

# Challenges in OTC Derivatives Processing

## A Federal Reserve Perspective

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# Overview: Industry Issues

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- **Underlying Conditions**

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

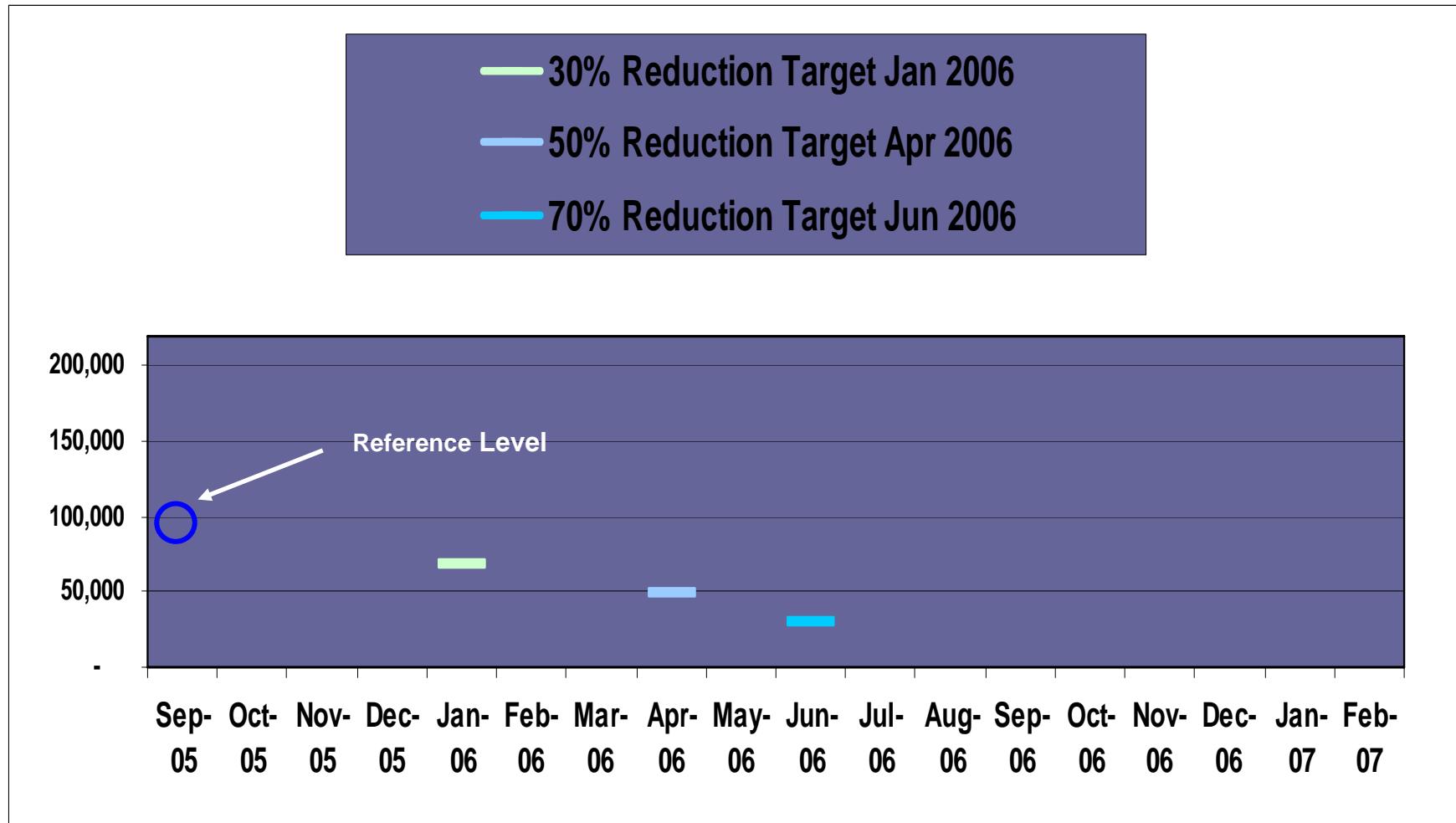
- **Problems**

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

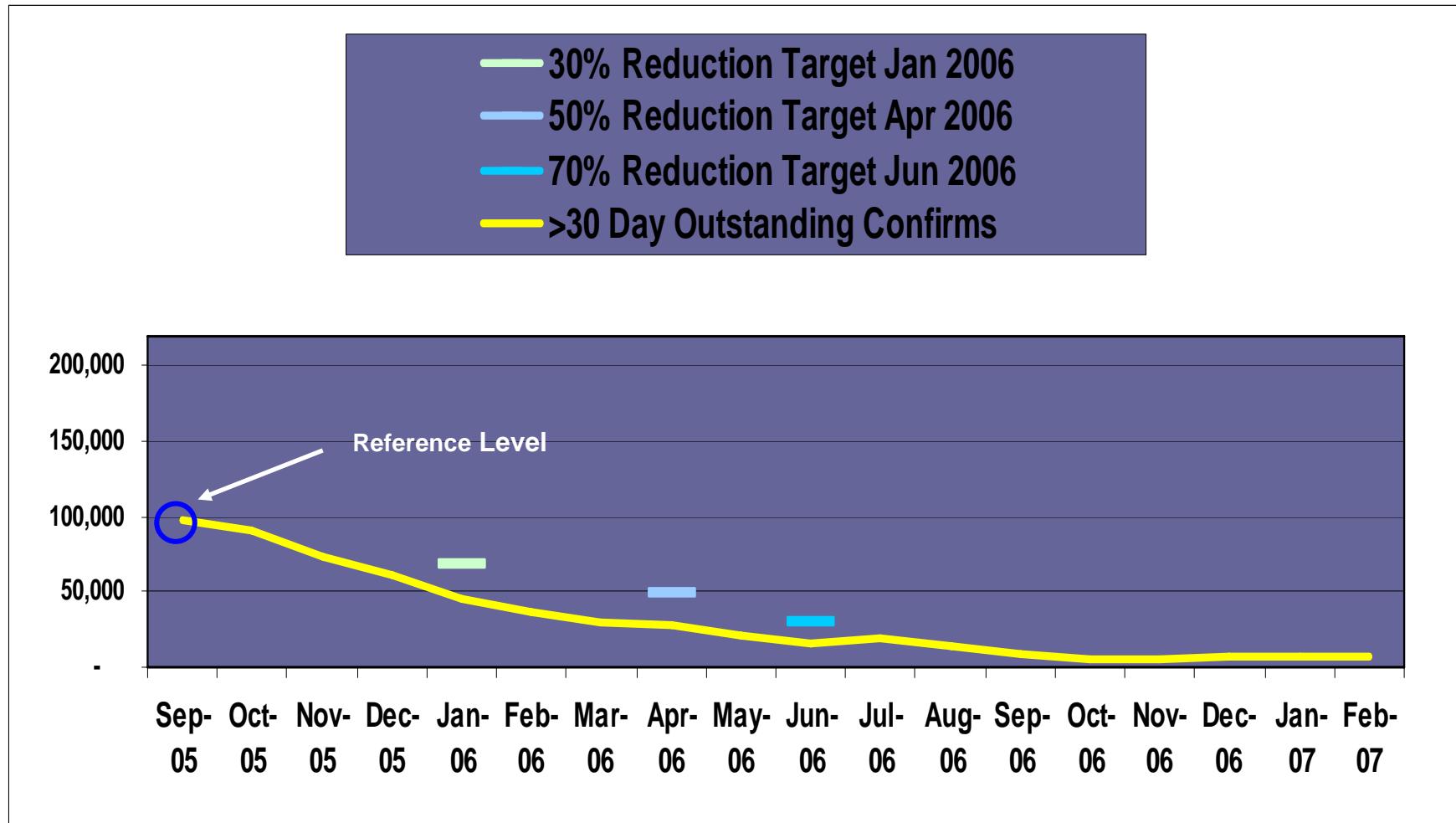
# Overview: Industry Response and Progress to Date

- **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

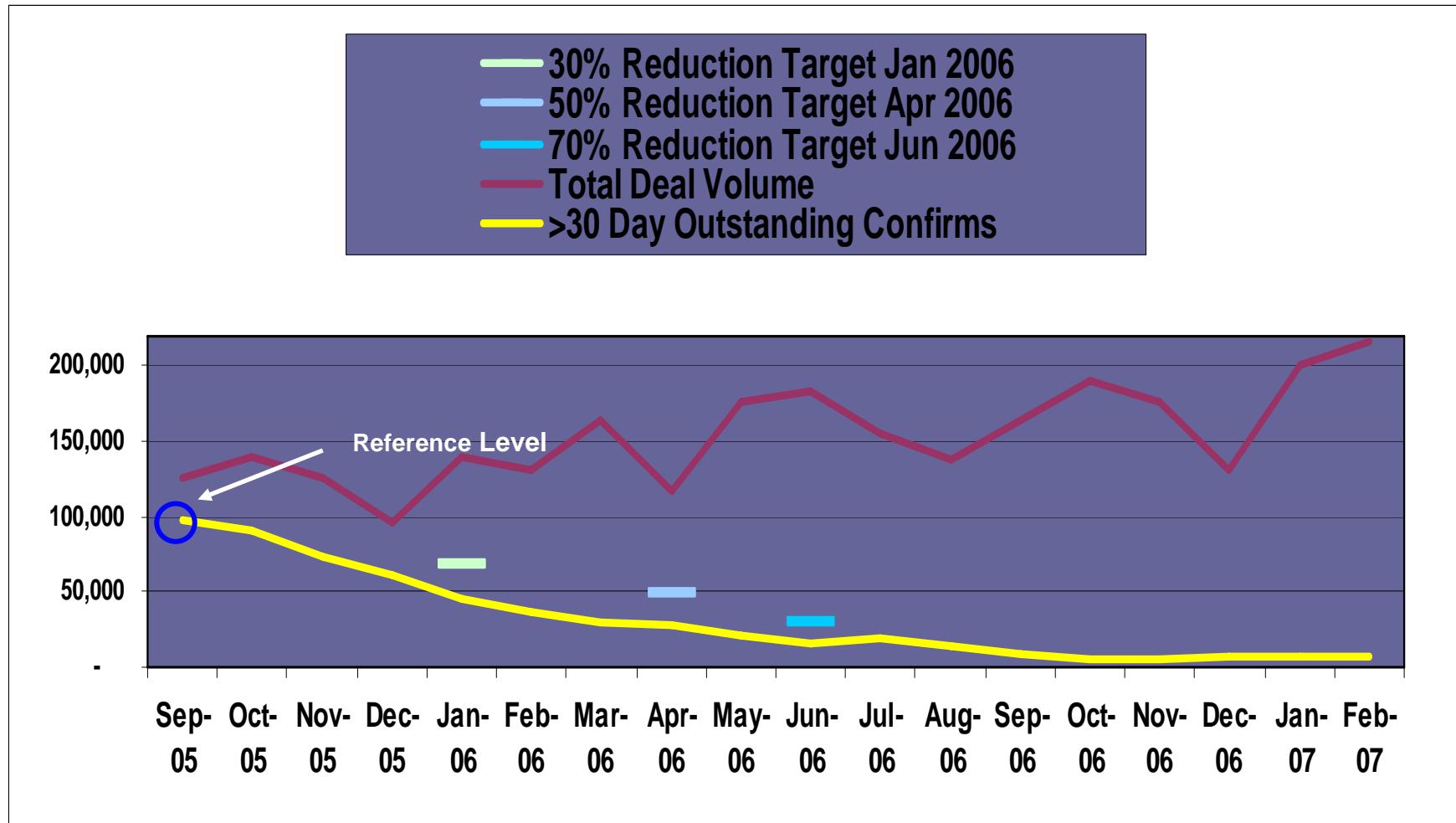
# CDS Processing Milestones: Reduction in >30 Day Outstanding Confirmations



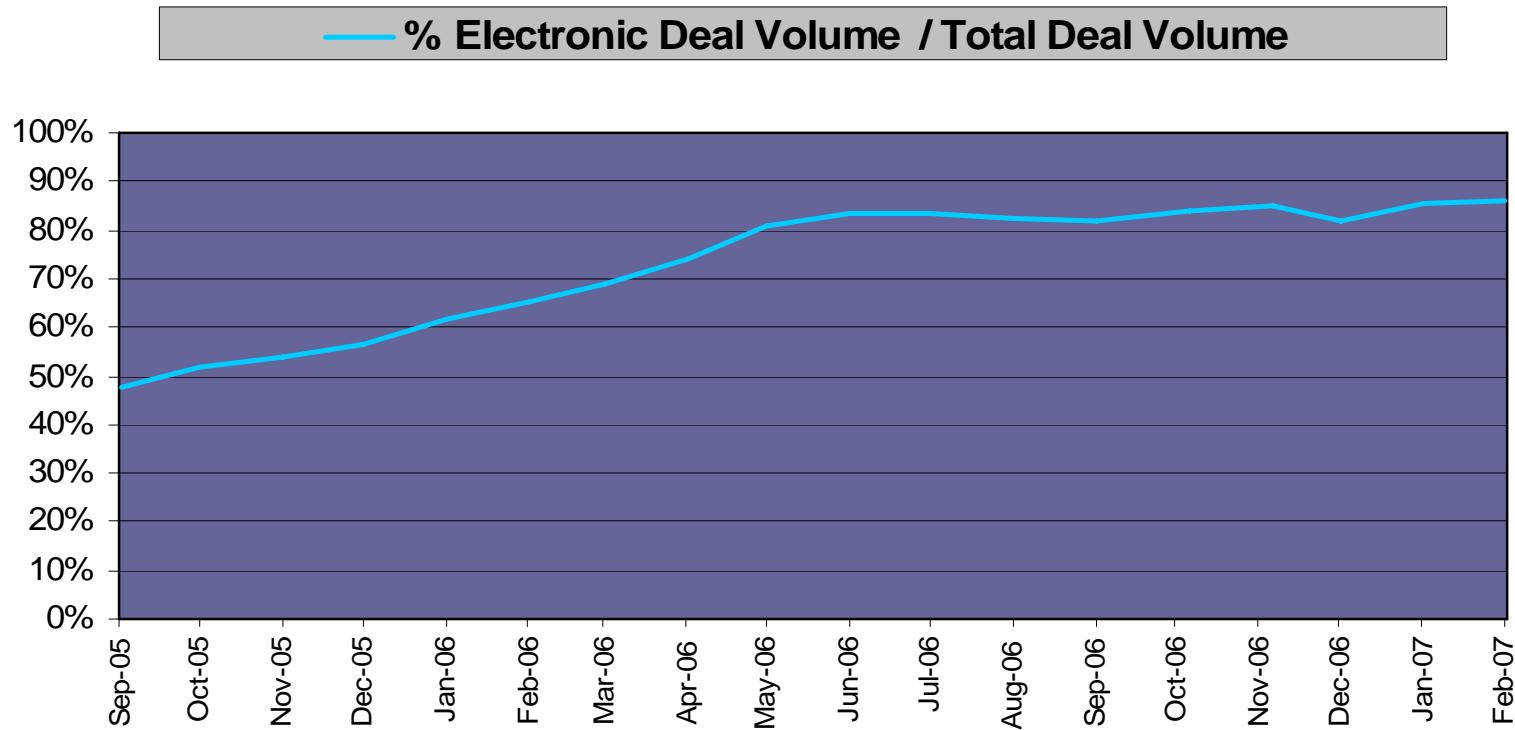
# CDS Processing Milestones: Reduction in >30 Day Outstanding Confirmations



# CDS Processing Milestones: Reduction in >30 Day Outstanding Confirmations



# CDS Processing Milestones: Electronic Confirmation



# CDS Processing Milestones

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- **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

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- **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

# Equity Derivatives Processing

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- **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

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- 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