

Challenges in OTC Derivatives Processing A Federal Reserve Perspective

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Overview: Industry Issues

- **Underlying Conditions**

- High Growth
- An increase in the variety and complexity of products
- A shift in financial activities away from highly regulated entities
- Globalization

- **Problems**

- Growing CDS confirmation backlogs
- Novation (assignment) of CDS trades without consent
- Lack of clarity over credit event resolution process
- Settlements

Overview: Industry Response and Progress to Date

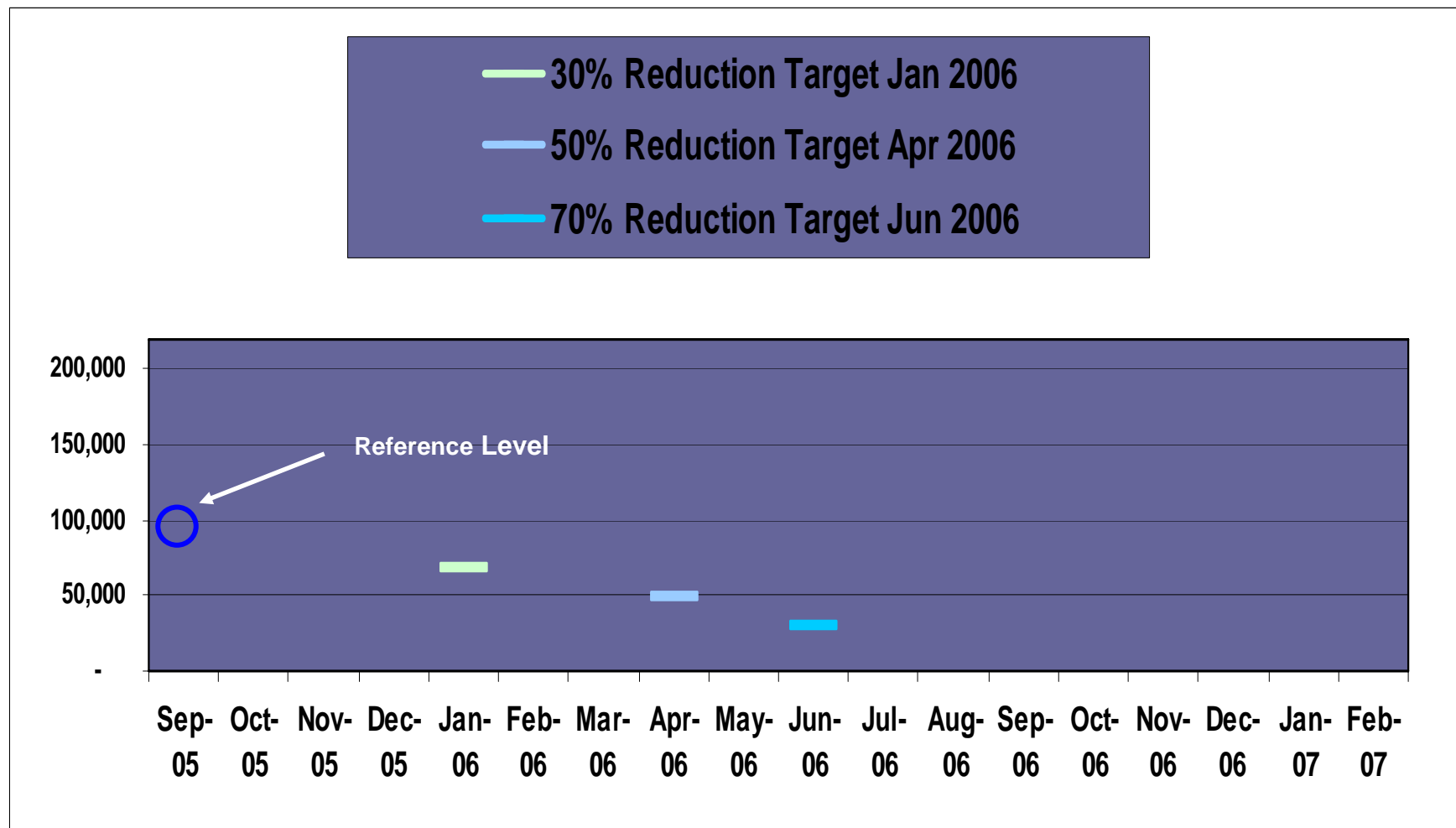
■ Commitments

- Implement a Novation Protocol
- Increase Electronic Processing of CDS Confirmations
- Reduce Backlog of Unconfirmed Trades from Sept. 2005 levels
 - 30% by January
 - 50% by April
 - 70% by June

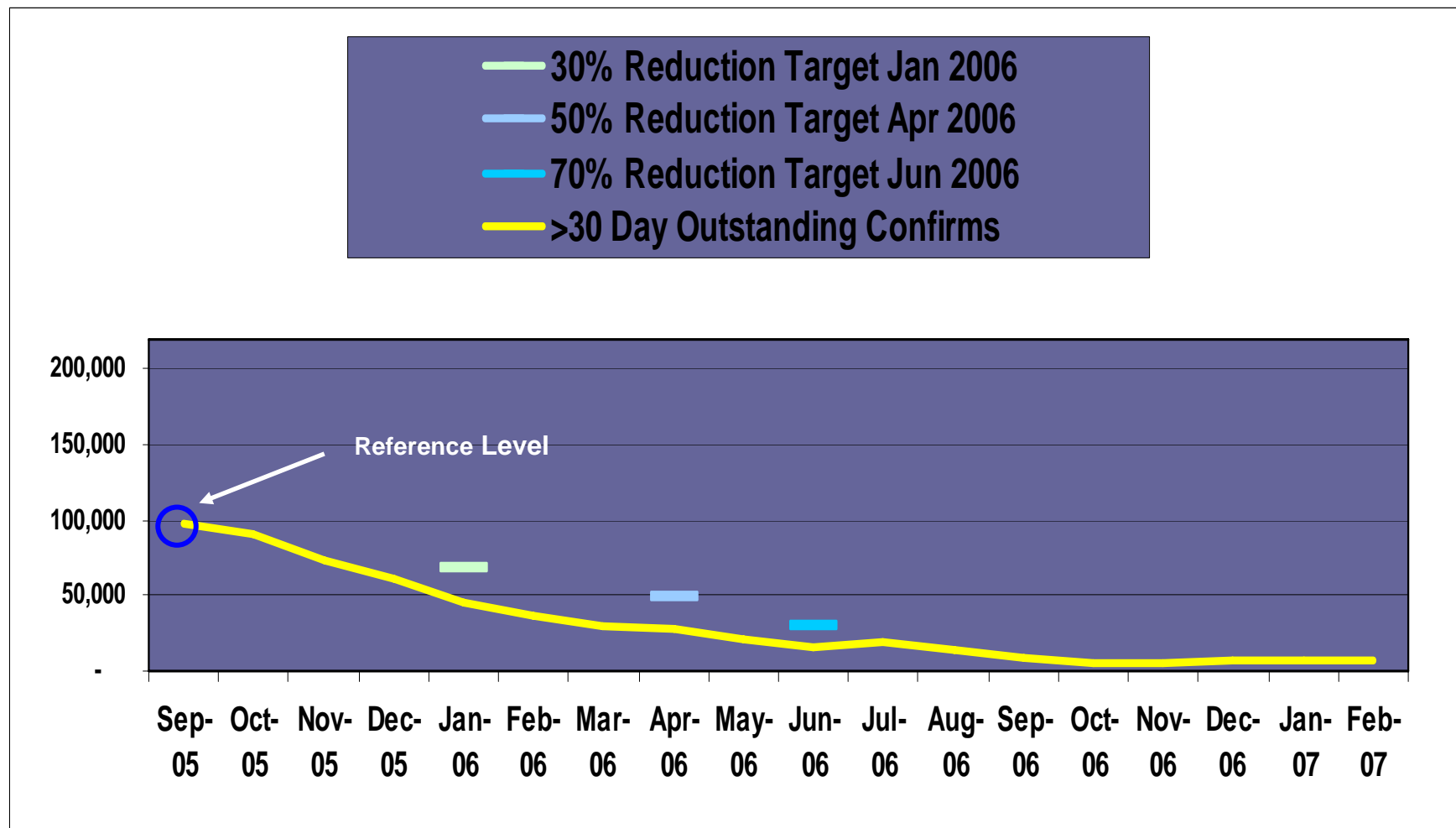
■ Progress

- ■ Adopted ISDA Novation Protocol as Industry Standard in Sept. 2005
- ■ Increased electronic confirmation processing from 46% in Sept. of 2005 to 86% in Feb. 2007
- ■ Reduced confirmations outstanding >30 days by 93% from Sept. 2005 to Feb. 2007

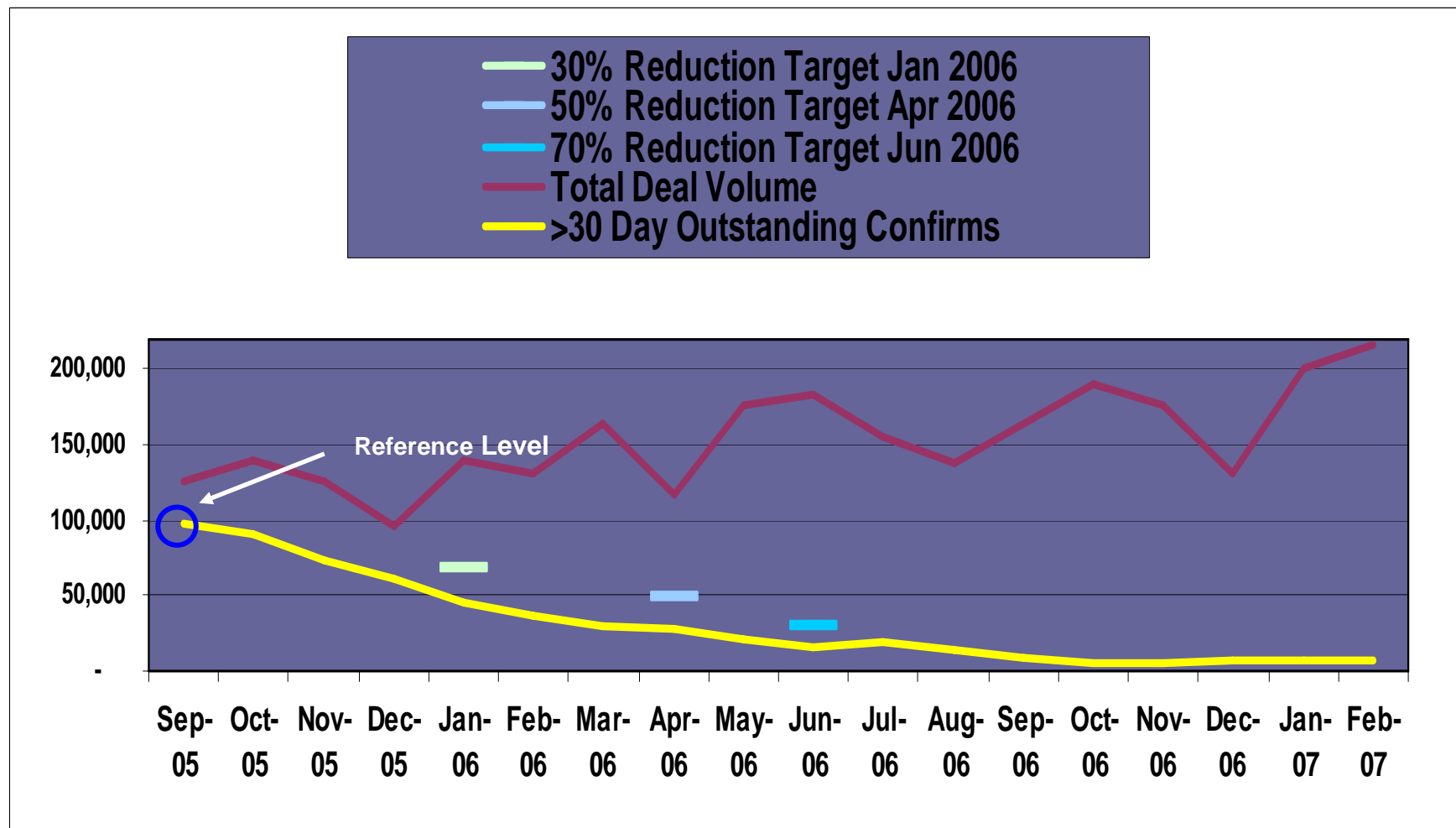
CDS Processing Milestones: Reduction in >30 Day Outstanding Confirmations



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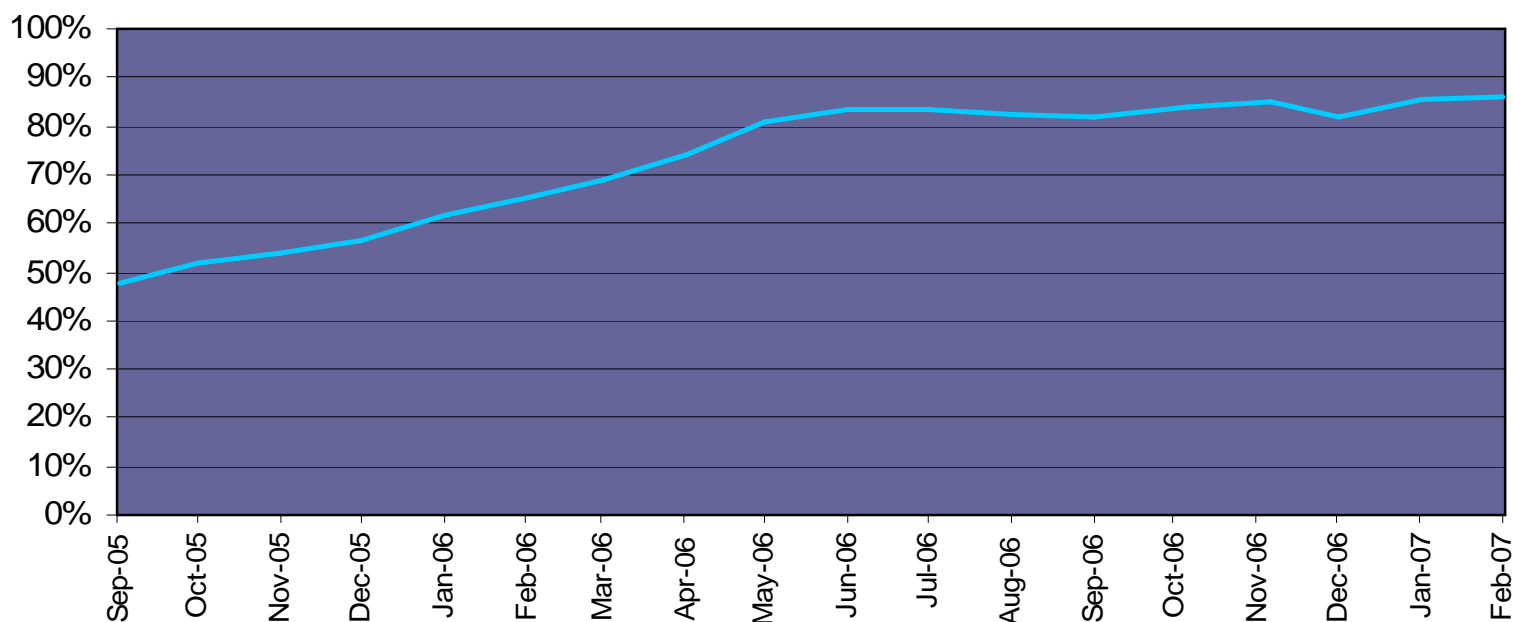


CDS Processing Milestones: Reduction in >30 Day Outstanding Confirmations



CDS Processing Milestones: Electronic Confirmation

— % Electronic Deal Volume / Total Deal Volume



CDS Processing Milestones

■ Commitments

- Create an industry utility trade warehouse —————→
- Develop processing guidelines for both electronic and non-electronic trades —————→
- Establish a generally accepted procedure for settlement following a credit event —————→

■ Progress

- Activated the DTCC Trade Information Warehouse in Nov. 2006
- Improved the timely issuance of both electronic and non-electronic confirmations since March 2006
- Announced cash settlement of CDS during default events

The Next Challenge: Equity Derivatives Processing

■ **Industry Issues**

- Lack of standardized documentation and terms
- Lack of automation combined with high growth
- Confirmations outstanding for more days, on average, than any other category of OTC derivatives

■ **Industry Commitments**

- Improve and increase use of Master Confirmation Agreements
- Operate on two industry accepted platforms, one “fully” and one “credibly” by March 31, 2007
- Within 60 days new products must be electronically confirmed provided that an MCA and platform are available
- Reduce backlog of confirmations outstanding >30 days by 25% from summer 2006 to January 31, 2007

Challenges Ahead

- Increasing automated processing of CDS and Equity Derivatives
- Continuous product innovation leading to more complex trades
- High front-office error rates
- Recognizing the benefits of improved operational processes
- Sustaining progress long-term