

IMPORTANT NOTICE

The Depository Trust Company



#: 4244-08
Date: November 24, 2008
To: All Participants
Category: Settlement
From: Julie Krill / Settlement Product Management
Attention: Settlement Manager/Managing Director/Cashier
Subject: Expanded Debit Cap Look-Ahead Processing

Effective December 5, 2008, The Depository Trust Company (DTC) will expand the current Debit Cap Look-Ahead Processing to include Money Market Instruments (MMI) Maturity Presentments. DTC implemented its Look-ahead process in June of 2003 for debt securities to reduce the number of transactions blocked for net debit cap. This change reduced net debit cap blockage by approximately 20% during the critical 1:00 p.m. processing time. In 2004, Look-ahead was enhanced to include all equity transactions and valued pledge and release transactions in addition to deliver orders.

The Look-Ahead process reduces transaction blockage for securities by identifying a receive transaction pending due to a net debit cap insufficiency and determines whether an offsetting delivery transaction pending because of a quantity deficiency in the same security would permit both transactions to be completed in compliance with DTC's Risk Management system controls. The processing system calculates the net effect of offsetting transactions in the accounts of the three participants involved. If the net of the transactions results in positive risk management controls in all three accounts, the transactions will be completed.

In order to further reduce blockage in the system and improve the timeliness and certainty of transactions completing, DTC is expanding the Look-Ahead capability beyond same CUSIP pairs, to allow MMI Issuance Deliveries pending for a custodian's or Dealer's debit cap to pair-off against MMI Maturity Presentments pending for an Issuing/Paying Agent's debit cap. Look-Ahead is an internal enhancement to DTC's processing system; it will not be necessary for Participants to make any systemic changes. A detailed example of Look-Ahead accounting can be found in the attachment.

Questions regarding this Important Notice may be directed to your DTCC Relationship Manager, the Settlement Hotline at 1-888-382-2721 or the undersigned at 212-855-5906.

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Existing Look-Ahead

The purpose of Look-Ahead is to reduce blockage in the system caused by the Debit Cap Risk Management Control. The Look-Ahead process was created initially for Money Market Instrument (MMI) Dealers, but was expanded to equity securities as well.

The existing Look-Ahead process finds transactions that are recycling because the receiver is at its debit cap. It then looks to see if the receiver has a delivery for the same CUSIP that is pending for shares. If this situation is located, DTC's Account Transaction Processor (ATP) calculates the effect to collateral and debit cap for all three parties involved and if the net effect will not override collateral or debit cap for any of the three participants, ATP processes the transactions simultaneously.

For example, assume participant A is delivering 100 shares of XYZ to participant B for \$1,000 and participant B has a redelivery of the 100 shares of XYZ to participant C for \$1,010. Participant B's receive is recycling due to insufficient debit cap and B's delivery to C is recycling for insufficient shares.

For simplicity, assume that the price per share is \$10 and there is a haircut of 10%; therefore, the collateral value is \$900. Assume all 3 participants each have \$15,000 collateral monitors and \$10,000 debit caps. Assume participant A has a net debit of \$3,000; participant B has a net debit of \$10,000 (and has therefore used its entire cap) and participant C has a net debit balance of \$5,000.

In this example, participant B's receive from A for \$1,000 would be recycling for B's insufficient debit cap (\$10,000 net debit and \$10,000 Debit Cap). Without the Look-Ahead process, participant B would have to send in a Settlement Progress Payment (SPP), i.e., a Fedwire to DTC's Fed account for at least \$1,000 which would lower its net debit to \$9,000 and allow it to use its \$1,000 available Debit Cap.

The Look-Ahead process, however, captures the delivery from A to B pending for debit cap and locates the redelivery in the same CUSIP pending for insufficient position from participant B to participant C. Once the pair is located, ATP calculates the effect on controls for A, B and C and if A's delivery to B and B's delivery to C are processed at the same time and controls will not be overridden for A, B or C, ATP completes the deliveries.

In this example, if the receive to B and B's redelivery were processed simultaneously, participant B would actually end up with a lower debit \$9,990 instead of the \$10,000 debit. Therefore, the Look-Ahead process prevents participant B from having to send money by "looking ahead" to its delivery and calculating the effect. In this example, the effect to A, B and C's collateral and debit cap is displayed below. Note that all three participants are under their debit caps and end with positive collateral monitors, i.e., controls are not overridden:

Attachment: Look-Ahead Examples

Part.	Collateral Before	Collateral After	Debit Cap	Balance Before	Balance After
A	\$15,000	\$15,100 ¹	\$10,000	-\$3,000	-\$2,000 ²
B	\$15,000	\$15,010 ³	\$10,000	-\$10,000	-\$9,990 ⁴
C	\$15,000	\$14,890 ⁵	\$10,000	-\$5,000	-\$6,010 ⁶

Modified Look-Ahead for Maturity Presentments

In order to look for additional opportunities to reduce debit cap blockage, DTC will modify the existing Look-Ahead process to find pairs of transactions between two participants that are pending for both party's debit caps. This situation occurs when Issuing Paying Agents (IPAs) have maturity presentment receives pending for insufficient debit cap and have MMI issuance deliveries pending for the receiver's debit cap.

For example, assume participant A (an IPA) has an issuance delivery for 100 shares of XYZ to participant B for \$1,000 and participant B has a delivery (maturity presentment) of 100 shares of ABC to participant A for \$1,000.

For simplicity, assume that the price per share for XYZ is \$10 and there is a haircut of 10%; therefore, the collateral value is \$900. Assume that the price per share for ABC is \$8 and

¹ Participant A loses \$900 (collateral value of the 100 shares), but gains \$1,000 for the settlement value of the transaction so the net effect to its collateral monitor is +\$100.

² Participant A receives a \$1,000 credit for the delivery to B so its \$3,000 net debit is reduced to a \$2,000 net debit.

³ Participant B gains \$900 (collateral value of the 100 shares received from A), but loses \$1,000 for the settlement value of the receive from A so net -\$100 for the receive from A. However, Participant B loses \$900 (collateral value of the 100 share delivery to C), but gains \$1,010 for the settlement value of the delivery to C so net +\$110 for the delivery to C. Therefore, the net collateral impact of both the receive and delivery is +10.

⁴ Participant B receives a \$1,000 debit for the receive from A, but receives a \$1,010 credit for the delivery to C so its balance becomes less negative by \$10 so -\$9,990.

⁵ Participant C gains \$900 (collateral value of the 100 shares received from B), but loses \$1,010 for the settlement value of the receive from A so the net effect to its collateral monitor is -\$110, but its collateral monitor is still positive.

⁶ Participant C receives a \$1,010 debit for the receive from B so its \$5,000 debt is increased to a \$6,010 debit, but it is still not over its \$10,000 debit cap.

Attachment: Look-Ahead Examples

there is a haircut of 10%; therefore, the collateral value is \$720. Assume both participants each have \$15,000 collateral monitors and \$10,000 debit caps. Assume both participants are close to their debit caps, i.e., A has a net debit of \$9,990 and participant B has a debit of \$9,900.

In this example, A would not be able to pay the maturity presentment (MP) from B for \$1,000 and B would not be able to pay for the issuance receive from A for \$1,000 and one of the two participants would have to send in a settlement progress payment (SPP). If A sent in the SPP for \$1,000 then A would be able to pay for the \$1,000 MP and the credit that B would receive from the MP would allow it to pay for the issuance delivery from A.

With the proposed modifications to the Look-Ahead process, neither participant would have to send in an SPP. Instead, ATP will select pairs of pending deliveries between A and B and will calculate the effect on controls for both participants and will process them simultaneously as long as neither participant's controls are overridden.

In this example, the effect to A and B's collateral and debit cap is displayed below. Note that both participants are under their debit caps and end with positive collateral monitors, i.e., controls are not overridden:

Part.	Collateral Before	Collateral After	Debit Cap	Balance Before	Balance After
A	\$15,000	\$14,820 ⁷	\$10,000	-\$9,990	-\$9,990 ⁸
B	\$15,000	\$15,180 ⁹	\$10,000	-\$9,900	-\$9,900 ¹⁰

⁷ Participant A would lose \$900 for the collateral value of the 100 shares for the issuance delivery to B for XYZ, but would gain \$1,000 for the settlement value of the issuance and would gain \$720 for the collateral value of the 100 shares for the maturity presentment of ABC, but would lose \$1,000 for the settlement value of the MP. Therefore, the net affect would be a loss of \$180 in collateral.

⁸ Participant A's settlement balance would be a wash, i.e., -\$1,000 for the MP and +\$1,000 for the issuance.

⁹ Participant B would lose \$720 for the collateral value of the 100 shares for the MP to A for ABC, but would gain \$1,000 for the settlement value of the MP and would gain \$900 for the collateral value of the 100 shares for the issuance receive of XYZ, but would lose \$1,000 for the settlement value of the issuance. Therefore, the net effect would be a gain of \$180 in collateral.

¹⁰ Participant B's settlement balance would be a wash, i.e., -\$1,000 for the issuance and +\$1,000 for the MP.