The Dodd-Frank Act dramatically changes the regulatory model for all financial services companies in the United States—financial/bank holding companies, banks, nonbanks, and foreign banking organizations. Its increased federal supervision encompasses many notable changes to the structure, supervision, and regulation of the U.S. financial services industry.

On July 21, 2010, President Obama signed into law H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Title VII of the act gives federal regulators authority to oversee for the first time the Over-The-Counter (OTC) derivatives market, which is estimated at more than $600 trillion. The new regulatory framework will affect swap dealers and Major Swap Participants (MSPs) in all business areas of the OTC derivatives market, including clearing, trading, capital, margining, reporting, and recordkeeping.

Congress has designed the Dodd-Frank Act to become effective in stages. The Commodities Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) generally have 360 days after enactment to promulgate the rulemakings required in Title VII, although some are required to be completed sooner. Among the changes:

- Most derivatives will clear through central counterparty (CCP) clearing facilities. Generally financial entities must clear all swaps subject to mandatory clearing requirements.
- All swaps subject to the clearing requirement must be executed on a regulated exchange or a swap execution facility (SEF) to the extent possible.
- Regulators are charged with setting capital and margining requirements for uncleared swaps. (Absent an exemption, these requirements may significantly reduce commercial end-users’ ability to participate in the OTC markets.)
- For reporting and recordkeeping, cleared swaps are subject to real-time price and volume reporting requirements, and all swaps are required to be reported to trade repositories.

Implications and Challenges

KPMG’s Financial Services practices have worked together to identify areas where the Dodd-Frank Act elevates challenging issues for firms classified as swap dealers—who face the brunt of the new regulations. Swap dealers must begin taking immediate action to address the impending requirements created by the legislation.
Evaluating your current organizational structure: Many market participants are establishing program management functions for reviewing infrastructure/organization gaps and for monitoring regulatory developments as details are resolved and guidance is issued. Your organization will need to address the impact of regulatory reform from the perspective of staffing, process, technology, data requirements, analysis, and reporting.

Redefining legal entities based on the Volcker Rule and push-out provisions: The Volcker Rule imposes restrictions on banking entities with respect to proprietary trading, including derivatives, as well as investments in, or sponsorship of, hedge funds or private equity funds. The new swaps push-out provision will force banks (and some nonbank MSPs) to move certain swaps-trading operations into separately capitalized, nonbank affiliates or be faced with limited to no federal assistance. The push-out provision primarily affects high-yield credit default swaps (CDS), commodities, and equity swaps. (A significant percentage of the derivatives market will be exempt.)

Defining your new operational model: More-stringent regulatory scrutiny and supervision will likely call for a significant increase in regulatory resources to analyze the number and complexity of the issues to be addressed. To assess your organization’s readiness to meet the new requirements, consider the answers to questions such as:

- Have we already established a task force and program on impact assessment to evaluate the new legislation?
- Have we embarked on a program to engage regulators in the formation of new rules?
- Do our professionals have the time to dedicate to appropriately respond to the rapidly changing regulatory environment?
- Are we able to monitor for and anticipate changes that will affect our business?
- Do we fully understand the expectations and implications of all the new rules with regard to:
  - Transaction execution?
  - Transparency and reporting?
  - Clearing initiatives?
  - Capital and margining?
  - Corporate structure?
- Do we understand all of our fiduciary responsibilities?
- Will we be able to efficiently implement new controls and define new procedures to minimize risk within the firm?
- Do we have an integrated transformation plan that:
  - Identifies key interdependencies?
  - Establishes sequence, priority, and high-level cost estimates?
  - Includes an implementation roadmap that will incorporate strategic business capabilities?
  - Defines quick hit opportunities for accelerated implementation?
- Will we be able to maintain a competitive advantage?

The success of your company’s effort will hinge on being able to manage and integrate activity across a multidisciplinary team including key operations and business process owners, technology, compliance, legal, risk, finance, and other critical stakeholders.
Develop a Transformation Path to Address Critical Capability Gaps

<table>
<thead>
<tr>
<th>Define legal entity and resulting regulatory status:</th>
<th>Evaluate options:</th>
<th>Align structure with vision:</th>
<th>Essential capabilities:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Swap dealer?</td>
<td>• BHC status change?</td>
<td>• Gap analysis to identify scope of necessary changes</td>
<td>• Connectivity to CCPs and SEFs</td>
</tr>
<tr>
<td>• Major swap participant?</td>
<td>• Wind down certain businesses?</td>
<td>• Capital requirements</td>
<td>• Changes to collateral management, trading, and recordkeeping systems</td>
</tr>
<tr>
<td>• Nonbank financial company?</td>
<td>• Spin off certain businesses?</td>
<td>• Regulatory mapping</td>
<td>• Evaluation of current trade status—novating trades</td>
</tr>
<tr>
<td>Considerations:</td>
<td>• Restructure (move to affiliate)?</td>
<td>• Registration requirements</td>
<td>• New fiduciary responsibilities and business conduct standards</td>
</tr>
<tr>
<td>• Effect of pricing transparency, new and existing competitors, and deleveraging on bottom line</td>
<td></td>
<td></td>
<td>• Maintaining trading records/audit trail</td>
</tr>
<tr>
<td>• Impact of new capital and margin requirements on liquidity</td>
<td></td>
<td></td>
<td>• Reporting and recordkeeping</td>
</tr>
<tr>
<td>• Viability of current model</td>
<td></td>
<td></td>
<td>• Facilitating bespoke transactions and tri-party option for initial margin</td>
</tr>
</tbody>
</table>

Expanded Powers
Under the Dodd-Frank Act, the CFTC has authority exclusively over index-based swaps for:
- Swap dealers and major swap participants
- Swap data repositories
- Derivative clearing organizations with regard to swaps
- Persons associated with a swap dealer or major swap participant
- Eligible contract participants
- Swap execution facilities.

The SEC has authority exclusively over security-based swaps (or single-name swaps):
- Security-based swap dealers and major security-based swap participants
- Security-based swap data repositories
- Clearing agencies with regard to security-based swaps
- Persons associated with a security-based swap dealer or major security-based swap participant
- Eligible contract participants with regard to security-based swaps
- Security-based swap execution facilities.
Why KPMG?

KPMG’s experienced regulatory professionals include former regulators, supervisors, examiners, and compliance practitioners. Our professionals have the skills and qualifications to help financial services entities evaluate their organizational readiness for the new regulatory requirements. Our experience and extensive financial services qualifications in the areas of large-scale change management equip us to assist your financial services organization with the strategic operational and technical transformation needed to meet the regulatory challenges ahead.

The Right Approach

As your adviser, KPMG can assist in gap-analysis reviews, offer broad and wide-ranging strategies, and provide objective implementation guidance. Working hand-in-hand with your senior management team, we can help you anticipate and manage regulatory risk and make the right choice, at the right time, and at the right cost. Our effective, efficient, and highly collaborative approach helps you:

• Prepare for the impact of the reform on your systems and processes, business, and people, from the current-state assessment through the implementation deadline.
• Leverage our public policy and government affairs experience to obtain perspectives that are informed by the latest developments.

The Right Commitment

We are personally committed to exceeding your expectations. From project management and execution support to providing deep subject-matter knowledge, we will help inform your strategy on various provisions of the reform. KPMG is poised to begin working with you immediately to:

• Strengthen enterprise-wide programs
• Implement effective governance and risk management frameworks
• Enhance internal controls
• Create a culture of risk management and compliance.

Global Strength in Financial Services

KPMG has dedicated considerable resources to becoming a leading service provider worldwide to the financial services industry. Our Financial Services practice is our largest line of business, representing about a quarter of total firm revenue. Our global strength includes approximately 21,000 KPMG LLP and KPMG International professionals as well as 1,500 partners. Our people understand the issues, trends, and risks relevant to financial services companies as they meet the multifaceted challenge of regulatory reform.

For more information, please contact the following Financial Services Regulatory Practice professionals:

Howard Margolin
Partner, Advisory
1-212-954-7863
hmargolin@kpmg.com

Christopher Dias
Principal, Advisory
1-212-954-8625
cjdias@kpmg.com

Steven Whiting
Principal, Advisory
1-212-872-6289
swhiting@kpmg.com

Eamonn Maguire
Managing Director, Advisory
1-212-954-2084
emaguire@kpmg.com

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.