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NEWSLETTER

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Managing the Risks of Ex-Clearing Trades

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The challenge of processing broker-to-broker obligations confirmed and settled outside a clearing corporation (known as ex-clearing) has intensified in recent years as financial firms' need for real-time information has increased. At the same time, some in the industry have raised the red flag because these transactions, which are confirmed and settled directly between brokers using highly manual and error-prone processes, potentially create operational and counterparty risk.

Just how much risk these trades pose is somewhat of a mystery – a fact that creates concern for both market participants and regulators. The problem is that unlike the overwhelming majority of transactions in equities, corporates, municipals and unit investment trust securities executed in the U.S. markets, which are processed through and guaranteed by DTCC's clearing agency subsidiary, National Securities Clearing Corporation (NSCC), ex-clearing trades are visible only to the trading parties. That means it's impossible to estimate how many of these trades exist and the total dollar value outstanding as well as whether a particular firm has a high concentration of them on their books.

The issue is not ex-clearing trades per se, but rather that these obligations are matched and confirmed manually, through phone calls, faxes and emails, and are not held in a central location, which would reduce operational risk.

Recognizing the need to modernize these decades-old practices, DTCC launched the Obligation Warehouse (OW) last month. Working collaboratively with industry partners, including the Securities Operations and Data Management Sections of SIFMA, DTCC has created a more efficient and cost-effective system for processing ex-clearing trades and certain other open obligations. The service also delivers real-time capabilities for NSCC Members participating in OW to view virtually all of their failed trading activity in the U.S. marketplace for equities, corporates, municipals and unit investment trust securities.

In building OW, DTCC leveraged existing systems and enhanced its current fail clearance system, known as the Reconfirmation and Pricing Service (RECAPS), to automate the matching and confirmation of ex-clearing trades. In other words, no more phone calls, emails or faxes.

We also created new tools to track, manage and resolve certain unsettled obligations in real time. First, we automated the processing of ex-clearing fails so firms no longer have to perform this function themselves using outdated manual processes. Next, we added functionality to store these obligations in a central location until settlement, marking the first time theis information has been captured in a single place.

The OW will also reconfirm and re-price fails to current market value on a monthly basis instead of the current quarterly schedule. This mitigates counterparty risk and reduces net capital charges. In addition, a new daily maintenance function will check for eligibility with NSCC's Continuous Net Settlement (CNS) system and make updates for certain corporate actions. And finally, the OW pushes real-time updates as well as end-of-day reports directly to firms to enhance transparency around this data.

What the OW accomplishes for the industry is significant. In fact, it represents a giant leap forward in helping financial firms better manage and address the risks and costs associated with their ex-clearing trades and fails. The OW meets the unique needs of our customers while also offering a solution for certain inefficiencies and risks associated with ex-clearing activity.

To learn more about the Obligation Warehouse, log onto www.dtcc.com. Or contact: Craig Donner (212) 855-2531 or cdonner@dtcc.com