

The Depository Trust Company

IMPORTANT

B#: 3831

DATE: September 25, 2002

TO: Participants

CATEGORY: Settlement/Underwriting

FROM: Product Management

ATTENTION: Settlement Manager/Managing Director/Cashier

SUBJECT: Inventory Management System

In the “DTCC’s Straight-Through Processing Initiatives” important notice #Z0003 (see attached), dated September 25, 2002, the Inventory Management System (IMS) was detailed. IMS is being built to address a series of deficiencies or “gaps” in the settlement process by developing capabilities to permit Participants to centrally manage their own settlements as a way of furthering STP.

The key components of IMS include:

- New authorization capabilities (replacing the Authorization and Exception system (ANE)) which Participants can use to stage transactions for automated settlement
- A new “profiling” system, which will allow Participants greater control over the timing and order of their deliveries by transaction types and asset class via pre-defined profiles to eliminate today’s frequent direct intervention in the settlement process that inhibits STP.
- Capabilities permitting the linkage of transactions so particular receive transactions are associated with particular deliveries.
- Controls permitting the retention of failed deliveries for the following settlement day, eliminating Participants’ need to re-input these instructions.

One of the key aspects of IMS will be to create a replacement for the current Authorization and Exception (ANE) system¹. As a result of industry feedback, DTCC has designed IMS to permit authorization and control within asset class of different transaction types, e.g., Night Deliver Orders (NDOs), etc. and permit increased authorization options. IMS functionality will be available via computer-to-computer communications using a 15022-message format or via a browser interface. The creation of IMS will also make possible a warehousing facility for future deliveries through the Night Deliver Order function and, the re-introduction of dropped deliveries. All three initiatives, the replacement of ANE, warehousing and the re-introduction of dropped deliveries will be available in Phase I.

Implementation Approach.

IMS will be implemented in two phases subject to SEC approval. The first phase of the IMS rollout is scheduled to occur in July of 2003. The second phase will create an optional customized delivery and recycle profile and is scheduled to be implemented in December of 2003.

Attached is a detailed description of the Phase I functionality the authorization profile, drop profile and warehousing will provide. The messaging specifications for interfacing with IMS via the ISO 15022 message formats will be distributed via an Important Notice in October.

With the exception of utilizing the new PTS IMS function, Participants will not be required to make systemic changes and can continue to process their deliveries as they do now. All IMS features are optional and Participants can migrate to any or all features.

Questions regarding this notice may be directed to the undersigned at (212) 855-3900 or your Relationship Manager.

John Kiechle
Product Management

¹ ANE is used by participants to authorize (agree to be delivered) affirmed institutional deliveries from Omgeo's Tradesuite system.

IMS AUTHORIZATION PROFILE

Currently, Participants control the processing of their institutional deliveries received from a matching utility system (such as Omgeo's Tradesuite system) through the Authorization and Exception system (ANE). ANE will not send a delivery to the processing system without an affirmative authorization from the delivering Participant (a so-called active authorization process). This affirmative authorization is given either on an item-by-item basis or through a "global" authorization, with the Participant also able to submit exceptions to explicitly withhold a delivery from processing. Conversely, deliveries from the National Securities Clearing Corporation's Continuous Net Settlement system (CNS) are automatically processed unless the Participant instructs NSCC (via an exemption). Other deliveries, e.g., Night Deliver Orders, along with authorized institutional and CNS deliveries, are processed by DTC at pre-defined times. All of these transactions may pend ("recycle") in the event of a position deficiency or a problem with system controls; these recycles are processed based on one of two recycle options – a "First In First Out" process or a DTC pre-established recycle queue.

Participants generally have sought greater control over their processing than these procedures permit. For this reason, over the years, Participants have built internal inventory management systems or adopted internal manual procedures that exempt deliveries from automatic processing so that they can control the sequence and timing of their deliveries. This has created a STP shortfall, caused the industry to build redundant systems and has increased the number of reclaims.

Even with the new IMS functionality, Participants will not be required to make systemic changes and can continue to process their deliveries as they do today. All IMS features are optional and Participants can migrate to any or all features they deem valuable.

Authorization Options

A Participant can choose how it would like to authorize its deliveries, either actively or passively.

Active – in this mode, deliveries will **not** be processed unless an authorization is sent. Authorizations and exemptions can be on a trade-for-trade basis or through a global authorization. Global authorization or exemption capabilities will also be available via the Participant Browser System (PBS) display screens.

Passive – the new passive authorization option will immediately authorize a delivery when it is received and process it on its settlement day, unless it is exempted. Institutional deliveries are currently received at approximately 1 p.m. on S-1, if they are passively authorized, they will be submitted for processing in the night cycle.

Eligible Transaction Types and Asset Classes

For Phase I, the following transaction types will be available for authorization and delivery through IMS:

- 1) Institutional deliveries from a matching utility,
- 2) CNS,
- 3) Night deliver orders (NDOs),
- 4) Re-introduced drops, and
- 5) ACATS auto deliveries.²

Note: it is anticipated that IMS will add CNS balance orders as a new transaction type to the authorization profile in January 2004.

² ACATS auto deliveries consist of free bank to broker ACATS deliveries and valued broker-to-broker non-CNS eligible deliveries.

Recognizing the need for flexibility and options, authorization profiles can be created for the following asset classes: equity, municipal debt, corporate debt or money market instruments (MMI). Within each asset class, a Participant can choose which authorization mode it would like applied as its default for the different transaction types above. For example, within equities, a Participant can choose to be active for matched institutional deliveries and passive for CNS deliveries.

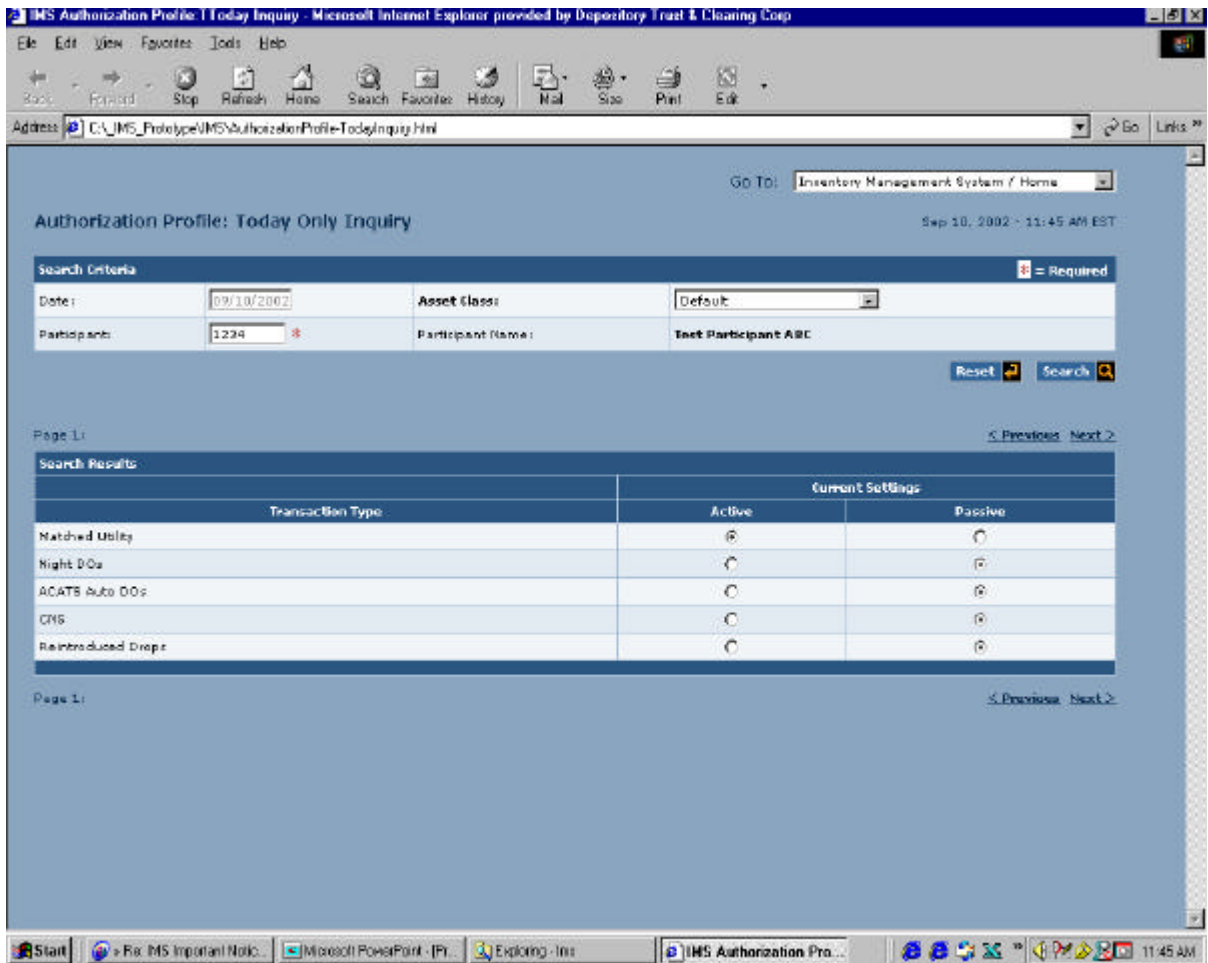
Switching Authorization Modes Intraday

Participants will be able to switch between modes of authorization, e.g., active to passive authorization intra-day in real time for each transaction type/asset class via PBS, PTS or 15022 formatted message. If a Participant switches its authorization mode from active to passive for a particular transaction type/asset class or several transaction types/asset classes simultaneously during the processing day, all deliveries that have **not** been authorized or exempted, i.e., in the unprocessed state, will be staged for processing. For example – many broker Participants would like to have greater control over the timing of their deliveries in the transaction types noted above. In today’s processing environment, some Participants will authorize deliveries that they have sufficient position for, but, they will exempt their CNS and institutional deliveries in securities with inadequate position until their memo seg file or “free box” is determined. The authorization profile will permit Participants the flexibility to control which transaction type/asset class deliveries they want processed and when. Participants can also use their profiles to switch their authorization mode at a pre-set time during the processing day, e.g., 4 a.m. or they can submit a 15022 message indicating which transaction types/asset classes to convert from passive to active and vice versa.

When a Participant changes its authorization mode from active to passive for multiple transaction types using a 15022 message, eligible deliveries that have not been acted upon, i.e., the unprocessed state, will be staged for processing in the following order: CNS, ACATS auto deliveries re-submitted drops, institutional deliveries from a matching utility and night deliver orders. A Participant can send in a global message for any of its transaction type/asset classes. For example, a Participant may want to change its authorization mode to passive and authorize its unprocessed equity matched deliveries, its equity CNS deliveries and its equity night DOs via one global message. Intra-day authorization mode changes will not effect how a Participant’s profile is defined for processing on the following business day.

Deliveries in all transaction types, except CNS, that are scheduled for processing on the next settlement date and have not been acted upon by the end of the day will be marked exempt. These deliveries will be maintained in IMS for 21 business days as ANE does for institutional deliveries today.

Below is an example of the IMS PBS screen with drop down keys that will allow a Participant to change an authorization mode intra-day:



Authorization Profile Maintenance

Participants may want to change their profile for the start of the following delivery day. Profile changes can be applied in advance using an effective date. The authorization mode chosen will be applicable to all deliveries expected to settle on the “effective” settlement date and following. Thus, a Participant can change its profile intra-day for today’s settling trades, while also having a different profile for deliveries that are to be collected and processed for tomorrow’s settlement.

Institutional Matched Utility Trades

The authorization profile default for institutional matched utility trades will be “active” authorization. The muni trade file currently received from NSCC will continue to be merged with the matched trades from Omgeo for settlement authorization.

CNS Deliveries

Participants may wish to continue to control their inventory internally and therefore continue to exempt their CNS delivery obligations (also known as short covers) through NSCC’s standing instructions or the PTS CNSE function. Participants can also continue to use their computer-to-computer communications method to process CNS exemptions through NSCC.

CNS Deliveries through IMS

CNS deliveries that have not been exempted at NSCC will flow through IMS. In IMS, the default authorization method for CNS deliveries will be “passive” and, without Participant intervention, the deliveries will be sent to the processing system. Thus, Participants that want to exempt their deliveries

through NSCC should leave the profile default passive, and CNS processing will continue as today for them.

Participants may wish to control when their deliveries that have not been exempted at NSCC, are processed. In this instance, the Participant should change its profile for CNS deliveries to active, authorize deliveries it can immediately process, and then change their intraday profile to passive for CNS deliveries they want processed based on an event or time of their choosing (e.g., after their memo seg file has been processed).

For Phase I, Participants will only be able to authorize or exempt their entire CNS delivery at the CUSIP level – partial deliveries will not be permitted until Phase II.

CNS also processes 5,000 – 10,000 same-day settling trades, which are processed later in the processing day. IMS will process these deliveries as it does all other CNS deliveries. The current default at NSCC for these deliveries is active authorization, i.e., they are considered exempt. Most of these deliveries are exempted automatically as a result. Participants can request at any time, via NSCC, that processing for these deliveries defaults to passive by notifying their relationship manager.

Night Deliver Orders

The authorization profile default will be passive for NDOs. A Participant would want an “active” authorization profile for its NDOs if they wish to control the timing of when their NDOs are processed.

ACATS Auto Deliveries

The authorization profile default will be passive for ACATS auto deliveries. Today, these deliveries are automatically processed late in the night cycle after CNS, matched institutional deliveries and NDOs.

DROP PROFILE

Participants will now be able to re-introduce their previous-day incomplete (“dropped”) deliveries by selecting the applicable reason codes in the IMS drop profile. The drop profile will permit Participants to distinguish between free and valued drops and the profile can also be chosen by asset class. Thus, a Participant could select to have only its “dropped” valued institutional deliveries (reason code 77) for equity transactions sent to IMS the next processing day. The re-introduced “dropped” transaction will then be subject to the Participant’s IMS authorization profile for re-introduced drops. Eligible drops will be all transactions that were not acted upon in the Receiver Authorized Delivery (RAD) system and any incomplete deliveries that recycled until the applicable valued or free recycle cutoff.

Re-introduced Drops Authorization Profile

The authorization profile default will be “passive” authorization for re-introduced drops. Re-introduced drops that have been authorized before the processing day will be staged after CNS and ACATS auto deliveries, but before institutional and night deliver order deliveries. During the processing day, unauthorized deliveries can be authorized individually or globally. Re-introduced drops that have not been authorized by the end of the processing day will be marked exempt.

DELIVERY WAREHOUSING

DTC’s current front-end edits do not permit a delivery to have a future settlement date. The current Night Deliver Order function only permits deliveries to have a future settlement date of the next business day or earlier. The Night Deliver Order PTS, CCF, CCFII and MDH input mechanisms will be modified to accept deliver orders with designated future settlement dates.

The warehouse feature of IMS will store deliveries on its database and direct these deliveries into the processing system as NDOs that are due to settle on the appropriate settlement day. These deliveries will follow the authorization profile set up by the Participant for that settlement date. There will be no limit to how far in advance a Participant can enter a delivery, however, any deliveries that have a settlement date greater than 21 business days will produce a 15022 warning message that this delivery is not due to settle for at least 21 settlement days. The settlement date default is to the next settlement day if the field is left blank.

This functionality will alleviate situations where Participants have to warehouse deliveries in their system, will be useful in contingency situations where Participants' communications with DTCC have been disrupted, and, will be available in Phase II, at the deliverer's option, to display deliveries to the receiver for reconciliation purposes.

"Warehoused" deliveries may include data that isn't yet eligible at DTC, e.g., a Participant account number, CUSIP, etc. IMS will accept these deliveries, but send the Participant a 15022 message that the delivery has ineligible data. "Warehoused" deliveries will then be re-edited along with NDOs prior to start-of-day processing. Participants will be able to delete "warehoused" delivery instructions.

IMS NOTIFICATION PROFILE

The Notification Profile allows Participants to customize what IMS output messages they receive, and the message density. IMS 15022 output messages will only be generated to Participants who update their Notification Profile, as the system default is to suppress these messages. The Notification Profile screen contains each of the eligible message types accompanied by a three-option radio-button labeled Full, Short, and None. A full-message includes all fields received and added to the transaction by DTC. Short messages include the DTC Transaction Identifier, the matching utility transaction identifier (if one exists), the Participant's transaction identifier (if one exists), the date and time the status change took effect. Click "None" if you wish to suppress notification when transactions change to this message status.

INQUIRY/UPDATE CAPABILITIES

The IMS front-end user interface will be available in both a 3270 PTS function that will replace the current ANE PTS function and a web-based graphical user interface. The web-based interface is being integrated with the current Participant Browser Services (PBS) service currently in pilot. Access for the browser interface is expected to be through existing frame relay connections, which will require RACF authentication. PBS is the scheduled replacement for 3270 green screen based PTS. Contact Mike Vellecca at 212-855-5678 or Dan Thieke at 212-855-4162 or your relationship manager for more information regarding PBS.

IMS inquiries over PBS and PTS are expanded to include more refined selection criteria, e.g., an inquiry by client (Agent Internal Account number for banks or Broker Internal Account for brokers), etc. In addition, because of the increased transaction types and authorization modes, the search criteria menu is expanded accordingly.

IMS will permit a Participant to define whether or not a user should have only inquiry or inquiry/update capabilities.

IMS delivery authorization can be submitted throughout the processing day (currently, the ANE system has a 2:30 p.m. (ET) cutoff for authorizing deliveries on a trade-for-trade basis and 10:00 a.m. for global authorization). With IMS, valued delivery authorizations submitted before 3 p.m. (ET) will be sent to the

processing system unless they are RAD eligible, i.e. NDOs and re-introduced drops; all valued deliveries that are authorized after 3 p.m. (ET) will be held by IMS until the following delivery day and then sent to the next processing step (i.e., RAD if it requires receiver approval or ATP). All free NDO, ACATS Auto DOs and re-introduced drops can be authorized up until the normal free recycle time, i.e., 6:15 p.m. ET unless they are RAD eligible. If authorization occurs for a free delivery after 6:15 p.m. ET, the delivery will be sent for processing at the start of the night cycle on the following delivery date.

The NDO system will pass all applicable transactions to IMS upon receipt. NDOs will no longer be routed to the Night Receiver Authorized Delivery (NRAD) system for receiver approval. Instead, IMS will check RAD eligibility as part of its edit process and feed day RAD as necessary.

CNS transactions can be authorized at anytime, however, if authorized after valued recycle cutoff (normally 3:10 p.m.) they will automatically drop in the settlement processing system and not be reintroduced the following processing day.

Valued and free deliveries that are “unprocessed” by the respective cutoffs on delivery date will be marked as exempt (today, deliveries in ANE that are not authorized by 7:30 p.m. the day before settlement (S-1) are automatically marked as exempt).

Below is an example of the IMS inquiry screen via PBS:

Go To: Inventory Management System / Home

Transaction Authorization: Inquiry Aug 23, 2002 - 09:59 AM EST

Search Criteria * = Required

Delivery Date(s) From:	<input type="text" value="08/23/2002"/>	To:	<input type="text" value="08/23/2002"/>
Asset Class:	<input type="text" value="All"/> *	Transaction Type:	<input type="text" value="All"/> *
CUSIP Number:	<input type="text"/>	Over \$:	<input type="text"/>
Deliverer:	<input type="text"/>	Receiver:	<input type="text"/>
AIA/BIA Number:	<input type="text"/>	FINS Number:	<input type="text"/>
Include These Types:	<input type="checkbox"/> Unprocessed <input type="checkbox"/> Exempt <input type="checkbox"/> Authorized <input type="checkbox"/> Submitted <input type="checkbox"/> Yellow <input type="checkbox"/> Red <input type="checkbox"/> Recycling <input type="checkbox"/> Made <input type="checkbox"/> Canceled <input type="checkbox"/> Dropped <input type="checkbox"/> Rejected		

Total Trades: 13,455 Total Amount: \$13,456,334.25

Page: 1 Records Displayed: 12 < Previous Next >

CUSIP	Control Number	Shares	Value	Settle Date	Contra	Type	Status
G9108L108	123456789	1,300	\$93,800	07/17/2002	90	Omgeo	Made
H01301102	1223456789	50,000	\$4,782,000	07/25/2002	5	Omgeo	Made
IPO200204	123456789	700	\$56,200	08/05/2002	161	NDO	Exempt
03674E108	MDD12345678	22,000	\$156,200	08/06/2002	161	CNS	Made
043436104	MDD12345678	18,000	\$7,256	08/06/2002	909	Omgeo	Exempt
073575102	MDD12345678	105,000	\$134,602	08/06/2002	913	Omgeo	Unprocessed
09249G106	MDD12345678	3,000	\$210,200	08/06/2002	997	NDO	Unprocessed
19247L106	MDD12345678	22,000	\$56,200	08/06/2002	2027	DROP	Exempt
364366R101	123456789	15,000	\$108,700	08/06/2002	161	Omgeo	Exempt
5819B101	123456789	22,000	\$356,000	08/07/2002	161	Omgeo	Unprocessed
517942207	MDD12345678	700	\$56,200	08/07/2002	161	CNS	Exempt
61744Y397	123456789	22,000	\$56,200	08/08/2002	161	DROP	Exempt

Page: 1 Records Displayed: 12 < Previous Next >

More records available.

COMMUNICATIONS

DTC currently offers several methods for communicating data transmissions to and from the depository's computing systems - MDH, CCF, CCFII, and MQ. The ANE messaging interface described below is available via any communication method supported by DTC. The new IMS messaging interface for ISO 15022 formatted output will be available via MDH, CCF and MQ.

ANE message interface – Usage and Formats

ANE message formats are proprietary fixed-field format. At noon on S-1, DTC receives a file from OMGEO containing all of the matched institutional trades scheduled to settle on the following settlement date. Participants have until 7:30 pm to complete the authorization and exemption process for the night cycle. ANE provides three variations for authorizing OMGEO trade data. They can choose one of three techniques: Global authorization with exemptions, global exemption with authorizations, or trade for trade authorization.

When using global authorization with exemptions the Participant transmits a file with a global message indicating that all trades are to be authorized with the exemption of the trades specifically identified as exemptions – all of which follow in the same transmission.

When using global exemption with authorizations the Participant transmits a file with a global message indicating that all trades are to be exempted with the exception of the trades specifically identified as authorized – all of which follow in the same transmission.

When using trade for trade authorization, no global instruction is submitted. Each trade must be individually authorized or exempted. If a trade is not excepted before 7:30 pm, it automatically is marked as excepted by ANE.

Descriptions of the ANE formats are available at DTC's web site at:

<https://dtcservices.dtcc.com/clientsvcs/documentation/membersdoc/Miscellaneous/08ane15.PDF>

IMS message interface – Usage and Formats

IMS message formats conform to ISO 15022 tag and field formats. Standard message types have been used where equivalence existed.

In general, the IMS Message Interface will support all activities within IMS. However, since many Participants have already coded the ANE messaging interface described above, DTC intends to allow Participants to continue to operate their existing interface for an undetermined timeframe, in order to leverage that technology investment. It should be noted however, that ANE was designed to support the authorization and exception of institutional trades from OMGEO only. Other transaction types that will be subject to IMS authorization will not be available for authorization via the ANE messaging interface.

Finally, it should be noted that transaction input is not affected by IMS. All transactions will continue to be submitted to DTC exactly as they are today.

IMS message interface – Transaction Types

Some IMS features, most notably Profile Maintenance, will only be supported by a terminal based interface, i.e., The Participant Browser System (PBS) or the IMS 3270 PTS function.

There are 5 different actions supported by the messaging interface: Authorize, Exempt, Unexempt, Cancel, and Switch Authorization Mode.

Authorize – used to release a transaction for its next processing step. If an authorization instruction is applied to a transaction prior to settlement date, the transaction will not be submitted until settlement date.

Exempt – used to withhold a transaction from the next processing step and will be excluded from any subsequent global authorization processing. Exempted transactions, however, can be authorized individually. Exempted transactions will be held for 21 days after which they will be deleted from IMS.

Unexempt – used to reverse a prior exemption instruction. Unexempted transactions are reprocessed through IMS where the authorization profile is reapplied – if the profile is in passive mode, the transaction is authorized, if in active mode, the transaction goes to the ‘unprocessed’ status, pending authorization or exemption on a global or transaction-by-transaction basis.

Cancel – used to permanently delete a delivery from IMS. Cancelled transactions in IMS are viewable on the audit trail for the normal retention period. Once cancelled, a transaction must be resubmitted to DTC in order to be processed.

Change Mode – used to modify the profile from active to passive or from passive to active modes, in real-time. These instructions cannot be executed on the transaction-level, but must be made globally (see Global Transaction Processing, below). Mode changes are applied retroactively to all transactions for the “effective” settlement date in question. When changing from active to passive modes, all transactions awaiting authorization at the time the change-to-passive-mode instruction is received are passively authorized. When changing from passive to active modes, the same rule does not apply since there would be no backlog of pending authorization transactions. Changing from passive to active will only effect any new transactions arriving in the system after the mode change.

IMS message interface – Global Transaction Processing

Each of the IMS message types can affect varying numbers of transactions. Based on the message parameters, any of the actions described above³ may affect:

1. All transactions
2. All transactions within an asset class
3. All transactions for a transaction type
4. All transactions for a transaction type within an asset class
5. An individual transaction

IMS notification messages

The IMS messaging framework is intended to support a real-time message-based interaction between DTC’s system and the Participants’. As each transaction is processed through the system a message is generated each time the status of the transaction changes. Participants can customize this interface using the

³ With the exception of the change-authorization-mode instruction, which cannot be applied to individual transactions.

Notification Profile (see IMS Notification Profile). These messages are MT5XX settlement advices. The various statuses a transaction may have as it flows through the system are:

1. RECEIPT

1.1. Received – when a transaction is first received by IMS, whether on settlement date, or prior to settlement date.

2. DELIVERER AUTHORIZATION

2.1. Express – certain transaction types may be designated as not subject to authorization (or prioritization in Phase 2). These transactions are designated as express, and are immediately submitted to ATP for processing.

2.2. Authorized – when authorized whether actively or passively.

2.3. Exempted – when exempted

2.4. Unprocessed – when an “unprocessed” instruction is processed. If the profile is set to passive at the time an exemption is lifted, authorization message will also be generated.

3. RAD – RECEIVER AUTHORIZATION

3.1. Sent for receiver authorization – only for RAD-eligible transactions, when sent to RAD

3.2. Authorized by receiver – when approved in RAD by the receiver

3.3. Rejected by receiver – when disapproved in RAD by the receiver

4. PRIORITIZATION

4.1. Green – although a phase 2 feature of IMS, all transactions will be treated as green in phase 1, meaning ready for immediate submission

4.2. Yellow – phase 2 only

4.3. Red - phase 2 only

4.4. Released – phase 2 only, when a red transaction is released by the deliverer it is ready to submit

5. PROCESSING/RECYCLING

5.1. Submitted – when transactions are handed off from IMS to ATP, the status changes to submitted

5.2. Recycling Green – if ATP cannot immediately satisfy the delivery, it recycles – either for deliverer’s shares or collateral, or for receiver’s collateral. When position or collateral becomes available the transaction is automatically retried.

5.3. Recycling Yellow – same as above for a transaction initially prioritized as yellow.

5.4. Recycling Red – same as above for a transaction initially prioritized as red.

5.5. Recycling Express – same as above for a transaction initially prioritized as express.

6. FINAL STATUS

6.1. Made – transaction is complete, shares and monies have been moved between Participant accounts, all collateral accounting completed.

6.2. CNS Partly Made – unlike most transactions in DTC, CNS deliveries can be partially completed. This status is generated when a share quantity less than the original total quantity of the transaction is made.

6.3. Dropped/Permanent – some transactions are not eligible for recycle processing in ATP, either by definition or by the choice of the deliverer. When such transactions are submitted for processing by ATP but cannot be made immediately due to insufficient deliverer’s shares or collateral, or receiver’s collateral, the transaction is dropped. In addition, when certain cutoff times are reached, transactions that are recycling are considered dropped.

6.4. Dropped/Resubmitted – any dropped transaction, as described above is tested against the Participant’s Drop Profile to determine if it should be reintroduced for processing on the following settlement day. If the transaction is to be resubmitted this status will be generated instead of the one above.

- 6.5. Rejected – transaction did not meet IMS’ or ATP’s criteria for processing. With the upfront editing done by IMS, ATP rejects should be extremely rare, but since CUSIP and Participant eligibility can change in real-time, it is a possibility.
- 6.6. Canceled – transaction was cancelled by the delivering Participant.

Other important notices detailing Participant testing timeframes and other relevant information will be sent as necessary. Questions regarding this notice may be directed to the undersigned at (212) 855-3900 or your Relationship Manager.

John Kiechle
Product Management



The Depository Trust &
Clearing Corporation
55 Water Street
New York, NY 10041-0099

IMPORTANT NOTICE

Z#: 0003

DATE: September 25, 2002

TO: **ALL PARTICIPANTS**

ATTENTION: **MANAGING PARTNER/OFFICER
OPERATIONS PARTNER/OFFICER, CASHIER
MANAGER P&S DEPARTMENT
MANAGER DATA PROCESSING DEPARTMENT
SETTLEMENT MANAGER/MANAGING DIRECTOR**

SUBJECT: **DTCC'S STRAIGHT-THROUGH PROCESSING
INITIATIVES**

Over the past several years DTCC's planning and development efforts have been directed principally at a series of related projects supporting an overall industry objective of achieving higher levels of straight-through processing (STP) in a broad range of industry processes. This objective, which clearly will deliver substantial industry benefit in its own right, has previously been linked with the effort to achieve a further shortening of the trade settlement cycle by mid-decade. With the recent determination by the Securities Industry Association's board of directors that the industry initiative should now be explicitly focused on STP, with further consideration of the shortening of the settlement cycle to be deferred for several years, DTCC believes that the industry needs further clarification of our own plans – which initiatives are part of the industry's STP objective, and will therefore be continued, and which initiatives are more directed toward the settlement cycle change and therefore will be deferred.

As a general matter, DTCC has consistently recognized that most of the key development efforts we have been focused on are STP projects, not projects directed at achieving a shorter settlement cycle. These key projects clearly align with the critical STP objectives identified by the SIA as the continued focus of industry efforts. DTCC is strongly committed to continuing with these projects on their current schedule, recognizing their importance as key "building blocks" for the overall STP objectives of the industry. We believe that continuing in these projects is essential for DTCC to provide the necessary support for the industry's continuing effort, so that significantly higher levels of STP can be achieved in accordance with the SIA's timetable.

DTCC's STP projects, formally described to the industry in DTCC's July 2000 white paper, *Paving the Way to Straight-Through Processing*, are broad in scope and include:

- Moving to real-time trade capture from the trading markets and intra-day trade reporting to participants,
- Rewriting the Continuous Net Settlement System (CNS),
- Introducing an inventory management system and other improvements in the depository settlement system,
- Combining the clearing corporation and depository settlement systems,
- Enhancing Underwriting services to move to more cost-effective and efficient electronic processing, and
- Enhancing other asset-servicing and messaging capabilities to meet industry objectives for corporate actions and securities lending communications, among others.

Individually, each of these projects brings efficiencies or other benefits to the industry. Collectively, they will enable firms to focus less on exception processing and more on providing value-added services as well as provide better service and more functionality, enable greater capacity and support business continuity planning. Implementation of these STP initiatives will provide substantial benefits to DTCC's participants and position the industry for future decisions about shortening the settlement cycle. More detail about these projects and their current status is set forth later in this notice.

DTCC has identified a few projects that will be deferred in line with the SIA's current view on the timetable for further shortening of the settlement cycle. These projects, previously included in the initial phase of the rewrite of the CNS system, generally involve accelerating reporting time frames in line with a shorter settlement cycle, which, of course, is not needed at this time.

* * *

The specifics of DTCC's current major projects and their status at this time are as follows:

REAL-TIME TRADE CAPTURE AND INTRA-DAY REPORTING

Real-Time Trade Capture. Real-time locked-in trade input has been in place for the New York Stock Exchange's On-Line Comparison System (OCS) volume for over a year. It is expected that trade capture for all of the NYSE volume will be real-time in mid-October. With the implementation of the American Stock Exchange's new Intra-Day Comparison for Equities (IDCE) process, all Amex trades are now locked in and fed to DTCC real-time. Work continues with Nasdaq to capture its data real-time by the first quarter of 2003, and plans are in place to incorporate QSR/ECN volume into this same environment, where appropriate, throughout 2003.

Intra-Day Trade Reporting. NSCC has been providing participants with intra-day output for the last several months. Making trade data available multiple times throughout the day allows firms to begin building their reconciliation processes intra-day

for more timely balancing and control applications. It also supports business continuity since it reduces the amount of data firms might be missing in case of a system failure or other dramatic event. The intra-day reporting project also included moving from seven different formats to one new consolidated format for all trade reporting. Intra-day distribution has also supported NSCC's capacity capabilities by moving the reporting of high volumes of data from massive end-of-day batches to slices of data at multiple times during the day. Efforts to convert firms to these new data feeds will continue throughout 2003. NSCC still plans to complete these efforts and discontinue the end-of-day batch distribution of trade data by the end of 2003.

CNS REWRITE

The major aspects of the CNS Rewrite include a completely new platform on which the system will run that will accommodate real-time updates to the system; improved access to CNS and depository information for participants; and the capability to add trades to the settlement process real-time for late input up until noon on settlement day.

The first changes to CNS will occur in June 2003 when NSCC changes its Balance Order processing for securities that are ineligible for CNS to eliminate redundant reporting. Today balance orders are created by separate processes based on product line with distinct processes for fixed income securities and for equities. Outputs from these processes are distributed to participants redundantly in separate reporting streams. These reporting redundancies will be eliminated through an enhancement to the Consolidated Trade Summary. NSCC Important Notice # A 5482, P&S 5052, released today, details the changes for first phase of the CNS rewrite.

The new CNS system, which is on target for implementation in January 2004, will be able to take in trades, net them and settle them up until noon on settlement day. Two additional Consolidated Trade Summary reports that will report trades settling on settlement date are being developed to support this. CNS will produce the first Supplemental Consolidated Trade Summary at 2:00 a.m. on the settlement date and the second one at 1:00 p.m. on the settlement date. In addition, CNS will provide intra-day messages for activity that occurs after the start of the day cycle as a result of settling trades and miscellaneous activity going into CNS on the morning of the settlement date so that participants can update their CNS positions immediately. These messages will be optional since the same information will also be reported on the second Supplemental Consolidated Trade Summary report at 1:00 p.m. or on the Miscellaneous Activity Report issued later in the afternoon on the settlement date.

Another new STP feature available in the new CNS system will be the ability to create automated Deliver Orders (DOs) for non-CNS depository-eligible securities. Today NSCC creates receive and deliver instructions or balance orders for non-CNS depository-eligible securities which participants then have to enter into the depository as DOs. To automate and streamline the processing of trades in non-CNS eligible issues, NSCC will create DOs for non-CNS DTC-eligible securities at the request of the delivering participant. This is an optional feature.

Other new features that will be implemented include the enhancement of the CNS Stock Borrow Program to include acceptance of instructions for the day cycle and the acceptance and real-time application of CNS “Fully Paid For” securities instructions. The Stock Borrow enhancement is intended to maximize the use of excess collateral thereby reducing the number of CNS fails and the potential liability of those fails. Participants will be able to provide CNS with a new file of available excess collateral from 5:00 a.m. until 1:00 p.m. for use in the day cycle. The real-time acceptance of CNS “Fully Paid For” instructions means that any receive into a participant’s Fully Paid For account will be updated to the participant’s memo seg position at the depository intra-day.

CNS will also generate an additional CNS Miscellaneous Activity report for the day cycle that will include reorganizations, stock borrows and any other miscellaneous activity received in CNS after the start of the day cycle.

INVENTORY MANAGEMENT SYSTEM

The industry’s prolonged discussions of the development of a new matching model that promotes straight-through processing for institutional transactions also identified a series of deficiencies or “gaps” in the processing systems for settling those transactions. Industry members, particularly members of the SIA’s Institutional Trade Processing Committee, pressed for DTCC to develop a series of capabilities to permit participants to centrally manage their own settlements, as a way of furthering STP in the settlement process itself. A working group under DTCC’s Settlement Advisory Board assisted DTCC in crafting the framework for the Inventory Management System (IMS), which is described in DTCC’s white paper, *Straight-Through Processing: A New Model for Settlement*, released in January 2002. This white paper is available on DTCC’s website www.DTCC.com, under Thought Leadership, White Papers.

IMS will provide new centralized control capabilities for the settlement process, including new capabilities for transaction authorization and new controls for the “queuing” and management of pending deliveries. The key components of IMS include:

- New authorization capabilities (replacing the Authorization and Exception system) that participants can use to stage transactions for automated settlement.
- A new “profiling” system, which will allow participants greater control over the timing and order of their deliveries by transaction types and asset class via pre-defined profiles to eliminate today’s frequent direct intervention in the settlement process that inhibits STP.
- Capabilities permitting the linkage of transactions so that particular receive transactions are associated with particular deliveries.

- Controls permitting the retention of failed deliveries into the following settlement day, eliminating participants' need to re-input these instructions.

One of the key aspects of IMS will be to create a replacement for the current Authorization and Exception (ANE) system that participants currently use to authorize affirmed deliveries from Omgeo's TradeSuite system. This replacement authorization system will support inputs from multiple matching utilities, a "passive" authorization process permitting participants to enter only exceptions, and other improvements.

DTCC has designed IMS to permit authorization and control within asset class of different transaction types and to permit increased authorization options. Participants will be able to access IMS functionality via computer-to-computer communications using a 15022 format or through a browser interface. IMS will also provide a warehousing facility for participants' future deliveries through the Night Deliver Order function and, the re-introduction of dropped deliveries.

IMS will be implemented in two phases subject to SEC approval. The replacement of ANE, warehousing and the re-introduction of dropped deliveries will be available in Phase I, the Authorization Phase, which is scheduled for implementation in July 2003. DTCC will implement the Delivery Profile phase (Phase II), which will enable participants to create an optional customized delivery and recycle profile, in December 2003.

A separate DTC Important Notice detailing Phase I functionality of IMS is also being released today as Notice # 3831.

SINGLE SETTLEMENT SYSTEM

DTC and NSCC each has its own settlement system. As a result of the integration, the redundancies of each individual settlement process have been identified. Efforts are under way to combine the two systems into one, with the first phase of this effort to be implemented in the first quarter of 2003. This will provide participants with consolidated reporting and one point of access for all settlement information. More information regarding these changes will be released later in the year.

UNDERWRITING SYSTEM ENHANCEMENTS

DTCC is developing a more efficient and timely underwriting process to support the distribution and trading of newly issued securities. Information will need to flow in a more automated manner. In the near term, DTCC plans to eliminate the hardcopy submission of underwriting detail and offering material, substituting electronic submission through the Internet and other existing technologies to meet this objective.

ASSET SERVICING AND MESSAGING CAPABILITIES

DTCC has participated in a number of STP/T+1 industry committees and organizations over the past two years. A common theme that emerged from participation in these committees and organizations is the need for an automated notification vehicle to improve efficiency over current industry practices which are largely manual in terms of notifying firms of stock loan recalls, buy-ins and corporate action liability notices.

To address this need, DTCC is developing an automated notification facility, or universal hub, to support the processing of stock loan recalls, corporate action liability notices and buy-ins that will be flexible and scalable so that it can support future needs and applications as well as a diverse base of existing customers and other domestic and global organizations. The hub has two components: A notification component to automate the communications process, and a tracking capability that will track the progress of a transaction and provide real-time status of activity. The notification component will be available for all applications residing on the hub, while the tracking capability will apply only to corporate action liability notices and buy-ins. The immediate need for the hub is for the notification of stock loan recalls. This capability will be available at the end of the first quarter 2003.

The hub, which will use globally recognized message standards (ISO 15022), will be easily accessible initially through messaging and file transfer protocols and subsequently through a browser-based protocol.

* * *

DTCC continues to be convinced of the significant industry benefits to be achieved with successful implementation of these, and other, STP initiatives. We are fully committed to completing our aspects of the STP project on time so that these key “building blocks” will be available to the industry as necessary pieces of the foundation for the overall industry initiative.

Additional information regarding DTCC’s STP Timeline and Project Plan is available on DTCC’s website (www.DTCC.com). Questions regarding these initiatives or this Notice may be e-mailed to Thomas McCarthy at tmccarthy@dtcc.com or Margaret Koontz at mkoontz@dtcc.com or to your Relationship Manager.