Securities Operations
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NEWS & VIEWS

A digest of leading securities clearance, settlement and related regulatory news.

INSIDE:

TRANSFORMING THE PROCESSING OF FAILS & OTHER OPEN OBLIGATIONS

By Susan Cosgrove, DTCC Managing Director, Clearance and Settlement/Equities

In the U.S. capital markets, the industry is well served by an automated post-trade process that seamlessly clears, guarantees and settles trades that on a peak day can top 19 billion shares, or average about $2 trillion. However, regulators, policymakers and financial firms are justifiably concerned about ex-clearing trades, which are managed broker-to-broker using highly manual and error-prone processes, including phone calls and faxes to exchange information to ensure final settlement.

The process is inefficient and expensive – and, more significantly, fraught with operational and counterparty risk. The problem is particularly acute for correspondent clearers, who process ex-clearing trades on behalf of their customers. But this increased risk extends beyond just the parties to the trade. It also flows directly into the financial system itself. Because these trades are processed outside of NSCC's systems, it is impossible to estimate their numbers – making them essentially invisible to regulators and the industry and creating systemic risk during a time when financial firms are searching for new risk mitigation strategies.

Fortunately, NSCC has been working closely with customers to offer a solution. NSCC's Obligation Warehouse (OW) will transform the processing of ex-clearing trades and other open obligations, automate the management of fails, and act as a central repository of open broker-to-broker obligations. It will provide transparency for the industry and regulators while delivering operational efficiencies, cost savings and risk mitigation to financial firms.

Empowering Ops Professionals with a Real-Time Automated Service

When it comes to comparing ex-clearing trades, ops professionals have had limited tools to manage trades bi-laterally. This has created needless operational risk for firms, as well as increased costs and diverted resources from other back office responsibilities. The OW will close the chapter on the manual processing of ex-clearing trades by empowering ops professionals with a real-time automated service that will electronically manage these transactions and communicate a successful match to each side of the obligation. A new workflow will make resolving uncompared trades a simpler and more convenient task. (However, as is currently the case, NSCC's trade guarantee will not apply to these trades.)

Matched non-CNS balance orders and trade-for-trade obligations, which have posed their own set of challenges for firms in the past, will also flow into the OW, along with non-CNS Automated Customer Account Transfer Service (ACATS), and enjoy greater efficiencies and risk reduction until settlement.

A More Efficient Way to Manage Fails

The OW goes one step further by also automating the management of ex-clearing and non-CNS fails. Because these trades exist outside CNS, the back office faces an accounting nightmare in handling these transactions – not to mention bearing the added costs for maintaining comprehensive records and dedicating personnel to keep track of their status. At many firms, these costs can sometimes outweigh the benefits of the trade over time, creating a tough balancing act when trying to align the needs of the trading desk with the demands placed on the back office.

Steve Melanaski

“Steven Melanaski, Past President of the SIFMA Securities Operations Division notes, “The Obligation Warehouse holds great promise. The benefit will be a streamlined process that eliminates unnecessary buy-in messaging and faxing of paper confirms, and an accompanying reduction of financial exposure due to a reduction in unconfirmed trades and reduced settlement fails. The OW answers the industry's need for a comprehensive, automated system that reduces the inherent risk managing ex-clearing and non-CNS fails.”

The OW will help mitigate this risk by consolidating all ex-clearing and non-CNS fails in a central location and store them until settlement. This is good news for brokers, who will gain real-time access to their fails data, and an efficiency booster for the back office, which will be freed from having to manually log and update the status of these obligations. A daily maintenance function will check the fails for CNS eligibility and make updates for corporate actions. To minimize mark-to-market exposure,

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TRANSFORMING THE PROCESSING OF FAILS *continued*

OW will also perform reconfirmation and rematching on a more frequent basis than its predecessor, NSCC's Reconfirmation and Pricing Service (RECAPS). In addition, firms will no longer have to resubmit their open items for RECAPS because OW will submit all matched fails aged greater than two days.

First-Ever Repository for Open Broker-to-Broker Obligations

The OW enhances transparency by fully capturing, for the first time ever, all trading activity in NSCC-eligible securities in a central location from trade date until settlement. As a result, ex-clearing trades will no longer be invisible to all but the parties to that particular transaction. Instead, the industry and regulators will have a complete view of all open obligations traded in the U.S. marketplace for equities, corporates, municipals and unit investment trust securities – and importantly, have a central vantage point to monitor and mitigate systemic risk.

Leveraging Existing Technology to Reduce Costs

Fundamental to DTCC's mission as a quick-to-market and cost-effective solutions provider for the industry is its ability to leverage existing systems and functionalities to solve new challenges facing the industry. The OW stands as a prime example -- NSCC leveraged RECAPS and ISO 15022 SWIFT messages to build the service at a fraction of the cost and time than if it had to start from scratch. For instance, ISO 15022 SWIFT messages, which are already used by NSCC for trade matching via the Real-Time Trade Management (RTTM) system, will serve as the heart of the OW's ability to facilitate real-time communication with customers.

A Thumbs Up from the Industry

NSCC worked closely with member firms, service bureaus as well as the Securities Industry and Financial Markets Association's (SIFMA) Securities Operations Society's Regulatory and Clearance Committee to help formulate the business requirements for the service. Unlike a for-profit company that seeks to define markets and drive customers to them, NSCC is constantly in the field talking to members, listening to their concerns and developing solutions to address challenges facing the industry. This collaborative product development approach is essential to meet the changing needs of firms in a dynamic business environment.

Pilot Program to Kick-off By End of 2009

While OW won't officially launch until the middle of 2010, NSCC is actively seeking participants for a pilot that will begin in the first quarter, 2010. And with NSCC working with the Financial Industry Regulatory Authority (FINRA) to maintain the current mandate requiring the reconfirmation of fails, the pilot program is an opportunity for firms to be among the first in the industry to take advantage of the OW's many benefits.

The OW is not a solution in search of a problem – it is the solution to a problem that has plagued the industry for years. For ops professionals, the OW represents an important step forward in bringing greater efficiency, cost savings and risk mitigation to the back office.

For more information about the Obligation Warehouse, or to join the pilot, please contact Tom Sakaris, Vice President, Equities Clearance Product Management, at tsakaris@dtcc.com, (212) 855-7595.

INNOVATIVE LEADERS *continued*

prices. It also points out the importance to looking for innovation everywhere. What was the last innovation you got out of finance? Sales? Everyone has to be in the process.

Look to the edges of your organization. That can mean the outlying offices. Often your employees there will be confronting the "real world" in a way that the main office, bound up in the status quo, really can't. It can also mean looking for innovative ideas from your new employees. Often someone with three months on the job understands enough about how the organization works to have some insight into what the organization is supposed to be doing, yet still has the ability to take a clear-eyed look at how well it does it.

You are the real "CIO." If you hire someone with the title of Chief Innovation Officer, make sure they plan to work themselves out of their job. Innovation has to be built into the fabric of the organization. It's not about marketing or about finance or product development. Many of the companies that are putting CIOs in place are trying to unravel decades of corporate culture that works against grassroots innovation. Ultimately, however, that cultural change has to come from the top. Innovate in the process of driving that cultural change—then dismantle your "office of innovation."

Study. There is a lot of innovate thinking in this area right now.

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