

SIFMA Internal Auditors Society Annual Meeting

Dodd-Frank Update

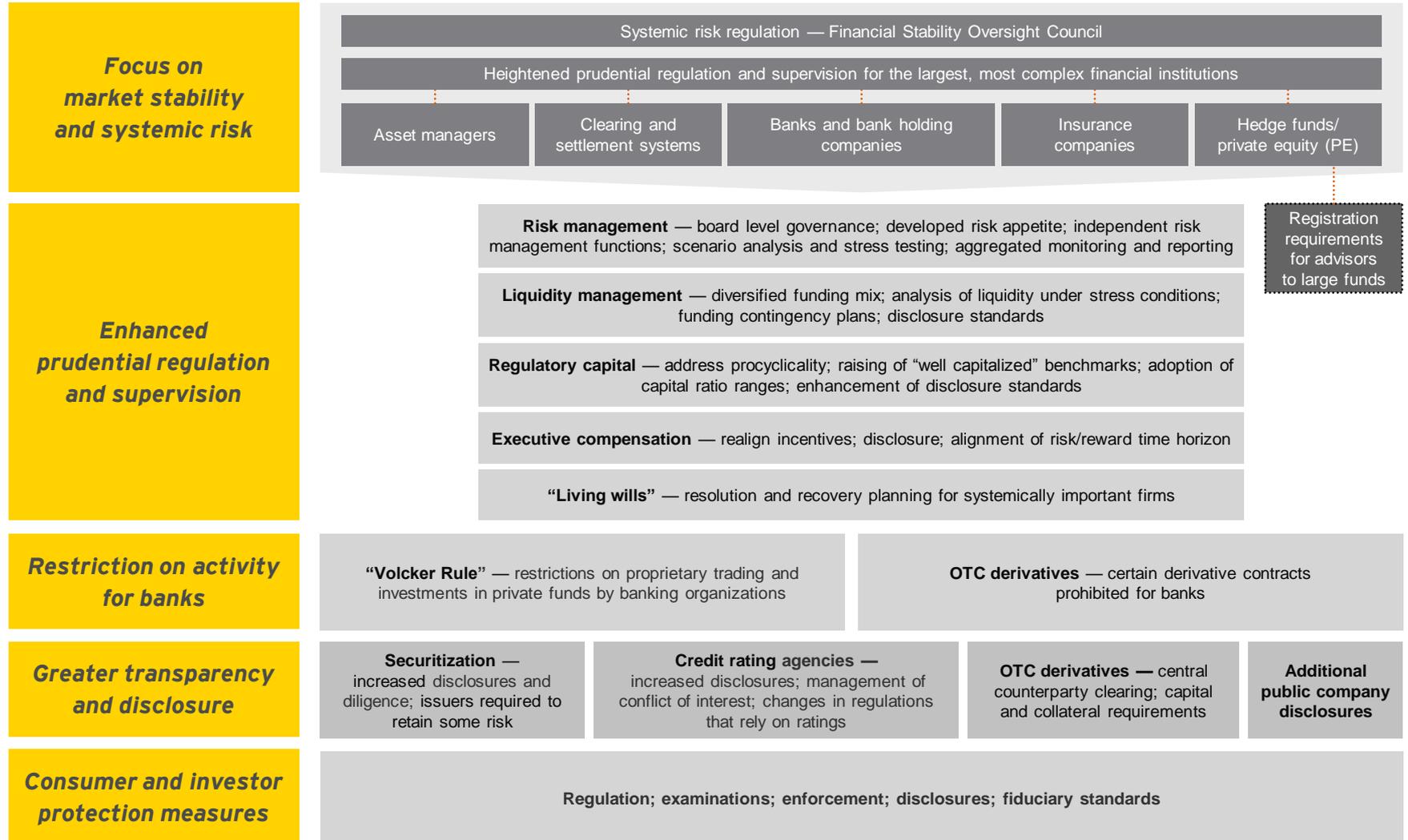
24 October 2011

Agenda

- ▶ Overview of Dodd-Frank Act
- ▶ Focus Areas
 - ▶ Volcker Rule
 - ▶ Living Wills/Resolution Planning
 - ▶ OTC Derivatives

The US regulatory landscape under Dodd-Frank

The Act lays out a framework; 300+ rules are required to build this out



Key developments in the first year

Regulatory authorities have begun rulemaking, with significant impacts for the industry

Focus on market stability and systemic risk

- ▶ The new regulatory bodies have started to lay out their agendas
- ▶ The FSOC is in the process of determining criteria for systemically important institutions
- ▶ Office of Financial Research (OFR) proposals to date have focused on standards for data collection and legal-entity identification

Enhanced prudential regulation and supervision

- ▶ Supervisory focus on prudential supervision for large banks under existing supervisory remits, including living wills and stress testing initiatives
- ▶ Proposed rules issued on living wills and some capital reforms and NPR on enhanced supervision
- ▶ Insurance firms are preparing for changes in regulatory regime – regulatory reporting impacts for many, while the largest firms are preparing for Fed supervision as SIFIs

Restriction on activities of banks

- ▶ Volcker Rule study points towards an intensive compliance regime, although some activities may still be viable under hedging premise
- ▶ Some banks have begun to wind down or spin off proprietary trading operations

Greater transparency and disclosure

- ▶ The SEC and CFTC have undertaken extensive rule-making regarding over-the-counter (OTC) derivatives clearing and reporting: extensive readiness and implementation work underway while rules are being finalized
- ▶ Proposed and (some) final rules on risk retention for securitization issued

Consumer and investor protection measures

- ▶ Continued focus on consumer protection by existing bank supervisors
- ▶ Proposed rules on interchange fees indicate the significant potential impact of consumer reforms on consumer banking revenues
- ▶ Broader SEC proposals for public companies including “say on pay” and whistleblowers

- ▶ Some “wait and see” by firms for final rules, but a recognition that they need to get moving
- ▶ Program management and governance – up and running, but not without challenges
- ▶ Firms are starting to evaluate broader, aggregate impacts of the reforms on capital and entity structures

Outlook for the next year: rulemaking implementation

Most of the rulemaking will be finalized in the next year with short implementation timeframes

Over the next 120 days (before end of 1Q 2012) – final rules on:

- ▶ Multiple aspects of OTC derivative reform
- ▶ Criteria for systemic designation of financial market utilities, and related risk management standards
- ▶ Criteria for systemic designation of non bank financial companies
- ▶ Enhanced prudential standards for large bank holding companies and SIFIs
 - ▶ Risk-based capital and leverage, liquidity, risk management, credit exposure limits, risk committee requirements, stress test and new prompt corrective action regime
- ▶ Rules for prudential supervision of non-bank SIFIs
- ▶ Incentive compensation
- ▶ Credit risk retention requirements for the issuance of asset backed securities

...and proposed rules on:

- ▶ Volcker Rule
- ▶ Credit exposure reporting requirements

Consumer rulemaking will gain momentum once the CFPB gets fully staffed and implementing its agenda

Some rulemaking may be delayed, but not by much – there is still a lot to be done and implementation windows will be tight, with most work starting in the next 12-18 months.

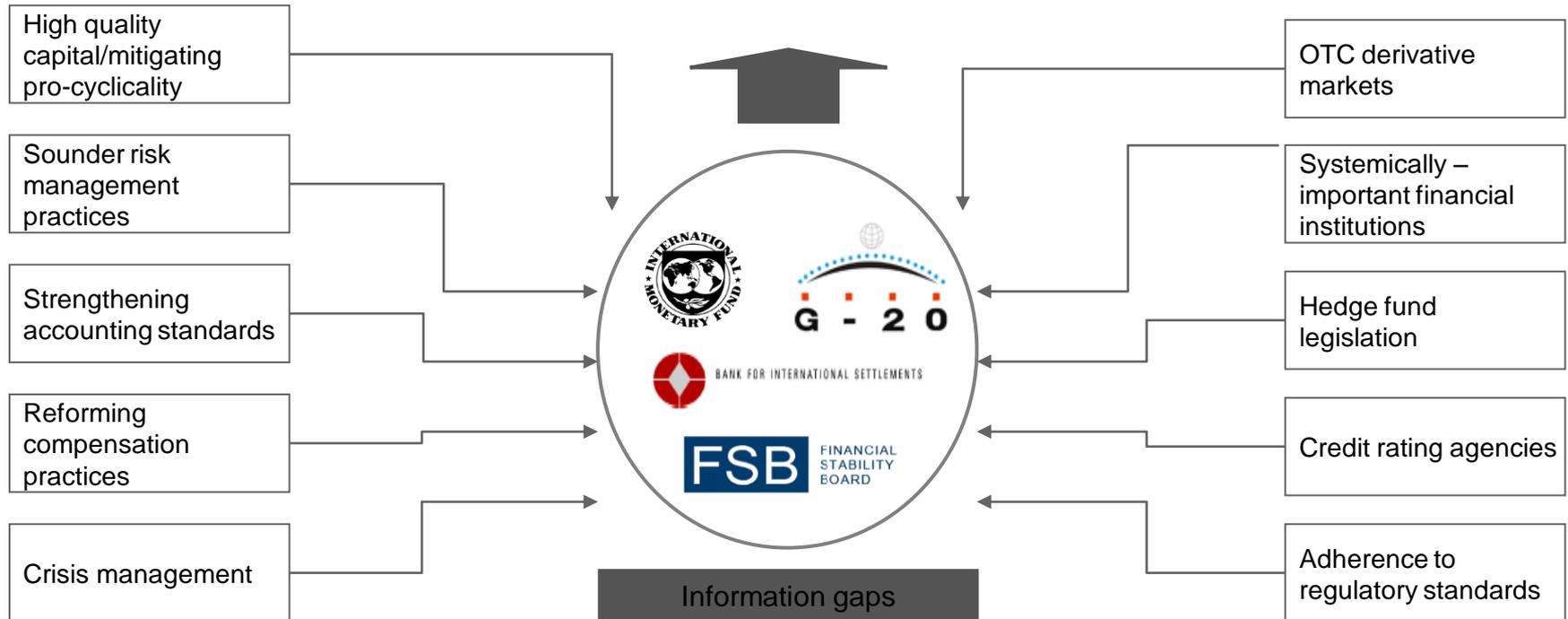
The landscape of future regulatory reform is truly global



Note: Many “regulations” are still only at proposal, draft or consultation stage. Nevertheless, all are expected to reach final enactment; however, much amended between now and then, and become enforceable law within the next two to three years. This is necessary to meet the commitments made by the G-20 summit countries. What is shown here are the major regulatory changes, and is not meant to be exhaustive.

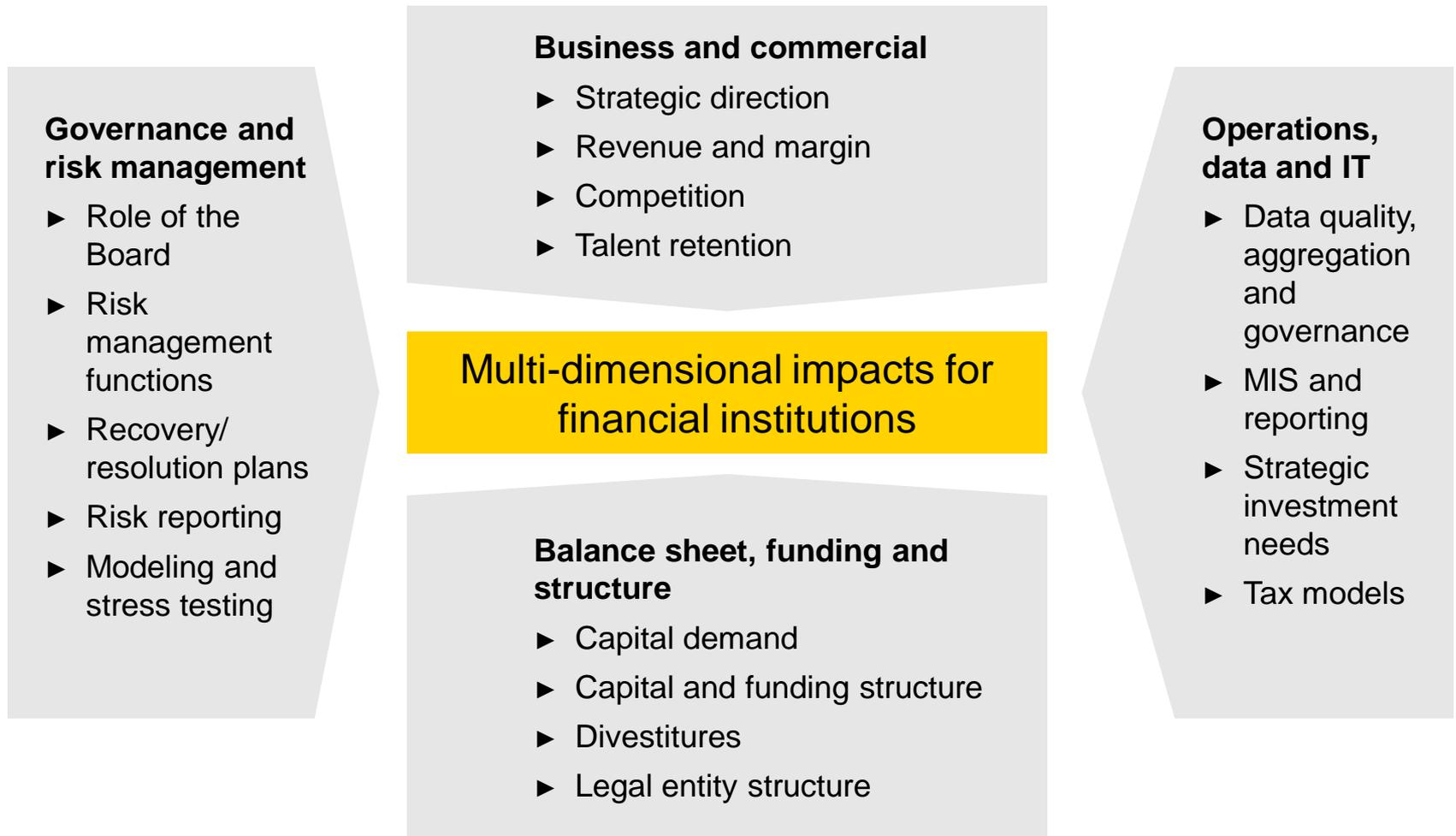
The G20 direction of travel

G20 Finance Ministers and Central Bank Governors

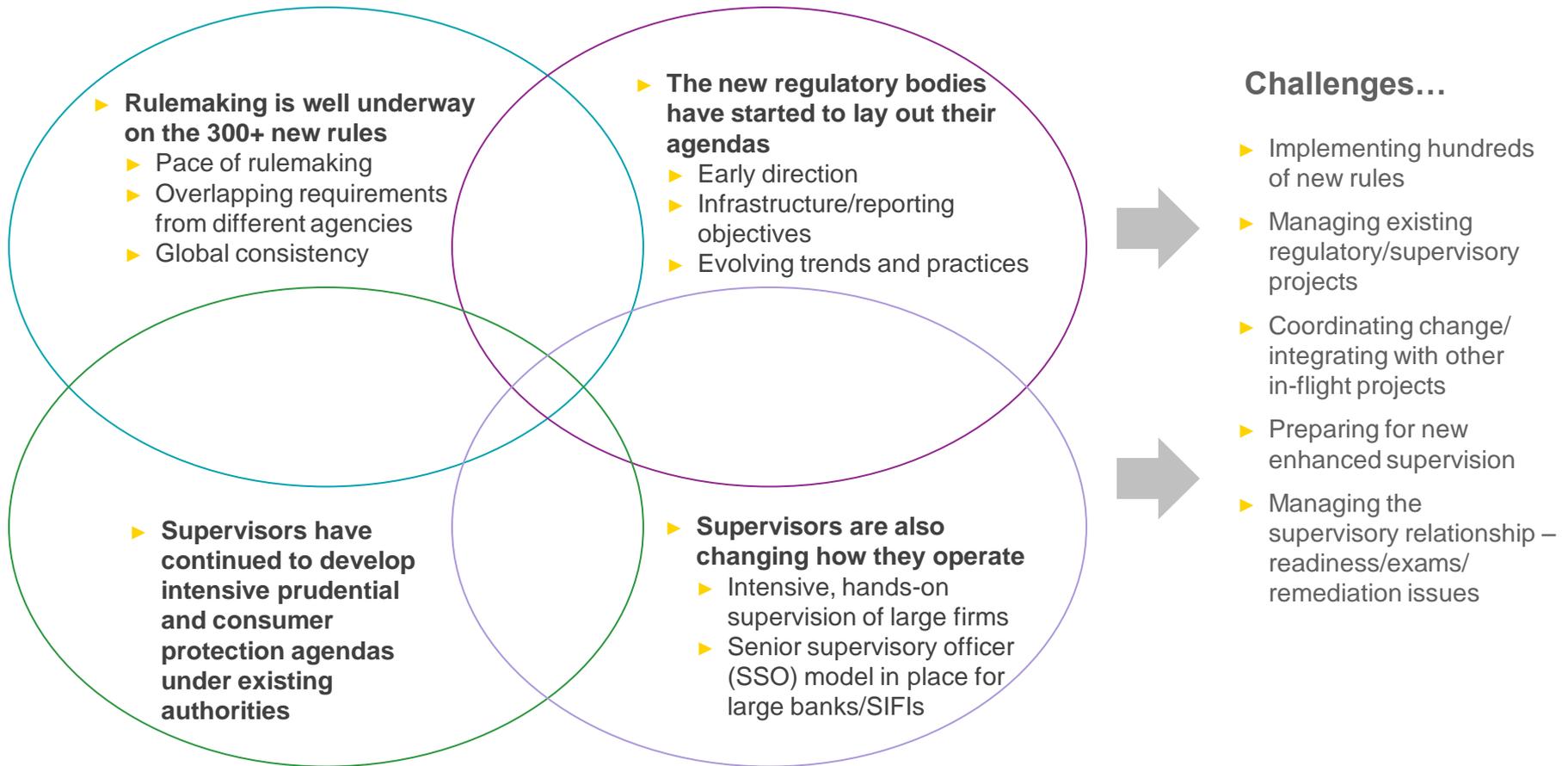


The impacts of Dodd-Frank are far-reaching

The new regime will impact many aspects of financial firms' business models

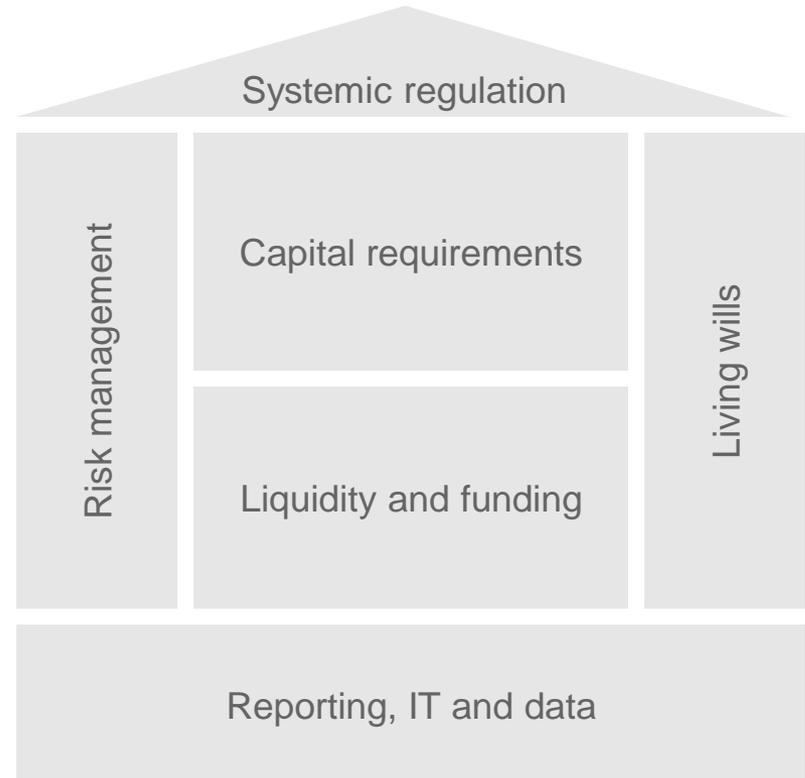


Outlook for the next year: managing regulatory change



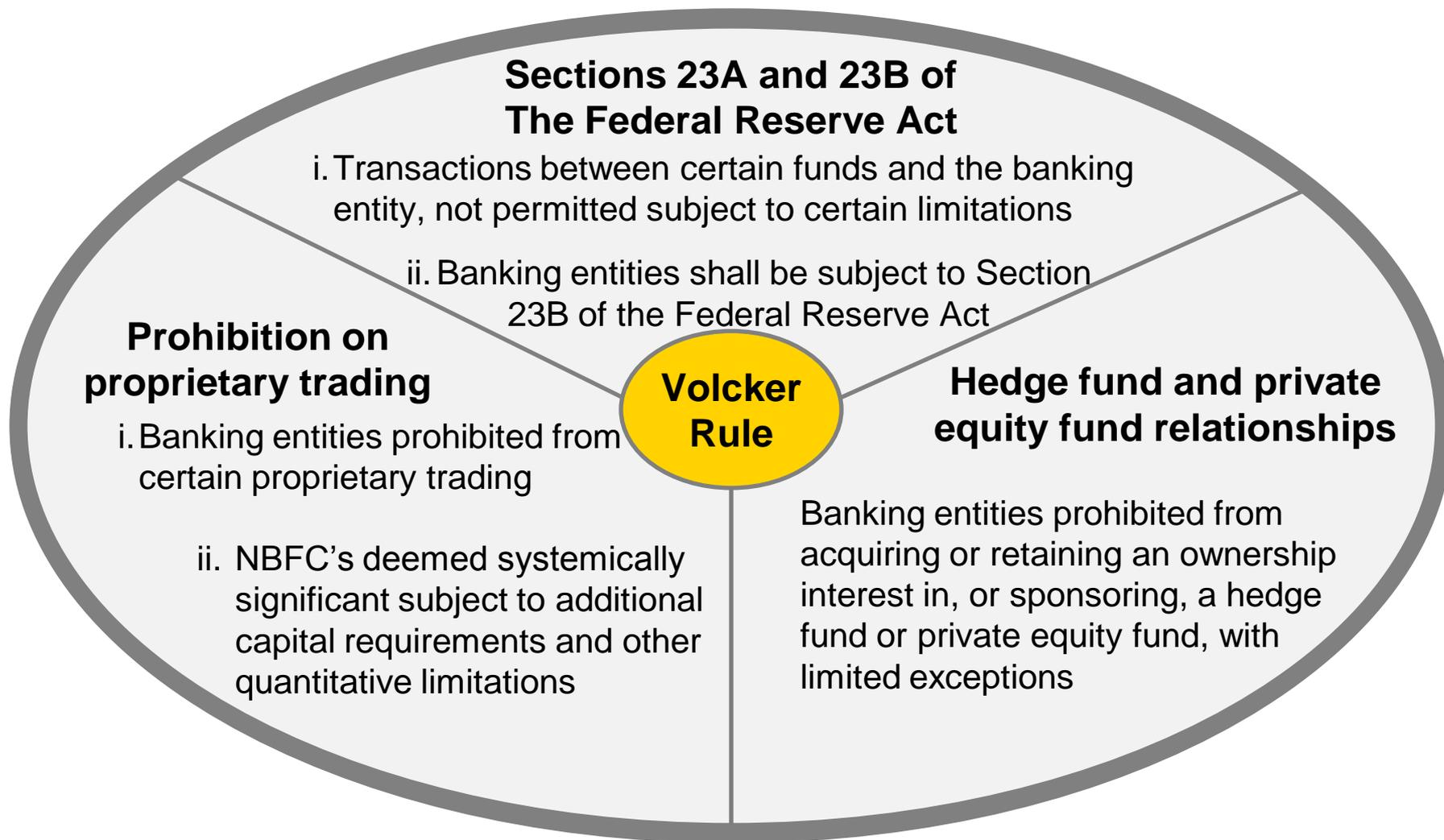
Large, interconnected firms face the greatest impact

- ▶ Systemically important firms under Dodd-Frank face heightened supervision
 - ▶ US bank holding companies with assets greater than \$50 bn
 - ▶ Other financial firms, including foreign banking organizations with \$50 bn+ in global assets and nonbanks deemed systemically important by the FSOC, considering:
 - ▶ Interconnectedness, extent and nature of transactions with other financial institutions
 - ▶ Importance as a source of credit and liquidity in the US financial system
 - ▶ Size, scope and complexity
 - ▶ Other primary regulators
 - ▶ Leverage and reliance on short-term funding



Volcker Rule

Introduction



Introduction

High impact 'Volcker Rule' calls for immediate planning

- ▶ Under the Volcker Rule, U.S. banking entities (including foreign-owned) are: (1) prohibited from proprietary trading, subject to limited exceptions; (2) prohibited from investing in hedge funds or private equity funds or sponsoring such funds, subject to limited exceptions; and (3) restricted on certain transactions between an entity that serves as an organizer, sponsor, investment advisor or investment manager of a private equity fund or hedge fund (or any affiliate of such entity) and the fund itself.
- ▶ **Impact:** assess trading desks vs. criteria for permitted activities, robust compliance program (policies and procedures, internal controls, etc.), quantitative metric production, documented liquidity management plan, recordkeeping and reporting needs to in place and effective on July 21, 2012.

Timeline

- ▶ July 2010 – Volcker Rule legislation contained in the Dodd Frank Act
- ▶ January 18, 2011 – FSOC issues Volcker Study
- ▶ September 30, 2011 – 205 page “preamble” and 83 page “text” to draft Volcker Rule leaked
- ▶ October 11, 2011 – 298 page Proposed Volcker rule (the “proposed rule”) issued by FDIC (contains 382 questions)
- ▶ January 13, 2012 – Comments due on proposed rule
- ▶ ??????? – Final Volcker Rules issued
- ▶ July 21, 2012 – Volcker Rule becomes effective, start of 2 year Conformance Period

What are Banks doing?

- ▶ Shutting down or disposing of proprietary trading business, and developing strategies for compliance with funds prohibitions
- ▶ Forming multi-discipline Volcker Working Group to monitor rulemaking and plan implementation
- ▶ Evaluating proposed rule:
 - ▶ Performing Impact Assessments - evaluating current business activities vs. significant amount of definitions and criteria in the proposed rule
 - ▶ Sizing operational and business impact – significant internal control and reporting requirements
 - ▶ Identifying “grey area” activities that require further interpretation
 - ▶ Developing point of views and communicating with rule makers and/or industry groups

Overview of the Volcker Rule per the Dodd Frank Act

The Volcker Rule consists of three parts	Who is affected?
<ul style="list-style-type: none"> ▶ Proprietary trading generally banned for banking entities, with limited permissible activities. Nonbank financial companies (“NBFC”) will be subject to additional capital requirements and other quantitative limits ▶ Banking entities banned from acquiring or retaining an ownership interest in, or sponsoring, a hedge fund or private equity fund, with limited exceptions ▶ “Covered transactions” between a permissible sponsored or an advised fund and the banking entity, including all subsidiaries, are not permitted. Said fund will have to seek credit and perform asset purchases/sales transactions with independent third party. Any transactions between said fund and banking entity will have to be at arm’s length and subject to market terms. 	<ul style="list-style-type: none"> ▶ Banking entities, such as FDIC-insured commercial banks, thrifts, and industrial loan companies (and companies that controls those depository institutions). Non-US bank (and any parent company) that has a US branch, agency, commercial lending company or insured depository institution. Any subsidiary of the above-mentioned entities. ▶ NBFCs that are predominantly engaged in financial activities, as determined by the FSOC, that “material financial distress” at the NBFC could pose a threat to U.S. financial stability.

Affected Entity category	Subject to prohibition?	Limitations on relationships with Hedge Funds and Private Equity Funds	Exceptions to Fund ownership interests
Banking entity	YES	Banking entities are permitted to organize and offer, including sponsoring, a hedge or private equity fund conditional that the bank:	<ul style="list-style-type: none"> ▶ Allowed to provide seed capital to permit fund to attract unaffiliated investors
Nonbank Financial Company (“NBFC”)	NO While not subject to the Rule’s prohibition, NBFCs will be subject to additional capital requirements and other quantitative limits	<ul style="list-style-type: none"> ▶ Provides bona fide trust, fiduciary, or investment advisory services ▶ Does not acquire or retain an ownership interest, except for a de minimis investment of 3% ▶ Does not guarantee, assume, or otherwise insure the obligations or performance of the fund or of any other fund in which such fund invests ▶ No director or employee of the banking entity takes or retains an ownership interest in the fund, except for one who is directly engaged in providing services to the fund ▶ Discloses in writing to prospective and potential investors , that losses in such fund are borne solely by investors in the fund and not by the bank ▶ Banking entity does not enter into “covered transactions” with the fund 	<ul style="list-style-type: none"> ▶ Must seek unaffiliated investors to reduce or dilute fund investment to not more than 3% of total ownership interest within 1 year after establishment of fund ▶ Aggregate investment interests in all such funds may not exceed 3% of Tier 1 capital ▶ Investment in Small Business Investment Companies (“SBIC”)

Definition of Proprietary Trading

Proprietary Trading	Covered Financial Position	Trading Account
<p>Engaging as principal for the trading account in any transaction to purchase or sell, or otherwise acquire or dispose of the following covered instruments:</p> <ul style="list-style-type: none"> ▶ securities, ▶ derivatives, ▶ contracts of sale of a commodity for future delivery, ▶ options on any such security, derivative, or contract 	<p>Scope of financial instruments subject to the prohibition on proprietary trading any position whether long or short, synthetic or otherwise, in a security, derivative or future, and any option thereon.</p> <p>Excludes:</p> <ul style="list-style-type: none"> ▶ Loans, spot fx, spot commodities ▶ Certain repo & reverse repo transactions ▶ Securities lending agreements ▶ Accounts used for bona fide liquidity management (see appendix for criteria that must be satisfied) ▶ Government Obligations (see next page) 	<p>Deemed a trading account if one of three conditions are met:</p> <ol style="list-style-type: none"> 1. Purpose: The account is used to take covered positions principally for short-term resale, price movements, arbitrage or hedging another trading account position. Rebuttable presumption is that it is a trading account if it is held a position for 60 days or less. 2. Market Risk Capital Rule: includes positions which are included in the calculation of risk-based capital under the Market Risk Capital Rule (which includes trading securities under U.S. GAAP) of a registered securities. 3. Status: the account is an account dealer, municipal securities dealer, government securities dealer, or a swap or security-based swap dealer and is used to take covered financial positions in connection with their registered activities.

Permitted Activities – Criteria to meet Exemption

Market Making	Hedging	Underwriting	Other
<ol style="list-style-type: none"> 1. Bona fide market marking (see indicia in Appendix) 2. Reasonably expected near-term demand 3. Registration under securities or commodities laws 4. Revenues from fees & bid/ask spreads 5. Compensation arrangements must be designed not to encourage or reward risk-taking 6. Consistency with Appendix B Commentary – features of permitted market making versus prohibited proprietary trading 7. Establish internal compliance program to meet criteria above 	<ol style="list-style-type: none"> 1. Hedges are in accordance with written hedging policies 2. Must be designed to reduce the specific risks 3. Hedges must be reasonably correlated to the targeted risk 4. Hedges must not give rise to new exposures. 5. Ongoing review of the correlation 6. Compensation does not encourage risk-taking. 7. Documentation requirements for hedging done by different entities. 8. Establish internal compliance program to meet criteria above 	<ol style="list-style-type: none"> 1. Only purchases and sales of securities 2. Distribution of securities for which the banking entity is acting as an underwriter 3. Must have the appropriate dealer registration or otherwise be exempt 4. Designed not to exceed the reasonably expected near-term demands 5. Revenues primarily from fees, commissions, and underwriting spreads 6. Compensation does not encourage proprietary risk-taking. 7. Establish internal compliance program to meet criteria below 	<ol style="list-style-type: none"> 1. <u>Government Obligations.</u> Includes U.S. and municipal general, limited and pass-through obligations and forward trading. Does not include foreign governments, derivatives on government obligations or obligations guaranteed by a government issuer. 2. <u>On Behalf of Customers:</u> fiduciary activity as an investment adviser, commodity trading advisor, trustee or in a similar fiduciary capacity and involves solely positions in which the customer is the beneficial owner; riskless principal; and trading by an insurance company for the separate account.

Compliance Program Requirements for Trading Activities (to be in effect July 21, 2012)

- ▶ **Internal policies and procedures:** Identification of trading accounts, trading units and organization structure; descriptions of missions and strategies, including authorized instruments/products, hedging procedures and holding periods; trader mandates; descriptions of risks and risk management policies; explanations of compliance, including identification of permitted activities; and remediation of violations.
- ▶ **Internal controls:** Authorized risks, instruments and products; risk limits; analysis and quantitative measurement of activities, including metrics reported to regulators; heightened review based on measurements, including internal escalation and regulator notification upon a reasonable likelihood of violation; firm-specific metrics as necessary. Timely notification to the relevant agency of any investigation and remedial action is required. Surveillance of compliance program effectiveness.
- ▶ **Senior management responsibility and accountability** for compliance: Board of Directors and CEO review and approval of the program, responsibility for culture of compliance and identification of responsible business line managers, appropriate trader mandates and management procedures
- ▶ **Independent testing** of program effectiveness: may be internal or external.
- ▶ **Training:** Must be provided to trading personnel, managers and others as appropriate.
- ▶ **Recordkeeping:** Must be sufficient to demonstrate compliance and be promptly produced to regulators upon request, with a five-year requirement.

Quantitative Metrics for Trading Activities

- ▶ For banks with trading assets and liabilities that equal or exceed (the average gross sum on a worldwide consolidated basis) \$5 billion, each trading unit must recalculate the following metrics daily, and report them monthly to regulators within 30 days of month end. “Trading unit” is broad and includes both individual desks and other organizational units:
 - ▶ Value-at-Risk and Stress VaR;
 - ▶ VaR Exceedance;
 - ▶ Risk Factor Sensitivities;
 - ▶ Risk and Position Limits;
 - ▶ Comprehensive Profit and Loss;
 - ▶ Portfolio Profit and Loss;
 - ▶ Fee Income and Expense;
 - ▶ Spread Profit and Loss;
 - ▶ Comprehensive Profit and Loss Attribution;
 - ▶ Pay-to-Receive Spread Ratio;
 - ▶ Unprofitable Trading Days Based on Comprehensive Profit and Loss and Unprofitable Trading Days Based on Portfolio Profit and Loss;
 - ▶ Skewness of Portfolio Profit and Loss and Kurtosis of Portfolio Profit and Loss;
 - ▶ Volatility of Comprehensive Profit and Loss and Volatility of Portfolio Profit and Loss;
 - ▶ Comprehensive Profit and Loss to Volatility Ratio and Portfolio Profit and Loss to Volatility Ratio;
 - ▶ Inventory Risk Turnover;
 - ▶ Inventory Aging; and
 - ▶ Customer-facing Trade Ratio.

- ▶ The proposed rule provides descriptions and general calculation guidance for the above metrics.

Covered Funds - Prohibitions

Core provisions are broadly consistent with statute, placing overall prohibition on acquiring or retaining ownership interest in, and certain relationships with, covered funds, while permitting activity as part of asset management and other key functions

Covered Funds

- ▶ Any issuer that would be an investment company as defined in the Investment Company Act of 1940 but for the exemptions listed in sections 3(c) (1) or 3(c)(7) of that Act
- ▶ Commodity pools
- ▶ Foreign equivalents of covered funds
- ▶ Any similar funds, determined by the appropriate federal banking agencies

Permitted Asset Management Activities - organizing and offering a covered fund, where:

- ▶ Banking Entity must provide bona fide trust, fiduciary, investment advisory or commodity trading advisory services
- ▶ Fund must only be offered to customers of such services
- ▶ Banking Entity must not provide guaranty, assume or otherwise insure fund obligations or performance; must disclose that losses are to be borne solely by investors
- ▶ Fund must not share same name or variation of same name as Banking Entity, must not use word 'bank' in name
- ▶ *Ownership interest only permitted to establish fund and provide with sufficient initial equity to attract unaffiliated investors; to make 'de minimis' investment*

De Minimis Asset Management Threshold

- ▶ Limited to 3% of invested capital or loss exposure for each fund
- ▶ Limited to 3% of tier 1 capital of the top tier BHC (or top-tier affiliate BHC in case of a chain of ownership)

*Ownership interest includes voting and non-voting equity of covered fund and debt securities with substantial equity characteristics. Excludes carried interest not reinvested in the fund, and permitted director/employee investments if not made with funds borrowed from banking entity.

Covered Funds - Permissible Activity / Exclusions

Proposed rule addresses certain industry concerns, e.g. fund of funds, custodial and other non-principal relationships and certain traditional operating companies, while espousing narrow view on foreign bank activity outside US

Investments not “As Principal”

- ▶ The rule’s prohibitions are limited to investments acting “as principal” i.e. excluding investments in fiduciary capacity, as custodians, brokers or agents for an unaffiliated 3rd party, qualified employee benefits (under ERISA) and investments by directors or employees in personal capacity

Other Permitted Activities

- ▶ Risk mitigating hedging activity
- ▶ Certain activity/investments outside the US by non US Banking Entities
- ▶ Certain loan securitizations
- ▶ BOLI, COLI, ownership in satisfaction of debt previously contracted in good faith
- ▶ Traditional JV, acquisition vehicles and subsidiaries engaged in providing liquidity management, with some limitations
- ▶ SBIC and other related investments

Other Exclusion from Prohibitions (based on Banking Entity Definition)

- ▶ Fund of Funds - Banking entity does not include fund of funds or any entity directed or indirectly controlled by covered fund of funds

Covered Funds - Requirements for Risk Mitigating Hedging Activity

- ▶ Risk-mitigating hedging activities are permitted, allowing for ownership interest in connection with individual or aggregated obligations or liabilities, only if:
- ▶ Acting as intermediary on behalf of a customer that is not a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund
- ▶ Directly connected to a compensation arrangement with an employee that provides investment advisory or other services to the covered fund; and designed to reduce the specific risks to the covered banking entity in connection with and related to such obligations or liabilities.

Requirements

- ▶ Undertaken in accordance with established internal compliance program
- ▶ Does not give rise, at the inception of the hedge, to significant exposures not already present
- ▶ Subject to continuing review, monitoring and management by the covered banking entity
- ▶ Compensation arrangements of persons performing the risk-mitigating hedging activities designed not to reward proprietary risk-taking
- ▶ Provides for supporting documentation of the risk-mitigating purpose of the activity

Covered Funds - Permitted Foreign Bank Non-US Activity – Limitations

Proposed rule clarifies permissible activity, taking a narrow view of how activity occurring ‘solely outside of US’ is defined

Permissible Non-US Activity

- ▶ Certain foreign banking entities can acquire or retain an ownership interest in, or to act as sponsor to, a covered fund so long as such activity occurs solely outside of the United States and the entity meets the requirements of sections 4(c)(9) or 4(c)(13) of the BHC Act.

Limitations

- ▶ Limits the extraterritorial application of statutory restrictions on covered fund activities and investments to foreign firms that, in the course of operating outside of the United States, engage in activities permitted under relevant foreign law outside of the United States, while preserving national treatment and competitive equality in the US
- ▶ The covered banking entity must not be directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States
- ▶ No ownership interest in such covered fund can be offered for sale or sold to a resident of the United States
- ▶ The activity must occur solely outside the United States.

Covered Funds - Other Permissible Activity - Limitations

Proposed rule includes exceptions for certain activities believed to promote safety and soundness of banking entities and financial system stability

Sale and Securitization of Loans

- ▶ A banking entity may acquire and retain an ownership interest in, or act as sponsor to, an issuer of asset-backed securities involving:
- ▶ Loans and contractual rights or assets directly arising from those loans supporting the asset backed securities
- ▶ A limited amount of interest rate or foreign exchange derivatives that materially relate to such loans and that are used for hedging purposes with respect to the securitization structure.
 - ▶ Allows a banking entity to acquire and retain an ownership interest in a loan securitization vehicle (which would be a covered fund for purposes of section 13(h)(2) of the BHC Act and the proposed rule) that the banking entity organizes and offers, or acts as sponsor to, in excess of the three percent limits

Bank Owned Life Insurance

- ▶ A separate account which is used solely for the purpose of allowing a covered banking entity to purchase an insurance policy for which the covered banking entity is the beneficiary, provided that the covered banking entity does not control the investment decisions regarding the underlying assets or holdings

Common Corporate Organizational Vehicles

- ▶ Certain joint ventures between the covered banking entity or one of its affiliates and any other person
- ▶ An acquisition vehicle, provided that the sole purpose and effect of such entity is to effectuate a transaction involving the acquisition or merger of one entity with or into the covered banking entity or one of its affiliates
- ▶ (iii) An issuer of an asset-backed security, but only with respect to that amount or value of economic interest in a portion of the credit risk that is retained by a covered banking entity that is a “securitizer” or “originator”
- ▶ A subsidiary engaging in bona fide liquidity management activities

Covered Funds

‘Super 23A’ Prohibitions and Conflicts of Interest

Super 23A provision prohibits covered transactions (as term is defined by Section 23A of Federal Reserve Act), with exceptions associated with permissible asset management activity and prime brokerage; Rule also includes blanket prohibition on conflicts

Super 23A Prohibitions

- ▶ No covered banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers a covered fund and no affiliate of such entity, may enter into a transaction with the covered fund, or with any other covered fund that is controlled by such covered fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c), as if such covered banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.

Exceptions

- ▶ ‘Prime brokerage transactions with a fund managed, sponsored, or advised by the banking entity (or an affiliate subsidiary thereof) has taken an ownership interest, if:
 - ▶ Certification of CEO (or equivalent) of the top-tier affiliate of the covered banking entity
 - ▶ Adherence to standards in Section 23B of the Federal Reserve Act (12 U.S.C. 371c-1) as if the counterparty were an affiliate of the covered banking entity.

Prohibited Conflicts of Interest

- ▶ Prohibition of any activity that would:
 - ▶ Involve a material conflict of interest between covered banking entity and clients, customers or counterparties
 - ▶ Result in a material exposure to a high-risk asset or high-risk trading strategy
 - ▶ Pose a threat to the safety and soundness of the covered banking entity or the financial stability of the US

Covered Fund Compliance Program

Proposed rule adopts a tiered approach to implementing compliance program, based on minimum standards designed to reasonably ensure and monitor compliance, suitable for size, scope and complexity of activities.

- ▶ All covered banking entities must establish an internal compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on investments in covered funds .

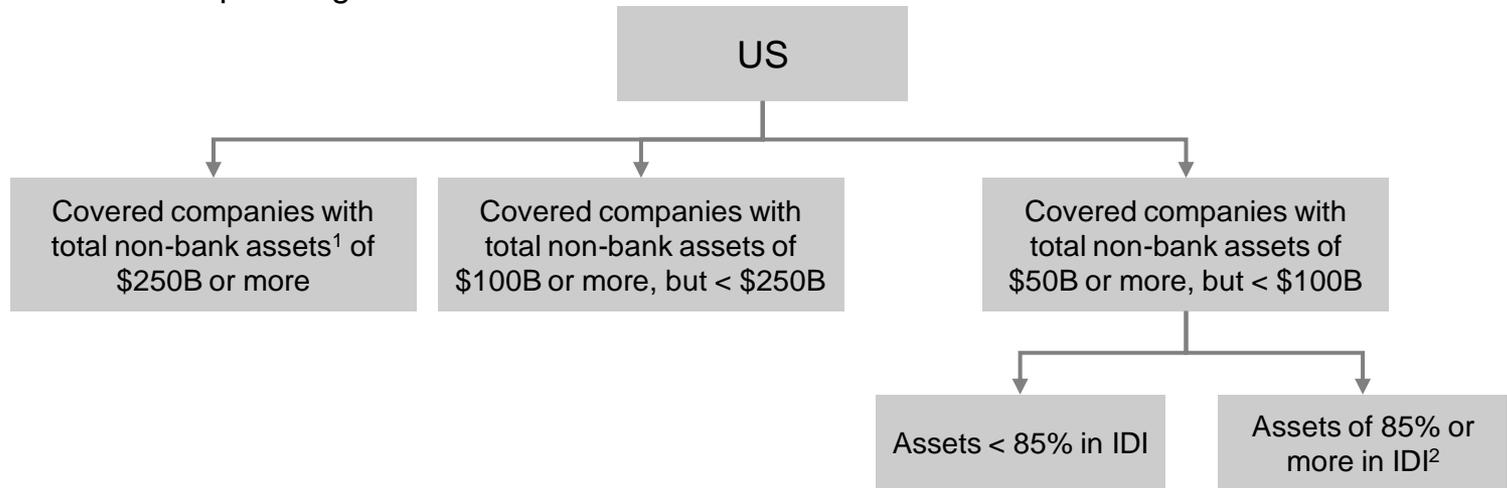
- ▶ The program must be appropriate to the size, scope, complexity of the business structure and activities of the covered banking entity and must at a minimum include:
 - ▶ Written policies and procedures designed to monitor compliance with prohibitions and restrictions,
 - ▶ System of internal controls to monitor and identify potential areas of non compliance
 - ▶ Management framework that delineates responsibility and accountability for compliance
 - ▶ Independent testing of the effectiveness of the program
 - ▶ Training for certain personnel
 - ▶ Record retention processes

US Resolution Planning Overview

- ▶ On September 13, the US regulators released two rules related to Resolution Planning. The first rule addresses Dodd-Frank Act (DFA) section 165d regarding resolution plans (“165d Rule”) and the second is resolution planning for a Covered Company’s insured depository institutions (IDIs) (“IDI Rule”).
- ▶ The IDI Rule will be effective as of January 1, 2012. The effective date of the 165d Rule, though not yet explicit in the guidance, is also expected to be January 1, 2012.
- ▶ **165d Rule** – Focus is on the orderly resolution of covered companies through the Chapter 11 bankruptcy process in the event of material financial distress or failure
 - ▶ The 165d Rule applies to US bank holding companies and foreign banking organizations with US operations with greater than \$50 billion in total assets, as well as to US non-bank Systemically Important Financial Institutions (SIFIs).
- ▶ **IDI Rule** – Focus is on the orderly resolution of an IDI in a manner that ensures the protection of depositors and “least costly” to the Deposit Insurance Fund
 - ▶ The IDI Rule applies to US insured depository institutions with greater than \$50 billion in total assets. Resolution through the IDI Rule will occur under the FDI Act.
- ▶ Both rules are designed to cover the range of business lines, legal entity and capital structure combinations within a systemically important financial institution. Each plan will be submitted to the Federal Reserve Board and FDIC and is expected to include a dialogue between the agencies and the institution as the plans are developed.
- ▶ 165d Rule detail is materially the same as the NPR released in March, with the exception of excluding credit exposure reporting. Credit exposure reporting will be adopted under a separate rulemaking process.

Scope of US Resolution Planning

► The scope of US resolution planning is as follows:



Initial Submission Date	July 1, 2012	July 1, 2013	December 31, 2013	December 31, 2013
Type of Plan	IDI Plan and 165d Plan	IDI Plan and 165d Plan	IDI Plan and 165d Plan	IDI Plan and 165d Tailored ³ Plan

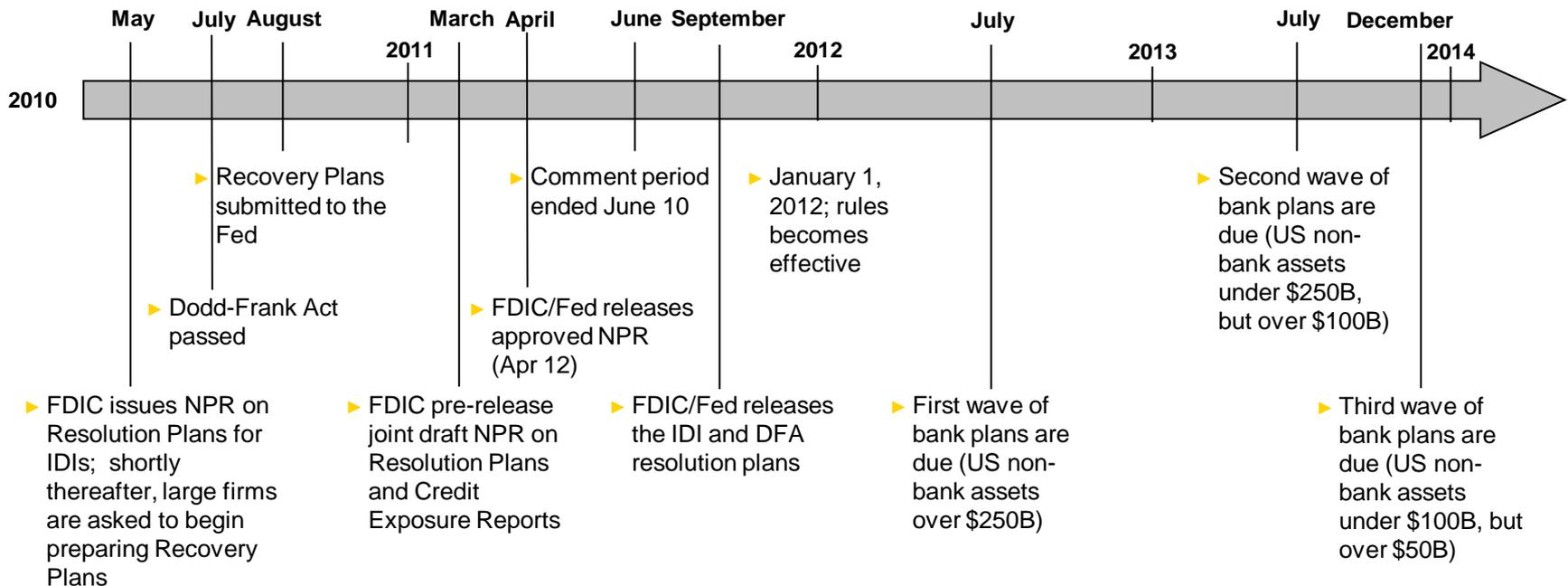
- Foreign-based covered companies will follow the same staggered timelines as US covered companies as proscribed by their total US non-bank assets.
- The rules maintain a provision whereby the regulators may ask an institution to meet a deadline that differs from that proscribed by the non-bank asset designation.

1. Note: the term “non-bank assets” has not been defined in the rules; the term can be interpreted as the difference between BHC assets per the FR Y-9C and IDI assets as reported to the FDIC.
 2. For foreign-based covered companies, the assets of the US IDI operations, branches, and agencies of which comprise 85% or more of such covered company’s US total consolidated assets.
 3. An eligible company intending to file a tailored resolution plan must provide written notice to the US regulators no later than 270 days prior to its resolution plan submission date.

FDIC / Fed Resolution Plan Timeline

- ▶ After the initial submission, Resolution Plans are required to be submitted to the FDIC/Fed on or before each anniversary date of the Covered Company and/or CIDI's initial submission date.
- ▶ No mandatory interim updates will be required, although notice of material changes impacting plans must be provided to regulators.

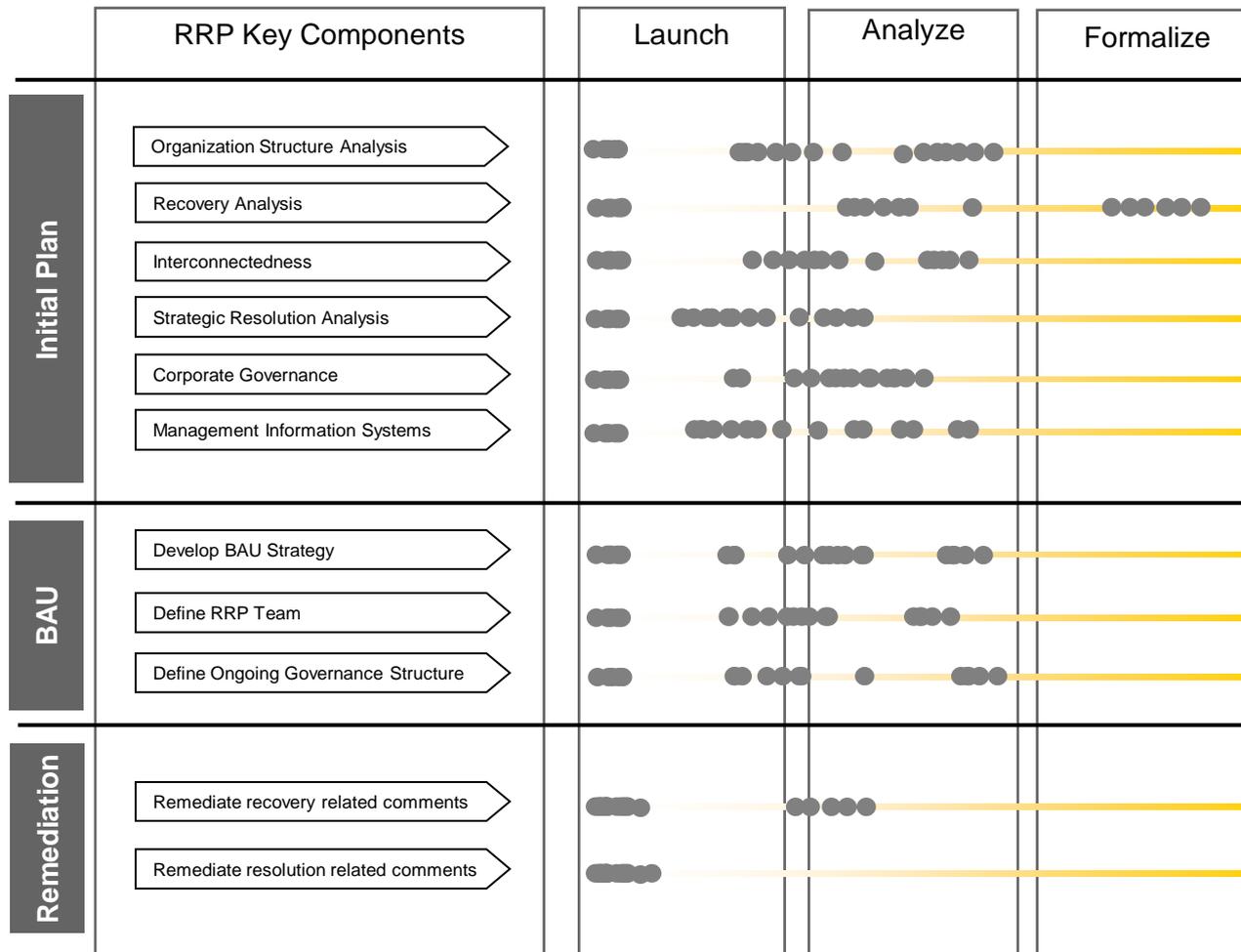
Key Dates



Throughout the process Banks are expected to be in close dialogue with their regulators to ensure consistency and application of the rule

US Industry Status on Living Wills

▶ Relative progress made by organizations subject to submitting RRP in the US:



Current Industry Focus Areas

- ▶ US global universal banks have made the most progress to date
 - ▶ Top 5 banks undertook recovery planning exercise last summer; many also have started significant resolution planning
 - ▶ Next tier of banks have started executing on recovery and resolution aspects of plans
- ▶ Several US subsidiaries of foreign banks have started the RRP planning process in the US, with a handful starting execution activities
- ▶ Organizations with simpler legal entity structures are considering streamlining strategic and resolution analyses particularly when majority of assets are in IDIs
- ▶ Most banks have established project teams while a few banks have developed permanent functions

Global Industry Status on developments in Financial Crisis Management

The **US** initiated a Recovery Plan pilot last year with a number of its largest banks, and this year released rules requiring BHCs and IDIs with assets over \$50bn to produce Resolution Plans. In **Canada**, OSFI and CDIC have initiated work on both Recovery and Resolution Plans.

ASIAPAC

Authorities appear to be closely monitoring events with recent increase in interest shown by HKMA, MAS and CBRC, though little immediate action. JFSA has initiated some pilot activity consistent with FSB timeline.

Significant uplift in **European** activity in 2011, with Regulators across jurisdictions initiating RRP pilots with major institutions.

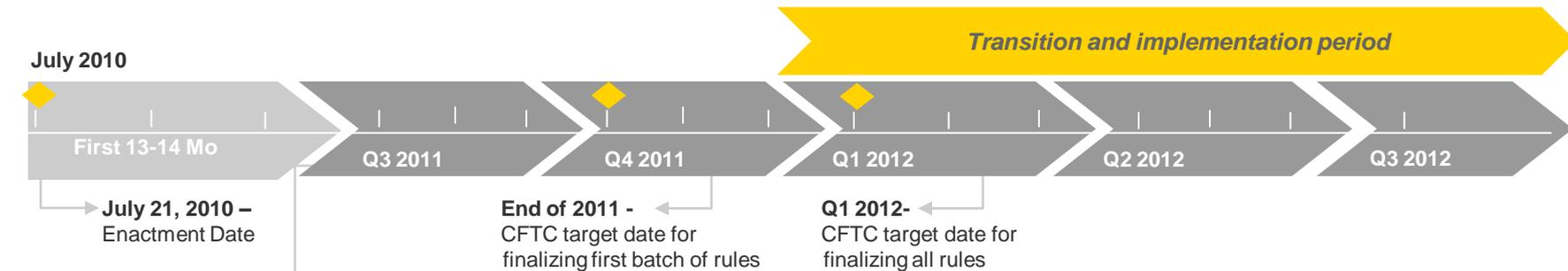
Oceania

APRA have now initiated Recovery Plan pilot in Australia. RBNZ introducing Open Bank Resolution requirements.

OTC derivatives reform timeline

CFTC and SEC issue proposed rules

CFTC and SEC finalize rules



Activity to Date

CFTC - 11 Rules finalized:

- ▶ Agricultural Commodity Definition
- ▶ Prohibition on the Employment or attempted Employment of Manipulative and Deceptive Devices
- ▶ Business Affiliate Marketing and Disposal of Consumer Information Rules
- ▶ Privacy of Consumer Financial Information
- ▶ Large Trader Reporting for Physical Commodity Swaps
- ▶ Removing Any Reference to or Reliance on Credit Ratings in Commission Regulation
- ▶ Process for Review of Swaps for Mandatory Clearing
- ▶ Provisions Common to Registered Entities
- ▶ Agricultural Swaps
- ▶ Final Rules for Implementing the Whistleblower Provisions of Section 23 of the CEA
- ▶ Swap data Repositories: Registration Standards, Duties and Core Principals

- An exemptive relief was finalized on July 14, 2011 pushing back the effective date of the Self-Enacting rules to the earlier of (1) the effective date of the applicable final rule further defining the relevant term; or (2) December 31, 2011

Based on September 2011 CFTC communication of proposed rule finalization schedule:

Remainder of 2011	<ul style="list-style-type: none"> • Clearinghouse Rules • Data Recordkeeping and Reporting • End-User Exception • Entity Definitions/Registration • External Business Conduct • Internal Business Conduct (Duties, Recordkeeping and Chief Compliance Officers) • Position Limits • Product Definitions/Commodity Options • Real-Time Reporting • Segregation for Cleared Swaps • Trading – Designated Contract Markets and Foreign Boards of Trade
First quarter 2012	<ul style="list-style-type: none"> • Capital and Margin • Client Clearing Documentation and Risk Management • Conforming Rules • Disruptive Trading Practices • Governance and Conflict of Interest • Internal Business Conduct (Documentation) • Investment of Customer Funds • Swap Execution Facilities • Segregation for Uncleared Swaps • Straight-Through Trade Processing

Based on September 2011 CFTC proposed Swap Transaction Compliance and Implementation Schedule:

- **Category 1** (swap dealers, security-based swap dealers, major swap participants, major security-based swap participants, or active funds) – **90 days from date of publication in the Federal Register**
- **Category 2** (commodity pools, private funds as defined in Investment Advisors Act of 1940 other than active fund, employee benefit plans, person predominantly engaged in activities that are in the business of banking or as defined by Bank Holding Company Act 1956) – **180 days from date of publication in the Federal Register**
- **Category 3 and 4** (entities whose positions are held as third-party sub accounts and entities not included in category 1, 2, or 3) – **270 days from date of publication in the Federal Register**

Industry challenges

Industry Initiatives

Implementation Programs	<ul style="list-style-type: none"> Work stream integration and cross functional coordination Regulatory rulemaking continues to show signs of delays and unclear timeframes Market driven changes may accelerate implementation (SEFs, Clearing, Reporting)
Business Model Requirements and Budgeting	<ul style="list-style-type: none"> Defining desired business model, including products and services provided and clarity on client base Determining connectivity to multiple CCPs and SEFs including changes in traditional voice trading Active business, operations and IT involvement critical
Legal Entity	<ul style="list-style-type: none"> Determining appropriate legal entity structure including number of entities to be registered Extraterritoriality issues and capital uncertainties as well as infrastructure support for legal entity changes
Electronic Execution/ Real time reporting	<ul style="list-style-type: none"> SEF connectivity and process changes to support real time and end of day reporting Move to electronic trading platforms from voice execution as well as changes in allocation and affirmation / confirmation processes
Clearing	<ul style="list-style-type: none"> CCP selection and connectivity Additional product / venue expansion Re-papering / creation of new agreements Guarantee fund contributions / capital requirements Risk and credit limit management
Margin / Collateral Management	<ul style="list-style-type: none"> Liquidity issues given potential exemptions and new proposed rules for dealer to dealer initial margin Asset protection / account structure model (e.g. legally segregated operationally commingled vs. omnibus) Collateral management scalability and optimization
Business Conduct Compliance	<ul style="list-style-type: none"> Increased focus on Front Office processes including pre-trade and post trade compliance activities Definition of a CCO organization and increase in scope of existing compliance activities over trading activities
Data Consistency	<ul style="list-style-type: none"> LEI working group and ISDA proposed Universal Product Identifier paper SEF / SDR integration Definition of "gold standard" Centralization of data and data enrichment further upstream to support reporting

Overview of industry responses to change

Actions by major sell-side participants

Actions by major buy-side participants

Assessing and anticipating impact

- Tracking, interpreting and responding to the rule-making to influence the impact of the Act
- Business Line impact assessments across the full scope of the Act including development of implementation roadmaps
- Foreign institutions are focused on the extraterritorial applicability
- Non-bank holding companies are focused on the potential SIFI designation and understanding the impact of the Act

- Analysis of sell-side entities including executing and clearing brokers as well as clearing houses:
 - ❖ Questionnaires – services to be offered
 - ❖ Level of required margin (initial and variation)
 - ❖ Build up house-view by clearing house in light of current and future implementations
 - ❖ Engage with clearing houses to understand detail of services offered and any restrictions
 - ❖ Comparison of services offered

Mobilizing response programs

- Establishing robust governance and program management structures with leadership across lines of business
- Defining key business strategies and legal entity structures alternatives to support derivatives activities
- Rule-making monitoring processes and responses. Given the volume of rule-making, many institutions are struggling to build effective processes to manage this process

- Conducting readiness assessments across business functions including:
 - ❖ Analysis of existing positions / clearing eligibility
 - ❖ Analysis of future plans for OTC usage and clearing ability
 - ❖ Review margin requirements including mandates to hold excess cash for margin
 - ❖ Evaluate counterparty risk and resulting changes to business / operating model

Starting priority implementations

- Initial efforts related to defining client service offerings, OTC derivative clearing and reporting requirements, and assessing Volker rule impact
- Defining project mandates, project plans, key milestones, timelines, and assigning accountability
- Identifying resource requirements, broad infrastructure and reporting needs

- Conducting MSP calculations to determine market participant designation as well as evaluating automations of calculations
- Identifying changes to current processes and systems to fit future target operating model
- Developing implementation roadmaps including key milestones, timelines, accountability, resource requirements and infrastructure and reporting needs

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