exchanges," said Belusa. "This flexibility ensures we can support the markets as they undergo change – due to

competitive, strategic, regulatory or other reasons – quickly and with minimal disruption to the industry."

Go to RIO

ISE operates on NSCC's Regional Interface Operation (RIO) Trade Capture and Reporting application, which processes U.S.-

domestic equity and corporate bond transactions from the regional markets. RIO is set up to handle customer input and output from multiple exchanges, which further contributed to making the addition of ISE relatively seamless, according to Robert Yodice, DTCC director, Equity Clearance and Settlement.

To implement the new platform, NSCC enhanced its participant master file to recognize ISE member clearing firms, along with the application that processes and transmits trades to customers. Now, NSCC customers can obtain all their ISE transactions from the RIO application with ISE segregated in a new section of the print image trade-reporting contract.

Additionally, NSCC added ISE as another valid exchange on its RIO intraday machine-readable output.

Real-time reporting

ISE is one of the first exchanges on RIO to report real-time messages to NSCC, as the norm in the past has been to report trades in

multiple batches. Real-time messaging will become the standard reporting method in the near future.

The ISE Stock Exchange currently executes orders at the midpoint price of the National Best Bid and Offer throughout the trading day. ISE reports that it plans to expand to a best bid offer market later this year.

The new exchange began trading with 10 stocks and plans to add new companies regularly. @



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– Hank Belusa



Fail Netting Goes Live – Successfully

by Jim Conmy

Fail netting – taking U.S. government securities obligations that failed to clear and recycling them through the netting process on the next business day in order to find a match – is proving to be a success, according to DTCC's Fixed Income Clearing Corporation, which went “live” with its new automated fail-netting service on September 22.

“By taking failed trade obligations from the previous day and routing them back through the netting process, our aim is cut down on the number of current fails,” said Rachel Tyler, DTCC product manager, Clearance and Settlement Group. “In this case, second time around is usually good news.”

Repeating the ‘rinse’ cycle

The idea behind the Government Securities Division's (GSD) fail-netting service is that by putting failed clearance obligations from the previous day back into the netting process, where they can be combined with new trading activity in the same CUSIP, there is a good possibility many of the fails can be eliminated.

“The process works particularly well when fail volume is high,” Tyler said, “as participants often enter opposing contracts to offset outstanding fails.”

Although fail volume can sometimes “spike,” it has been significantly lower this year than in years past. “However, as history repeats itself,” Tyler said, “we will experience events that contribute to failed obligations again, and this is when market participants will really feel the benefits of automated fail netting.

“Our experience with the service so far is that it's doing exactly what we expected,” Tyler continued. “We're

eliminating fails, which helps customers reduce their risk exposure and helps us minimize the need to carry failed clearance obligations on our books.”

Smooth operation

Operationally, the implementation of the new service went without hitches, according to Joseph Brennan, DTCC director, Operations. “FICC successfully tested the new fail-netting output with each and every GSD netting participant before we went live to ensure there were no problems,” Brennan said. “From an operations point of view, it was a ‘non-event’, which is always a good thing.” @



‘Driving DTCC’s Expansion’

In his first interview since becoming DTCC's president and CEO, Donald F. Donahue spoke with *Dialogue* magazine about the challenges facing the world's market infrastructure, along with his vision for DTCC's expansion into new service areas globally.

Titled “Driving DTCC's Expansion,” the cover interview appears in a special edition

of SWIFT's quarterly publication produced for the annual SWIFT Sibos conference, held in Sydney, Australia, in October. Donahue attended the week-long event, which brings together the industry's leading figures and firms from around the world.

To read the interview, visit www.swift.com, click “About SWIFT,” “Publications,” “*Dialogue* magazine.” @



Market Responds Favorably to New Service for Managed Accounts

by Karen Clarke

DTCC's September announcement that it will build a new service to streamline the processing of managed accounts, partnering with Citigroup Smith Barney and Global Transaction Services, the industry's leading sponsor and outsourcer, received ample coverage in the financial media.

"I think this has the potential to push

market, coupled with our operational capabilities and infrastructure, will bring an unprecedented level of efficiency to this growing segment."

Managed accounts – investment portfolios customized for high-net-worth investors – still rely on paperwork, faxes and phone calls to set up and maintain the account. This is a challenge for managers

distribution opportunities increase. The time and cost savings will be welcome news for SMA managers struggling with low profit margins and high cost margins." Jeff Strange, senior analyst at Cerulli Associates, *FUNDfire*, 9/13/06.

- "This collaboration is an important step forward in the industry's drive for adoption of the MMI message standards.

'Ultimately, this is about growing the managed accounts industry and helping investors reach their goals.'

Paul Hatch, managing director, Smith Barney, *Securities Industry News*, 9/18/06



Ann Bergin, DTCC managing director and general manager, Mutual Fund Services

the industry to the next level," Robert Del Col, president of FundQuest Inc., a Boston-based provider of wealth management solutions, told *InvestmentNews* (9/18/06).

Automating a new market segment

DTCC's service is the first of its kind to link managed accounts firms to a centralized platform through a single connection. It will automate and standardize the exchange of information on these accounts in near straight-through processing. Testing is expected to begin in November.

In an article about the new service in *The Asian Banker* (9/15/06), Ann Bergin, DTCC managing director and general manager, Mutual Fund Services, said, "This is a powerful partnership of world-class capabilities. The combination of Citigroup's leadership position in this

and sponsors with \$740 billion in assets under management. With the industry poised to reach \$1.5 trillion in assets in five years, market participants agree that greater efficiency is vital.

Marketplace reactions

Here are some of the other published comments about DTCC's new managed account service.

- "Industry experts are hailing the DTCC's announcement and Citigroup's involvement, calling it one of the largest victories to date in the effort to build a centralized, SMA-focused system." *FUNDfire*, 9/13/06.
- "Under the DTCC initiative, managers plugged into the organization's scalable hub would see processing and administration costs decrease and

'Industry experts are hailing the DTCC's announcement and Citigroup's involvement, calling it one of the largest victories to date in the effort to build a centralized, SMA-focused system.'

FUNDfire, 9/13/06

It moves it from an idea that the industry supports to the reality of implementation." Gary Jones, vice president, Industry Operations, the Money Management Institute, 9/13/06.

- "This announcement shows some real muscle and commitment by this industry, and ultimately, the consumer gets a better product." Jamie Waller, chief operating officer, Fugent Inc., *InvestmentNews*, 9/18/06.
- "Ultimately, this is about growing the managed accounts industry and helping investors reach their goals." Paul Hatch, managing director, Smith Barney, *Securities Industry News*, 9/18/06. @
[For more information on DTCC's managed accounts service, call the Mutual Fund Services helpline at 212.855.8877.]

DTCC Plans to Pilot a New Service for Alternative Investment Products in Early 2007

by Karen Gregory

DTCC, through its subsidiary National Securities Clearing Corporation (NSCC), is moving forward with plans to deliver a standard platform for processing and settling alternative investments in an automated, centralized and streamlined environment. The platform will leverage and customize existing systems to create a service that meets the unique needs of the industry, supports future growth and increases scalability.

In early 2007, 10 funds, fund administrators and broker/dealer firms are scheduled to pilot-test the proposed service, which is subject to approval by the Securities and Exchange Commission.

Automating a new market segment

The service is designed to address some major operational issues faced by the alternative investment product market. These include new account openings and subscriptions (purchases), tender offers (redemptions), commission payments, fund security profiles, position reporting, account activity, distributions, valuations and account maintenance.

For an industry that today largely relies on manual processing, the service will offer several key benefits:

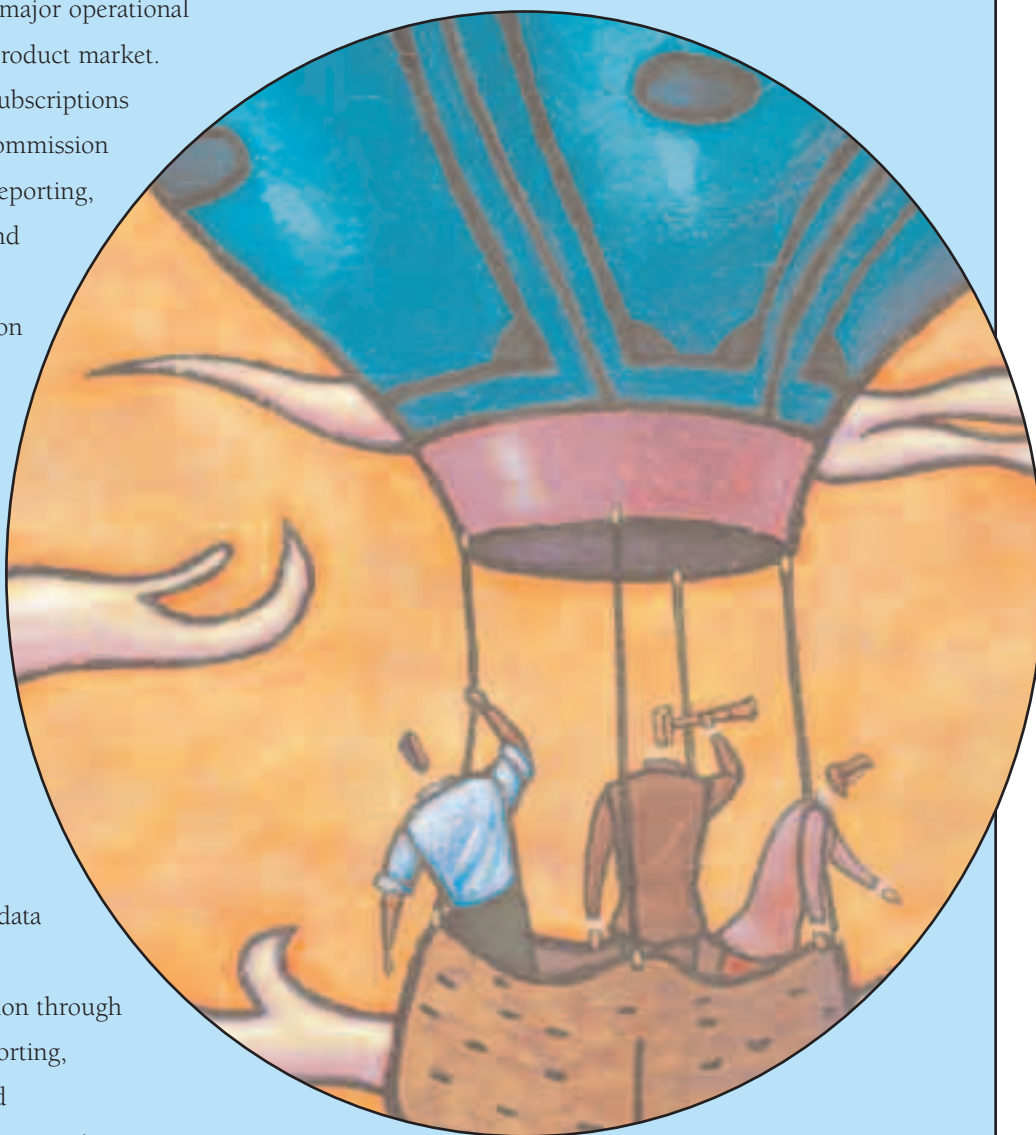
- Increased efficiencies and reduced costs through automation and standardization of transactions, the use of one standard file-transmission format and a centralized location that eliminates the need for multiple individual connections.
- Lower risk of errors through data repositories that store, back up and streamline information management.
- Settlement through electronic transfer of data and a centralized settlement process.
- Improved client service and communication through the timely dissemination of valuation reporting, commissions, account profile updates and acknowledgements and confirmations of transactions.

Documentation flow

In recent months, DTCC and its pilot committee have been discussing another critical operations issue: managing the flow of documentation.

“It’s become clear that the documentation requirements associated with these transactions are increasingly burdensome. Processing 40 to 50 pages for each transaction is not unusual,” said Ann Bergin, DTCC managing director and general manager, Mutual Fund Services. “We believe there’s an opportunity for us to create a solution that could redefine the process.”

DTCC is currently working with the committee to evaluate various ways to automate the transfer of these documents. @



FICC Adopts New Approach to Gauge Clearing Fund Requirements

by Jim Conmy

Beginning in January 2007, DTCC's Fixed Income Clearing Corporation (FICC) will calculate the clearing fund requirements of its Government Securities Division (GSD) participants using a "value-at-risk" (VaR) approach that is both broader and more sophisticated than the previous methodology.

The overall impact of the new approach, according to Cheryl Lambert, DTCC managing director, Risk Management, is likely to be a decrease from the roughly \$9 billion in clearing funds that government securities trading firms keep with FICC under current market conditions. The funds are set aside to cover any potential liability associated with a participant's failure to settle securities or funds obligations, or to satisfy obligations associated with the terms of repurchase agreements. DTCC's National Securities Clearing Corporation already uses the VaR model for its ongoing risk analysis and management.

Lower fund requirements

"Clearing fund requirements for most of our FICC member trading firms will probably drop because the new model measures risk more accurately," Lambert said. "However, some firms, depending on the composition of their portfolios, are likely to see an increase in their clearing fund contribution because we're now covering a three-day liquidation period to close out a portfolio instead of a single day. We're also geared to a confidence level of 99% instead of 95%, which means the system has less tolerance for risk," she said.

After analyzing sample portfolio data for 75 business days using the new VaR approach, FICC identified those brokers or banks whose clearing fund requirements might go up instead of down. "We've already been in touch with these firms to walk them through the methodology to ensure they understand the changes that are coming," Lambert said.

Widely employed in the financial industry as a risk management tool, VaR uses a number of interlocking methodologies to estimate possible losses for a given portfolio due to the uncertainty of the market during a specific time period. The discipline also lets companies run models to determine what confidence level for risk aversion they're comfortable with. The new approach will replace the margin factor method that FICC has traditionally used to calculate firms' clearing fund requirements.

New model examines more variables

Jiping Guo, DTCC vice president for Quantitative Risk Management, noted that the company's traditional model relies on



a specific set of bond characteristics to measure risk.

VaR values each bond individually, builds in hedging benefits, looks at the historical market information for the instruments and reaches a more comprehensive conclusion about their risk profiles.

In essence, according to Guo, VaR provides an estimate of the possible losses due to market volatility for a specific portfolio based on a given confidence level over a pre-set time horizon. The time period is usually the number of days required to close out a portfolio, while the confidence level reflects how much protection a firm hopes to achieve.

Five factors

For its new VaR clearing fund calculations, FICC will analyze five risk components:

- Bond volatility based on interest rate movement over a three-day period
- Exposure to mortgage-backed securities, which are increasingly used as collateral for general collateral finance repos
- Repo interest rate volatility over a three-day period
- Model coverage, which employs a daily "front-weighted" back test, meaning it gives more weight to recent data, using 150 days of portfolio for each participant
- "Margin requirement differential," which helps to mitigate the risk that a participant may fail to make up a deficiency in its required clearing fund deposit or be unable to meet "funds-only" financial obligations such as

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New Rules Approved for Calculating Clearing Fund Premiums

by Jim Conmy

DTCC's clearing corporations initiated new collateral premium rules in October that apply to Government Securities Division (GSD) members of Fixed Income Clearing Corporation (FICC) and members of National Securities Clearing Corporation (NSCC). The new rules, which the Securities and Exchange Commission approved on September 15, link collateral premiums far more closely to potential risks than previous methods.

For FICC's GSD members, who were routinely charged a premium of 25% on the amount by which their clearing fund requirement exceeded their excess net capital, the new rules mean a different formula – one that links any premium requirements directly in proportion to the amount of risk the members carry.

For NSCC, which until this month did not utilize a collateral premium, the new rules mean that members, depending on the nature of their portfolio, may now occasionally be required to pledge additional collateral based on the new formula. The calculation for determining the premium excludes certain components of the NSCC clearing fund. (For more detail, see NSCC Important Notice #A6304.)

Building in flexibility

"The new methodology gives us more precision in determining how much collateral premium, if any, our members may need to set aside for potential risks," said Richard Macek, DTCC executive managing director, Risk Management, Finance and Distribution Services. "It also fortifies the industry's objective of 'mutualizing' risk through the clearing corporations because it applies automatically and proportionately to each member based on their

specific risk profile for that specific day."

Some smaller member firms, Macek noted, expressed concern about the impact of the new rule. "But we feel there is adequate flexibility in the way the rule is written to address the risk issues involved and not overly burden these smaller firms. For example," he said, "if a member has an unexpected capital charge that doesn't really change its risk profile, we're not obligated to impose a collateral premium. We can make a case-by-case judgment."

That was then...

In the past, FICC's practice was to compare a member's clearing fund requirement each day against its excess net capital. If the clearing fund requirement exceeded the member's excess net capital, the clearing corporation would charge a premium of 25% on that difference and add it to the clearing fund.

"For example," explained Marc Golin, DTCC vice president, Risk Management, "if a member's clearing fund requirement was \$11.7 million and its excess net capital \$10 million, the clearing corporations would impose a 25% levy against the \$1.7 million difference and add the \$425,000 result to the member's clearing

'The new methodology gives us more precision in determining how much collateral premium, if any, our members may need to set aside for potential risks.'

– Richard Macek

New Approach for Clearing Fund Requirements

Continued from page 11

coupon payments due on bonds in a trade that has not yet settled.

History repeats itself

What the five components have in common is that they all use historical market information to create simulated losses. "The basic assumption," Guo said, "is that, from a risk perspective, history will repeat itself." @

[To learn more about FICC's VaR methodology, contact Jiping Guo, DTCC vice president, Risk Management, at jguo@dtcc.com or 212.855.5755.]

To make sure participants are acquainted with the new VaR methodology, DTCC's Risk Management department has scheduled a series of meetings to review the subject with customers. The one-hour sessions will be held at DTCC's New York City offices on Thursday, November 30, at 9:00 a.m.; Tuesday, December 5, at 11:30 a.m.; and Thursday, December 7, at 1:00 p.m. All GSD participants will receive an Important Notice regarding this and are encouraged to contact their relationship manager about the educational sessions.

fund, increasing it to \$12.125 million.” (\$11.7 million - \$10 million = \$1.7 million x 25% = \$425,000 + \$11.7 million = \$12.125 million.)

New calculations

To provide a more precise approach to calculating the collateral premium, the new rule does away with the fixed 25% calculation. It also ignores the calculation of historical averages that FICC will overhaul next year when it implements its new “value-at-risk” methodology for calculating GSD clearing fund requirements. (See article, page 11.)

Instead, the new rule takes the ratio by which a member’s clearing fund requirement exceeds its net capital, and multiplies that ratio against the difference between the clearing fund requirement and the actual net capital. The result is a much more dynamic, interactive formula for determining how much additional capital may be needed. Increases – or decreases – in collateral premium will come in direct proportion to changes in the ratio.

As in the example above, where the netting member has excess net capital of \$10 million and a clearing fund requirement of \$11.7 million, the new formula would calculate the ratio of the two numbers ($11.7 \div 10 = 1.17$) and multiply that ratio times the actual difference (\$1.7 million) for a total collateral premium of \$1.989 million ($1.17 \times \$1.7 \text{ million} = \1.989 million). The \$1.989 million of premium capital would then be added to the base clearing fund requirement of \$11.7 million, bringing the member’s clearing fund total to \$13.689 million.

Broader capital definition

“This approach allows us to raise or lower the premium exactly in proportion to any increase or decrease in the ratio,” Golin said. “Thus, it ties the additional capital premium directly to the risk presented, rather than basing it on a fixed 25% surcharge against the difference between excess net capital and the clearing fund’s need. It’s much more flexible.”

The new rule also expands the application of the collateral premium to bank and trust company netting members whose capital is measured as equity capital rather than as excess net capital, adjusted net capital or liquid capital.

The new rules went into effect October 16, 2006. @

[For more information, read the Important Notices on this topic at www.ficc.com/gov (Important Notice #GOV105.06) and www.nsc.com (Important Notice #A6304). You may also contact Marc Golin, DTCC vice president, Risk Management, at mgolin@dtcc.com or at 212.855.7640.]



Now Available: Deriv/SERV Connection via SWIFTNet

by Judith Inosanto

DTCC announced that a connection to its Deriv/SERV over-the-counter (OTC) derivatives matching and confirmation service is now available on SWIFTNet, which is SWIFT's Internet Protocol (IP) messaging platform.

The link between the two services allows customers on the SWIFTNet platform to deliver real-time transaction data to DTCC Deriv/SERV for matching and confirmation without having to create a separate, direct computer-to-computer connection to DTCC.

"Our ability to provide customers with access to Deriv/SERV via SWIFTNet enables them to reuse their investment in the SWIFTNet infrastructure and communicate with Deriv/SERV in a time-efficient and cost-effective manner," said James Donovan, head of Securities Industry Division and member of the Executive Committee, SWIFT. "This eliminates the need to operate and maintain multiple links or the need to perform spreadsheet uploads of data into Deriv/SERV."

Expanding options

Deriv/SERV provides automated matching and confirmation for a wide range of credit, interest rate and equity derivatives products. Its global customer base includes more than 640 dealers

and buy-side firms in more than 25 countries.

SWIFT is the industry-owned cooperative supplying standardized messaging services and interface software to the financial industry. In addition to computer-to-computer messaging, market participants can connect to Deriv/SERV via a secure Web-browser interface or a spreadsheet upload capability via the Internet.

"Our collaboration with SWIFT expands the options available to buy- and sell-side firms to transmit real-time data to Deriv/SERV," said Peter Axilrod, DTCC managing director, Business Development. "This allows us to provide even greater automation levels and accuracy to the market place."

How it works

Connectivity to Deriv/SERV is made available through the SWIFTNet InterAct messaging service. It is secured with SWIFTNet PKI for message authentication, encryption and integrity control.

"This link with SWIFTNet is another example of how DTCC is working with a number of complementary solution providers to provide the market with greater access to Deriv/SERV and the benefits of automated processing," said Axilrod. @



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Fund/SERV Posts Solid Growth in Offshore and Collective Fund Transactions

by Karen Gregory

The volume of offshore and collective funds (including stable-value funds) being processed through Fund/SERV has grown steadily over the past year.

Fund/SERV is provided by DTCC's National Securities Clearing Corporation (NSCC) subsidiary.

Offshore overview

At the end of the second quarter of 2006, offshore processing averaged more than 38,000 transactions a month, valued at over \$4.2 billion. This compares with just over 30,000 per month in 2005, worth \$2.4 billion.

One driver of the increased volume is the fact that in the past year, Fund/SERV has added three new offshore funds; seven more are in the process of becoming members.

"The number of individual funds on Fund/SERV has been increasing, as a result of existing clients creating new share classes and integrating their offshore business into their domestic processing model," said Paul Lacher, DTCC senior relationship manager, Mutual Fund Services. "Right now, we have close to 4,000 offshore funds from 49 fund companies." Offshore companies participate in Fund/SERV generally through a U.S. parent organization or affiliate, or a U.S.-based third-party sponsor.

Offshore funds are typically managed by U.S. fund managers and domiciled outside the United States in such places as Luxembourg and Dublin for distribution to the non-resident-alien market.

Lacher noted that offshore funds are attractive investments for several reasons. "For U.S. fund sponsors, many offshore funds are 'mirrors' of domestic funds in terms of investment objectives, portfolio composition and manager, the only difference being that they're sold to a different client base. Another reason for their appeal is that offshore funds include U.S. dollar- and euro-denominated product choices."

Fund/SERV handles offshore fund transactions in either dollars or euros and includes features such as submission of future trade

dates, where the processing date of the firm differs from the trade date of the fund; the ability to add, change or delete currency and country holiday lists; and external settlement outside NSCC.

Collective funds

Collective funds, or collective investment trusts, also have been moving onto the Fund/SERV platform at a progressive rate, said Chuck Patel, DTCC senior relationship manager, Mutual Fund Services.

A collective fund is an investment portfolio of assets from a group of investors that are pooled into a trust, which is then invested in stocks, bonds and other securities. The funds are

similar to mutual funds but available exclusively to qualified retirement plans, such as 401(k) plans, and are regulated by the Office of the Comptroller of the Currency and other banking regulators.

NSCC received approval from the Securities and Exchange Commission to process collective funds and other non-registered instruments in 2000. At the end of that year, the service processed a mere 600 transactions (a combination of collective and stable-value funds). For the first half of 2006, collective fund transactions alone had increased to more than 175,000.

Steve Ferber, executive vice president, AST Trust Company, said that plan-sponsor demand for lower-fee fund products

(collective funds accept only institutional clients and typically do not have the fees or expenses often found in retail products) was one factor driving expansion in this investment type. Another was growing interest from retirement plan advisors.

Of equal importance, Ferber commented, was a shift in the way they are valued. "Collective funds were often valued on a monthly basis, so they weren't compatible with daily-valued 401(k) plans. Once they conformed to daily valuation, existing technology helped put them on an equal footing with other fund options. Through the use of the Fund/SERV platform, collective funds can now be traded seamlessly and efficiently with other 401(k) options," he said. AST is currently trustee of more than 30 collective funds. @



Steve Ferber, executive vice president, AST Trust Company

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Thank you, once again, for the high marks. @

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

Stuart Z. Goldstein
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Printed by
DTCC Print Department