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Transformational change

BNY Mellon's Derivatives Collateral Net (DCN), a unique netting service for derivatives collateral management, and how it is transforming the industry



BNY MELLON BROKER-DEALER SERVICES

Transformational change

BNY Mellon this year launched Derivatives Collateral Net (DCN), a unique netting service for derivatives collateral management. Scott Linden and Mark Robinson of BNY Mellon talk about how they see it transforming the industry

Risk: BNY Mellon launched DCN in February this year. Could you give an update on its progress?

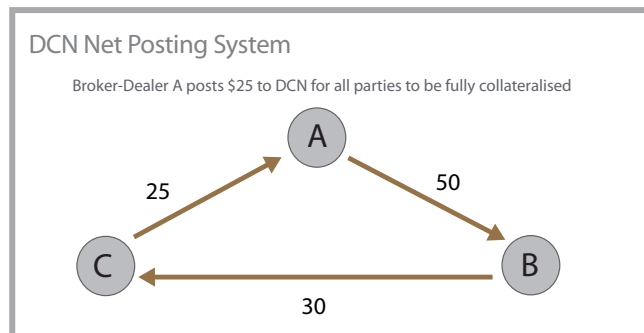
We have been consulting with select members of the Fed 15. We recognise that a netting solution requires critical mass to be efficient and we are working towards building that criticality. The current regulatory uncertainty is making it hard for some firms to venture into new ground in this area. Advanced thinkers realise that DCN offers a solution that directly addresses the risk management issues that the regulators are concerned about.

Risk: What are the major benefits DCN can bring to the industry?

DCN will be transformational. The industry has made huge strides in the last couple of years but the initiatives so far have been about improving existing structures. Portfolio reconciliation, electronic messaging and independent amount initiatives are moving ahead, and these improvements create a foundation from which DCN can move the market to the next level. Leading practitioners and regulators are already looking for the next big idea. DCN is about reducing risk, increasing transparency and reducing the operational complexity of the current collateral management process. Because DCN harmonises operational procedures, it greatly reduces the complexity of current practices. The beauty of DCN is that it doesn't change the fundamental bilateral nature of the OTC derivative legal framework. DCN complements the already accepted collateralisation process and brings the benefits of seamlessly rehypothecating collateral to create virtual collateral netting. There has been some confusion and miscommunication around rehypothecation in the OTC derivatives collateral process. There are some legitimate concerns regarding this practice with independent amount collateral requirements, but not with respect to the mark-to-market or variation margin collateral. In the DCN platform, it is a closed ring with bilateral deliveries supporting only the mark-to-market collateral requirement.

Risk: Could you explain the basic mechanics behind DCN?

DCN is a calculating and netting layer that exists on top of our collateral management platform that optimises the collateral movements needed to meet or make multiple margin calls. A company makes a single payment to DCN and DCN does all the work. The DCN legal document doesn't replace companies' CSA agreements, but amends certain provisions, primarily appointing BNY Mellon as a mutual custodian.



Risk: How do you see DCN helping to shape the future?

Given the many post-trade initiatives in the OTC derivatives space, it is not too forward thinking to envision reconciliation results being used to identify the agreed or undisputed amount and collateral messaging used to populate bilateral collateral requirements into the DCN platform. DCN would then compute and deliver a net collateral funding figure to members that would need to be satisfied. The result would be a net collateral deliver/receipt for each DCN member dealer, with DCN systematically rehypothecating collateral to satisfy the many bilateral collateral requirements. Although the initial phase of DCN is targeting the sell side, BNY Mellon is planning for a second phase of DCN to include buy-side institutions.

Risk: What is the next step for DCN?

We are going to be hosting a thought leadership seminar in the near future discuss the changes in the industry and to form the initial group of DCN users.

The views expressed herein are those of the authors only and may not reflect the views of BNY Mellon. This does not constitute derivatives collateral management advice, or any other business or legal advice, and it should not be relied upon as such.

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