

Economic Outlook and Regulatory Reform

Implications of the Dodd-Frank Act to Corporations

Citi Global Transaction Services

September 16th, 2010



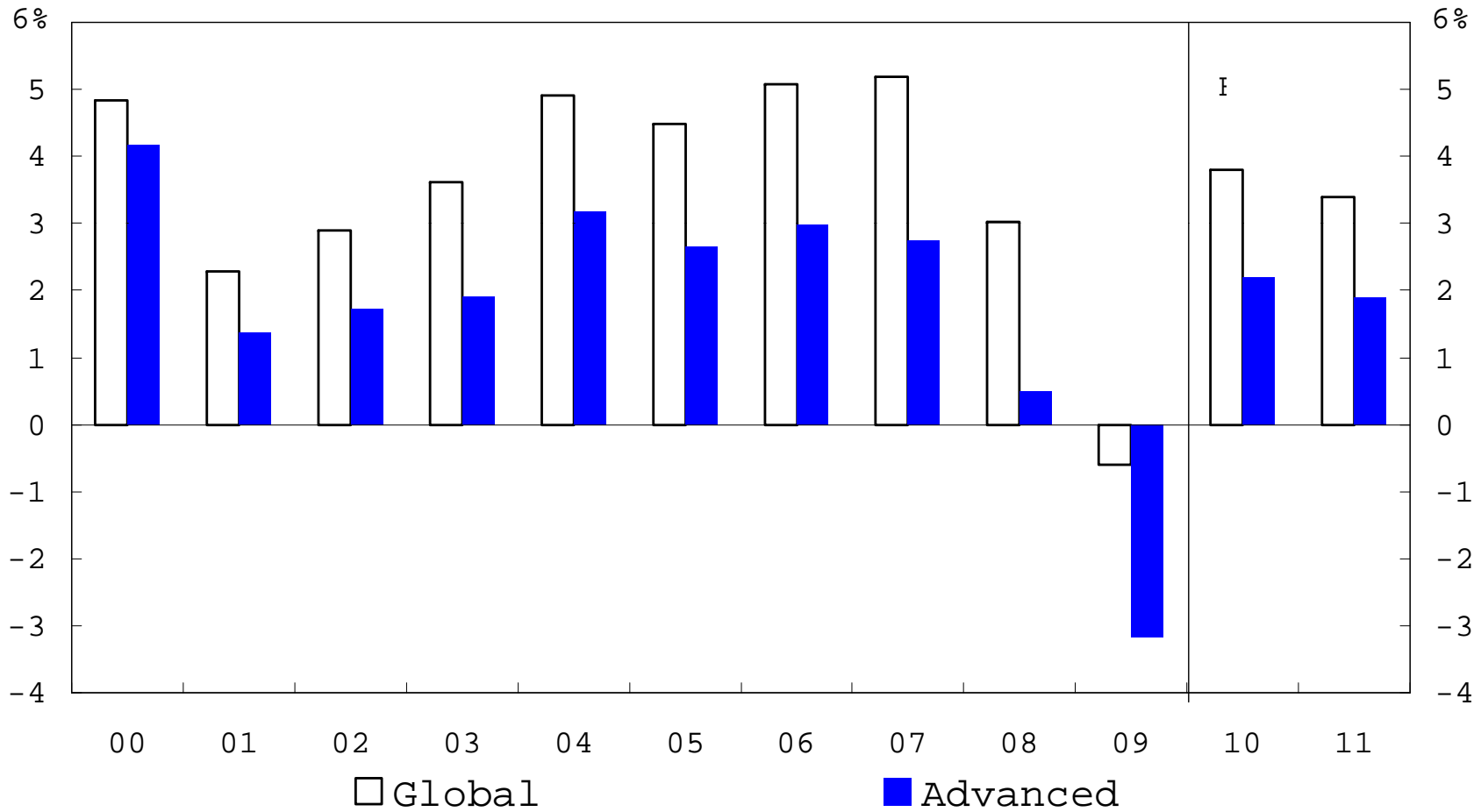
Today's Agenda

- Economic Outlook Robert V. DiClemente
- Overview of the Dodd-Frank Act Michael Berkowitz
- Dodd-Frank Act Implications: Transaction Banking Michael Berkowitz
- Dodd-Frank Act Implications: Derivatives William Hartnett
- Conclusion and Q&A All

Economic Outlook

The Outlook For Advanced Economies

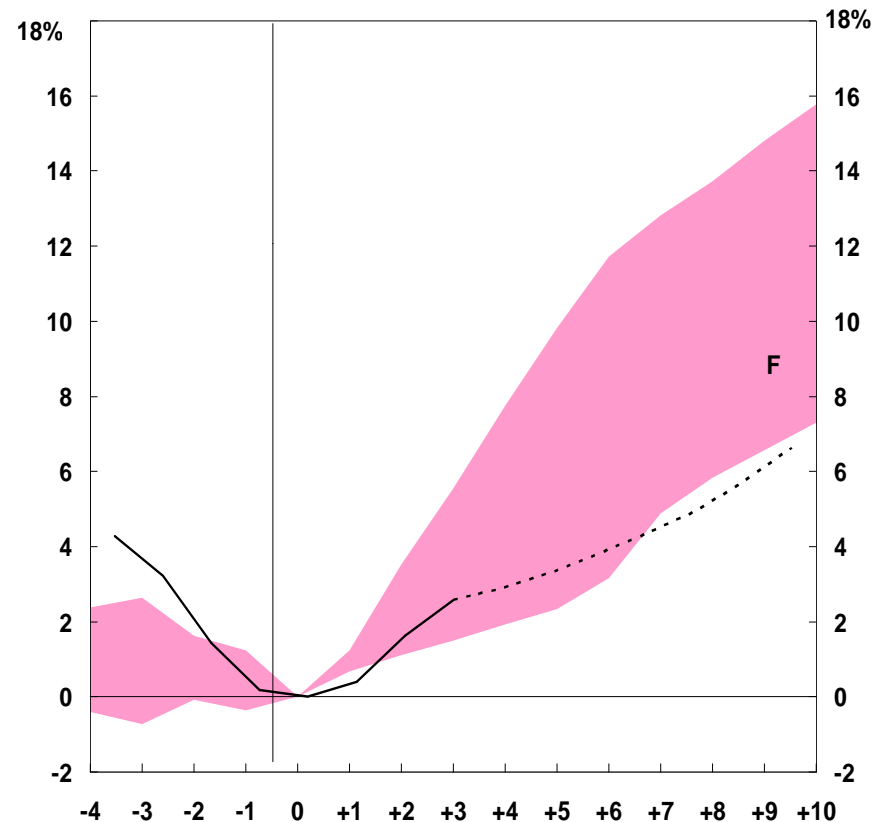
Annual Change in GDP for Globe and Advanced Nations, 2000-11F



Sustained But Slow U.S. Recovery With Two-Sided Risk

- The base case expects growth slowly recovering to trend, benign inflation and reenergized Fed accommodation, with low rates through all of 2011.
- Risks appear balanced: Lingering credit restraint, lagging heavy construction and state and local consolidation are balanced against upside cyclical potential (see chart), a strong profit rebound and a well advanced housing correction.
- Reduced risk appetite stemming from Euro sovereign debt concerns has reintroduced a threat to recovery from financial instability. But labor-related incomes are rising and longer leads to economic activity so far are reassuring.
- Political uncertainties make fiscal policy a near-term wild card with \$300b in tax hikes scheduled for 2011. Base case assumes most but not all will be deferred.

Real GDP Cumulative Change from End of Recession



Note: Shaded region denotes historical range for the real GDP matched to recession end.
Source: Bureau of Economic Analysis and Citi Investment Research and Analysis.

Outlook Highlights

➤ We anticipate uninterrupted but subpar growth. GDP is expected to expand by 2.1% this year and 2.7% in 2011. Unemployment remains at or above 9% over the forecast horizon with inflation hovering near 1%. Barring a decline in inflation expectations, a gradual strengthening in recovery's prospects should push bond yields back into a 3% to 4% range.

➤ Financial conditions remain key to the outlook for policy and the economy, with the Fed expected to hold rates near zero into 2012.

➤ Credit terms and standards at banks are easing slightly across several major loan categories and overall lending appears to be stabilizing, consistent with a healthier financial setting.

➤ Upward revisions to saving and income could be favorable signs for recovery if financial pressures on households abate. There are some indications that the elevated household saving rate may be durable but the drag from rising saving rates is expected to fade.

U.S. Economic Outlook Highlights (Annualized Percent Change Unless Notes), 2010-2011F

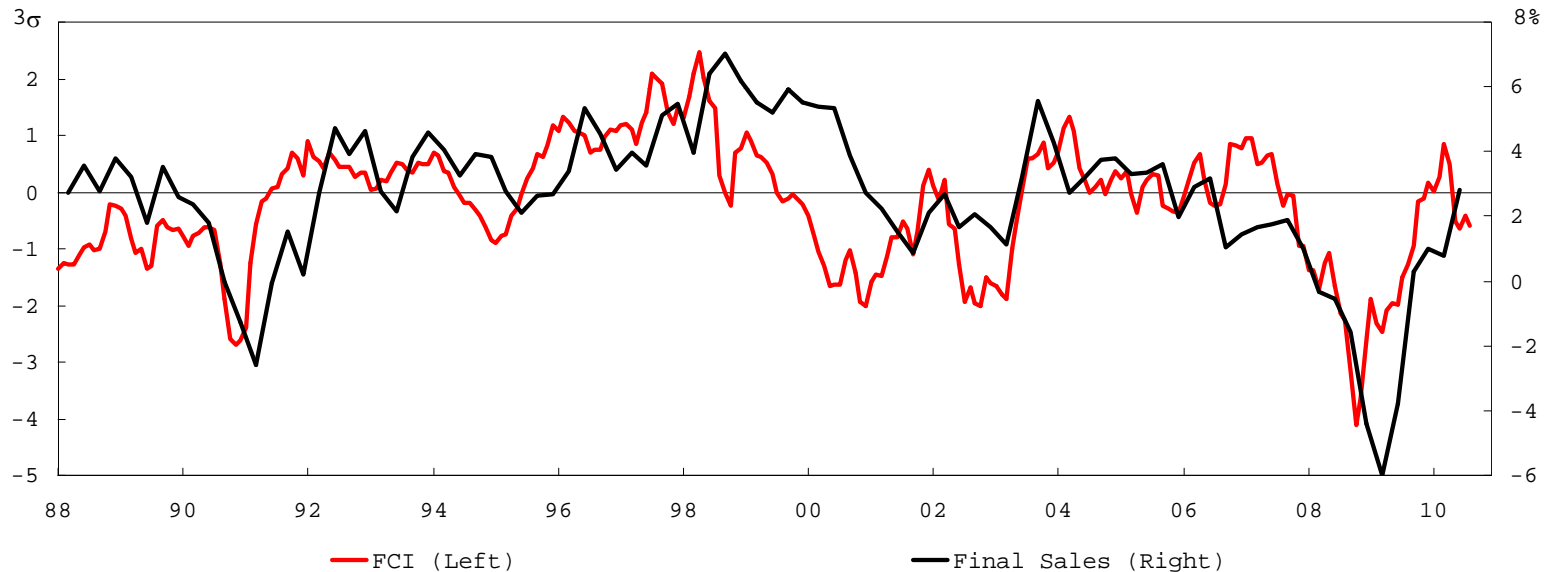
	2010			2011			
	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	1.1%	1.6%	2.0%	2.1%	2.3%	3.1%	3.4%
Domestic Demand	4.1	1.6	2.1	2.2	2.4	2.9	3.0
Consumer Spending	1.6	1.7	1.8	1.7	1.9	2.2	2.4
Housing	28.1	-11.6	6.0	15.7	18.9	21.3	22.6
Investment	16.8	6.8	6.8	6.4	7.9	9.6	9.6
Exports	9.0	7.9	5.5	3.1	4.6	7.9	8.0
Imports	31.2	6.0	6.0	4.4	4.9	5.2	5.1
Government	4.4	0.0	0.2	0.3	-0.3	0.4	0.7
Inventory Change (Contrib.)	0.2	0.0	0.1	0.1	0.1	0.0	0.2
Net Exports (Contrib.)	-3.3	0.0	-0.2	-0.3	-0.2	0.2	0.2
Unemployment Rate (Percent)	9.7	9.5	9.7	9.6	9.5	9.2	9.0
CPI (Y/Y Percent Change)	1.8	1.3	1.1	1.0	1.5	1.4	1.3
Core CPI (Y/Y Percent Change)	1.0	1.0	0.9	1.2	1.2	1.1	1.1
10-Year Treasury Yield	3.49	2.60	2.90	3.10	3.40	3.50	3.65

Note: Forecast based on data available as of August 18.

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, and Citi Investment Research and Analysis.

Securing Financial Stability Key to Moderate Expansion

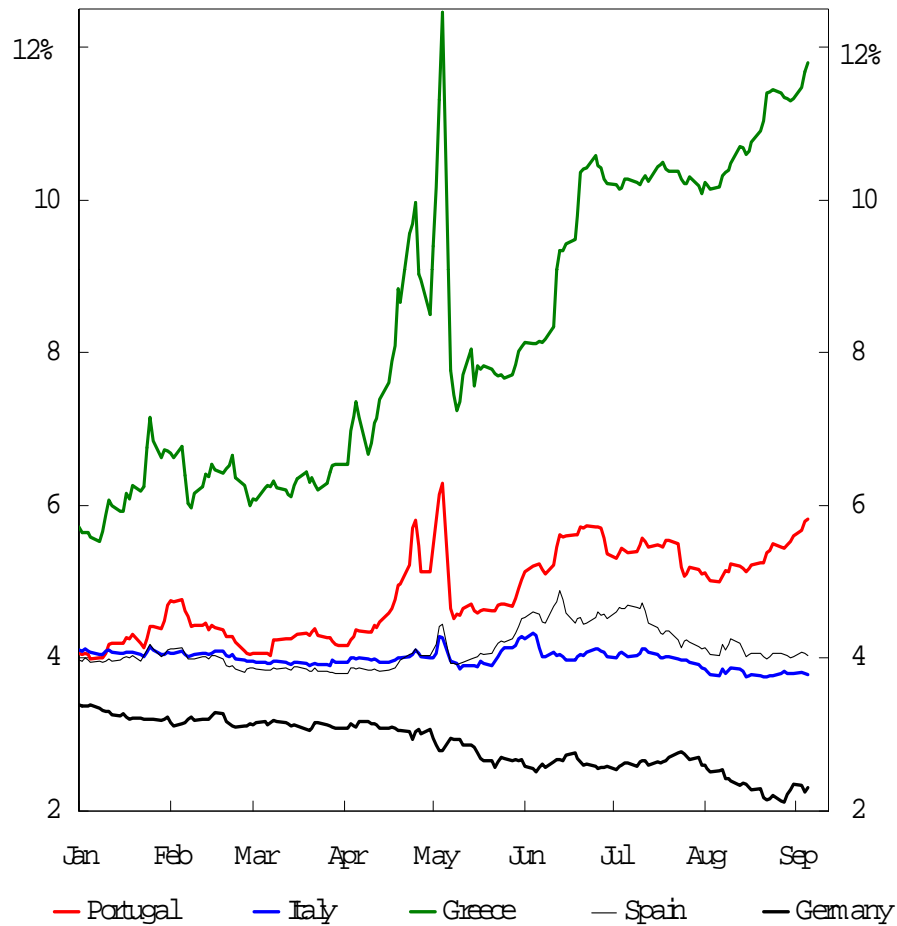
*Real Final Sales to Domestic Purchasers and Citi Financial Conditions Index
(Standard Deviations), 1988-Aug 10*



Note: Final sales are two-quarter smoothed, annualized percent changes.
Sources: Bureau of Economic Analysis and Citi Investment Research and Analysis.

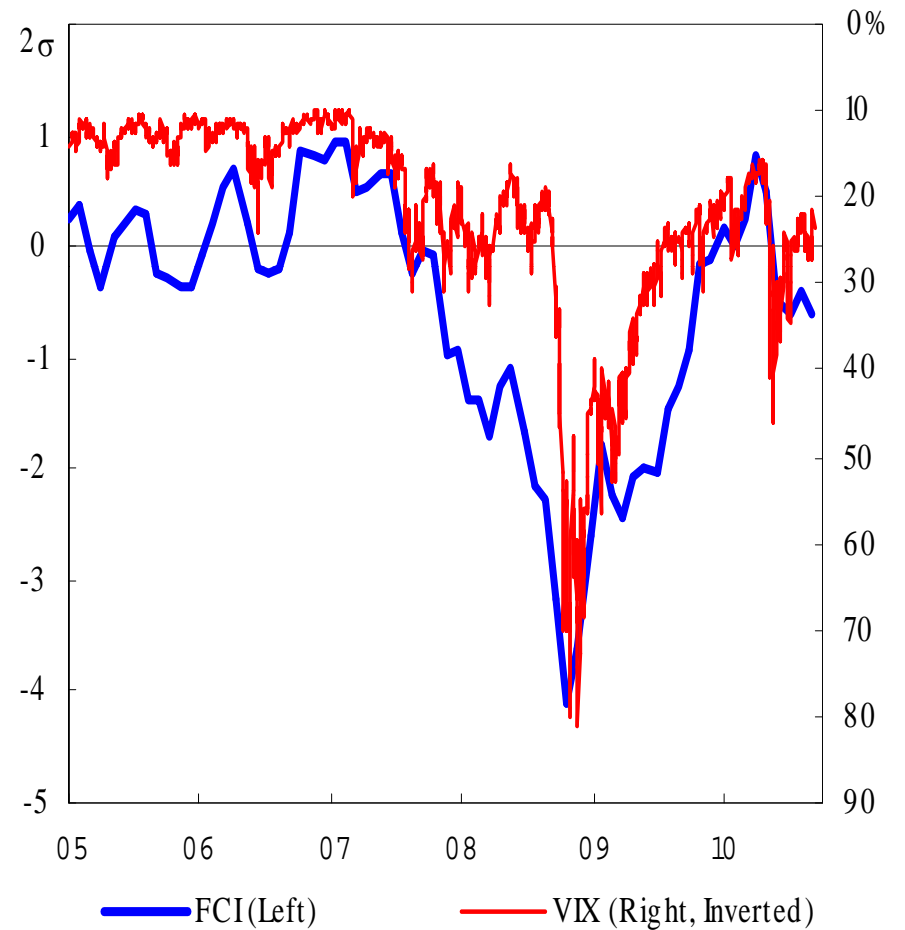
Europe's Debt Woes Threaten Financial Stability

Ten-Year Government Bond Yields, 2010-8 Sep 10



Source: Bloomberg.

Citi Financial Conditions Index and the VIX, 2005-8 Sep 10

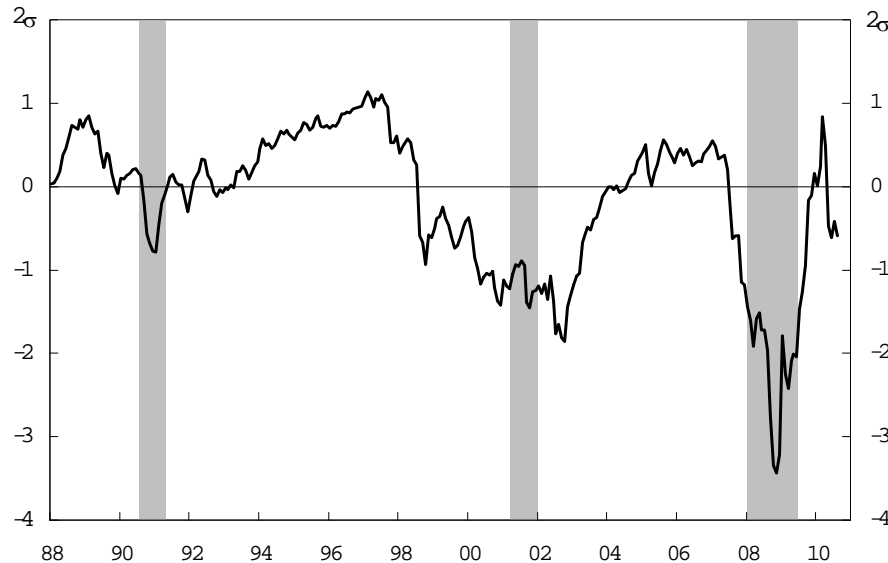


Sources: Bloomberg and Citi Investment Research and Analysis.

Long Leaders Do Not Point to a Broad Decline in Activity

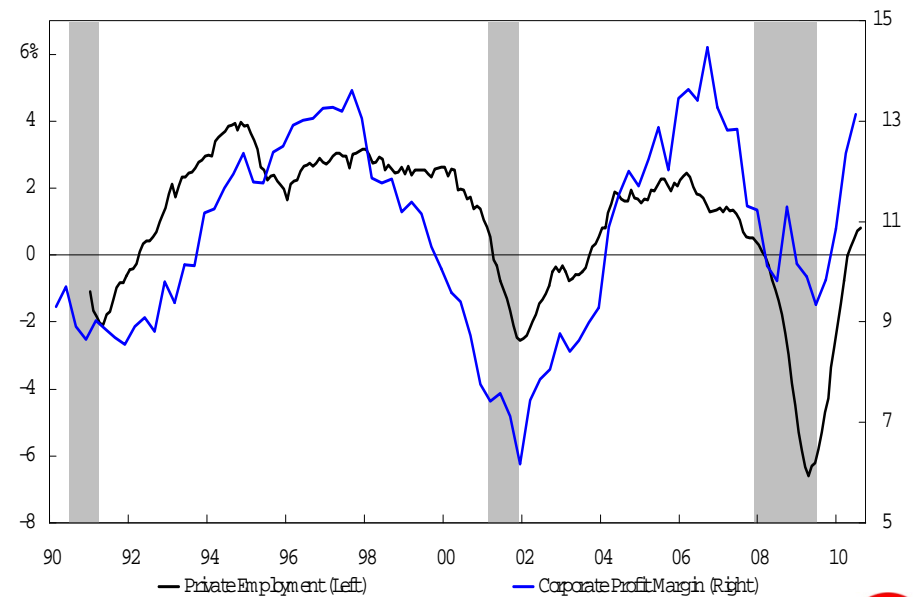
- *The sharp setbacks in financial markets and housing activity have raised concerns about a “double dip” recession.*
- *Near-term growth is likely to slow from 2¾% first half pace but real income appears to be holding up and an already sharply reduced scale of housing activity limits the potential drag on overall output.*
- *Longer-term leads to economic activity like the credit component of Citi’s FCI do not suggest recovery is threatened.*
- *Similarly, the pronounced recovery in profits and the associated restoration of wide profit margins point to modest growth in payrolls ahead.*

Credit Component of Citi Financial Conditions Index, 1988-Aug 10



Note: Shaded regions denote recessions.
Source: Citi Investment Research and Analysis.

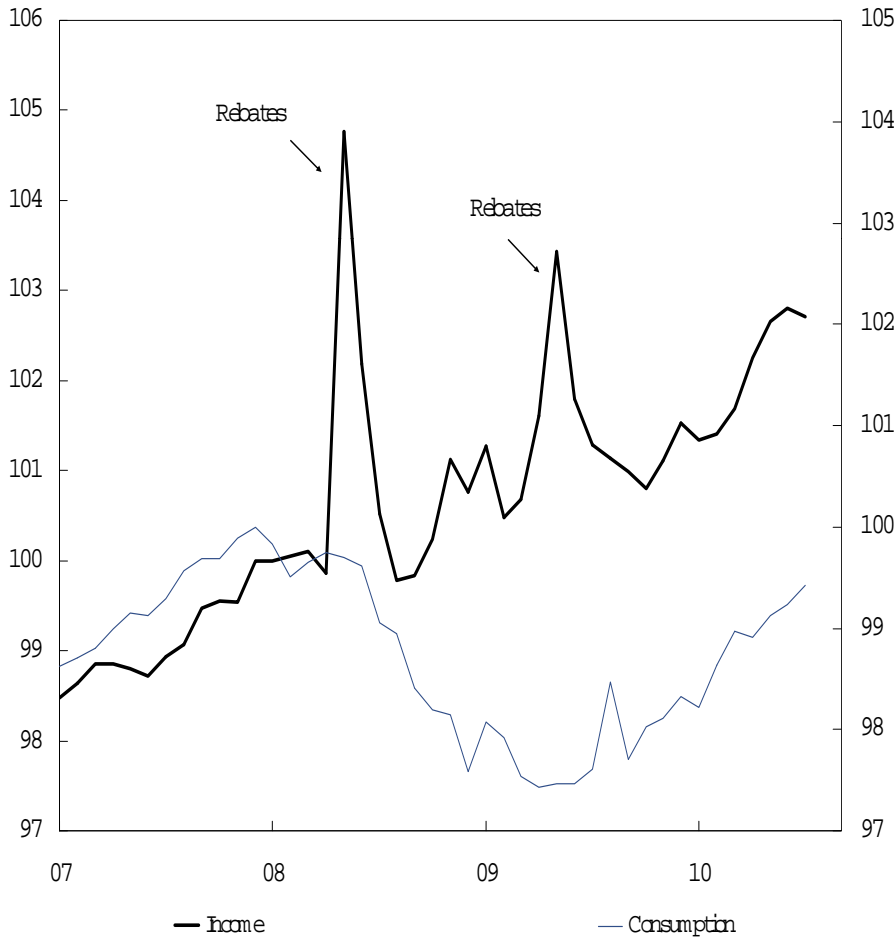
Private Employment (Six-Month Smoothed Annualized Percent Change) and Corporate Profit Margins, 1990-Aug 10



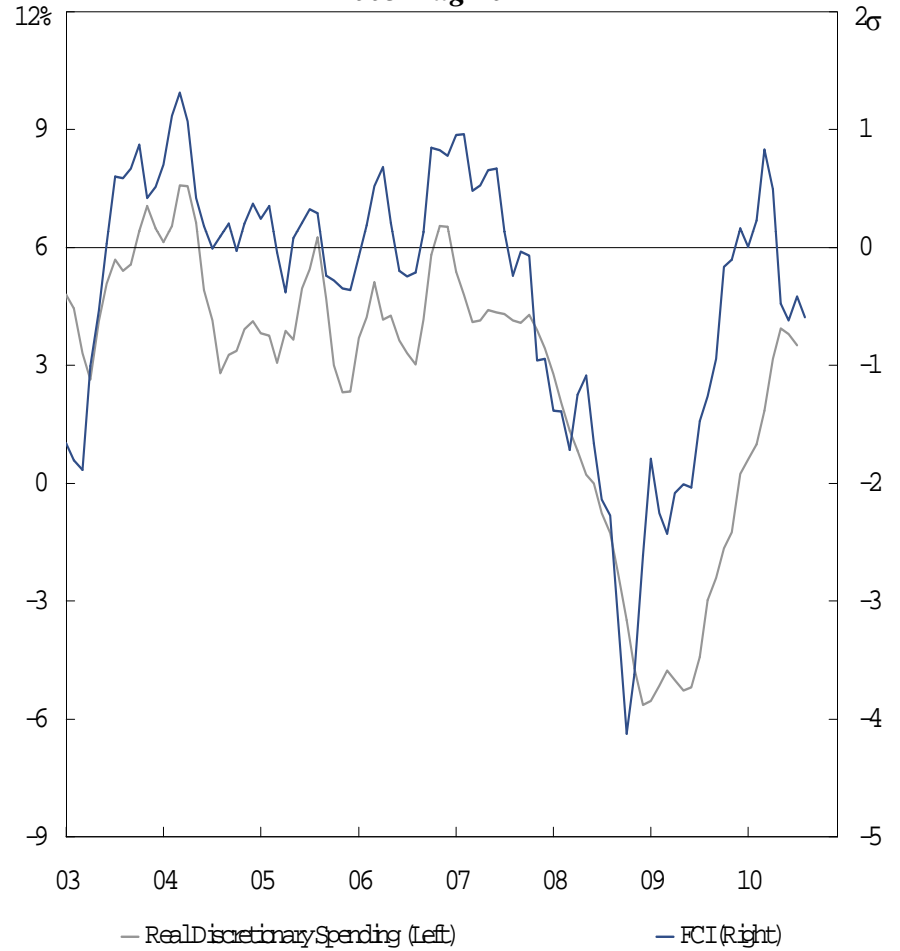
— Private Employment (Left) — Corporate Profit Margin (Right)
Note: Shaded regions denote recessions.
Source: Bureau of Economic Analysis and Bureau of Labor Statistics.

Labor-Driven Income Was Supporting Recovery Ahead of Financial Setback

Indexes of Real Disposable Income and Consumption (Dec 2007 = 100), 2007-Jul 10



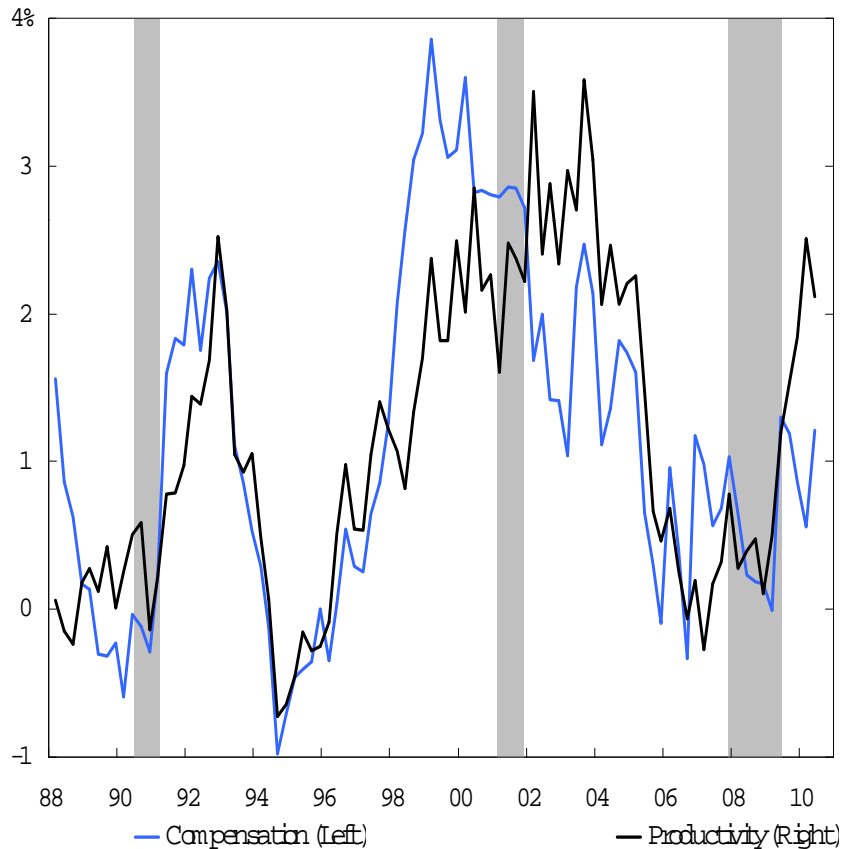
Citi Financial Conditions Index and Real Discretionary Consumer Spending (3-Month Moving Average of Year-to-Year Percent Change), 2003-Aug 10



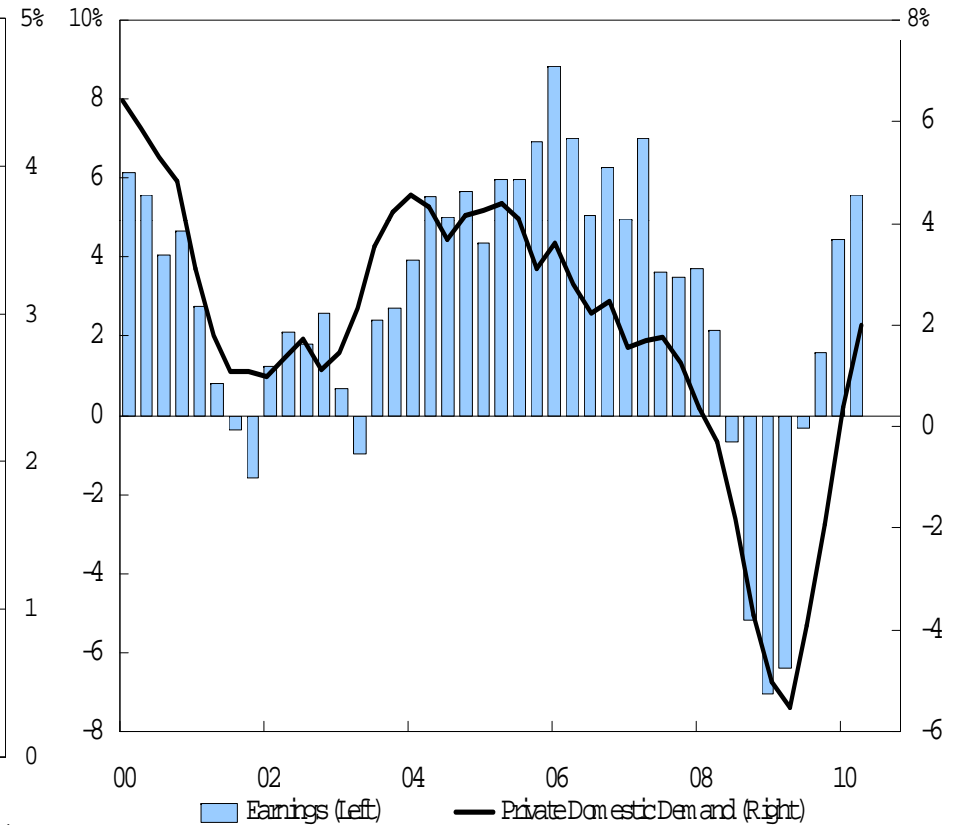
Sources: Bureau of Economic Analysis and Citi Investment Research and Analysis.

Productivity Points To Stronger Household Income

*Productivity and Real Compensation Per Hour
(Two-Year Annualized percent Change), 1988-2Q 10*



*Total Earnings Proxy (Annualized Pct Chg) and
Private Domestic Demand (Year-to-Year Pct Chg)*

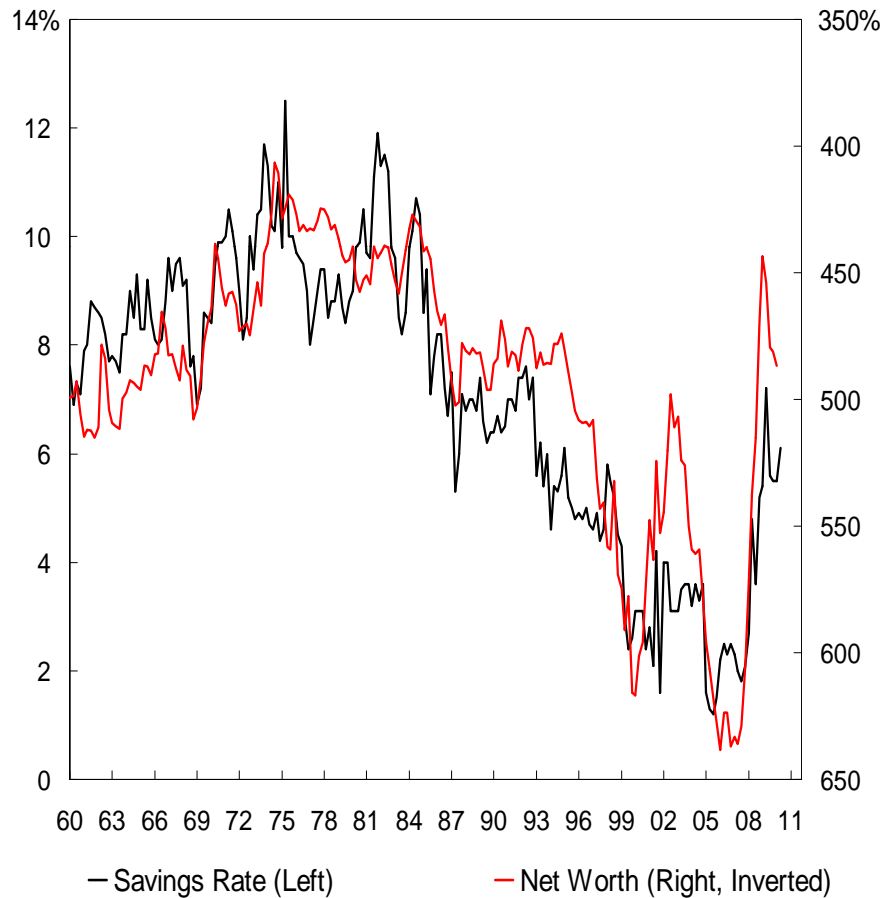


Note: The total earnings proxy incorporates payrolls, the work week, and hourly earnings. Sources: Bureau of Labor Statistics, Bureau of Economic Analysis and Citi Investment Research and Analysis.

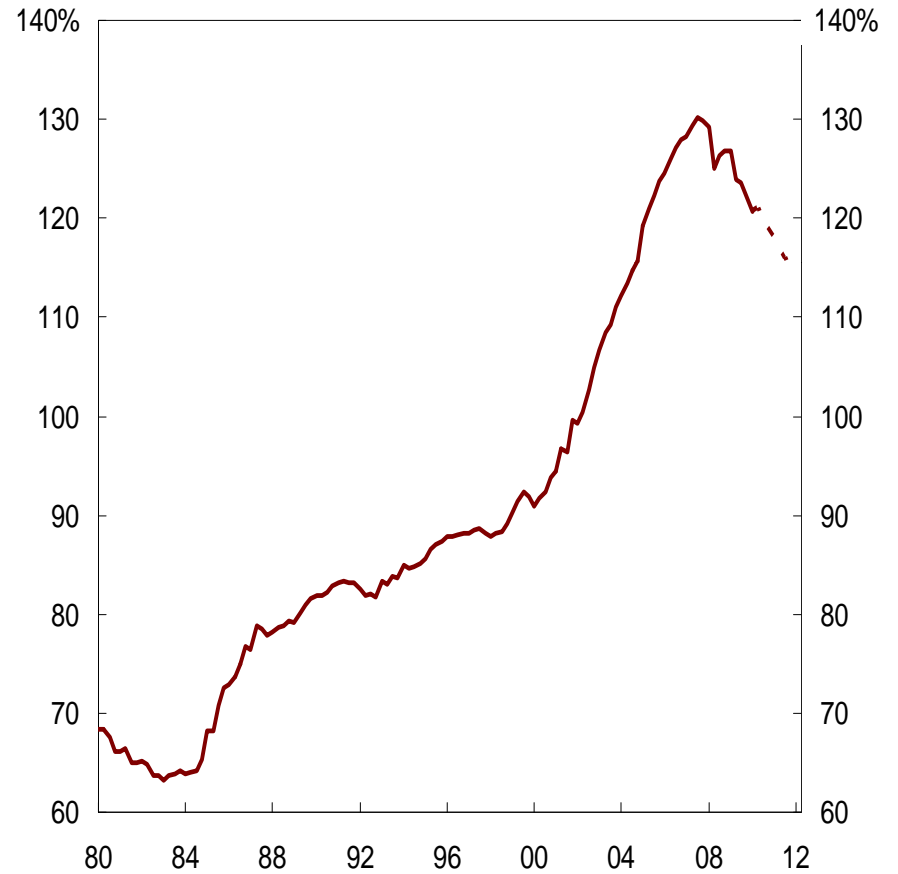


Overspending Gives Way to Saving and Deleveraging

Personal Savings Rate (Percent) and Net Worth as a Percent of Disposable Income, 1960-2Q 10

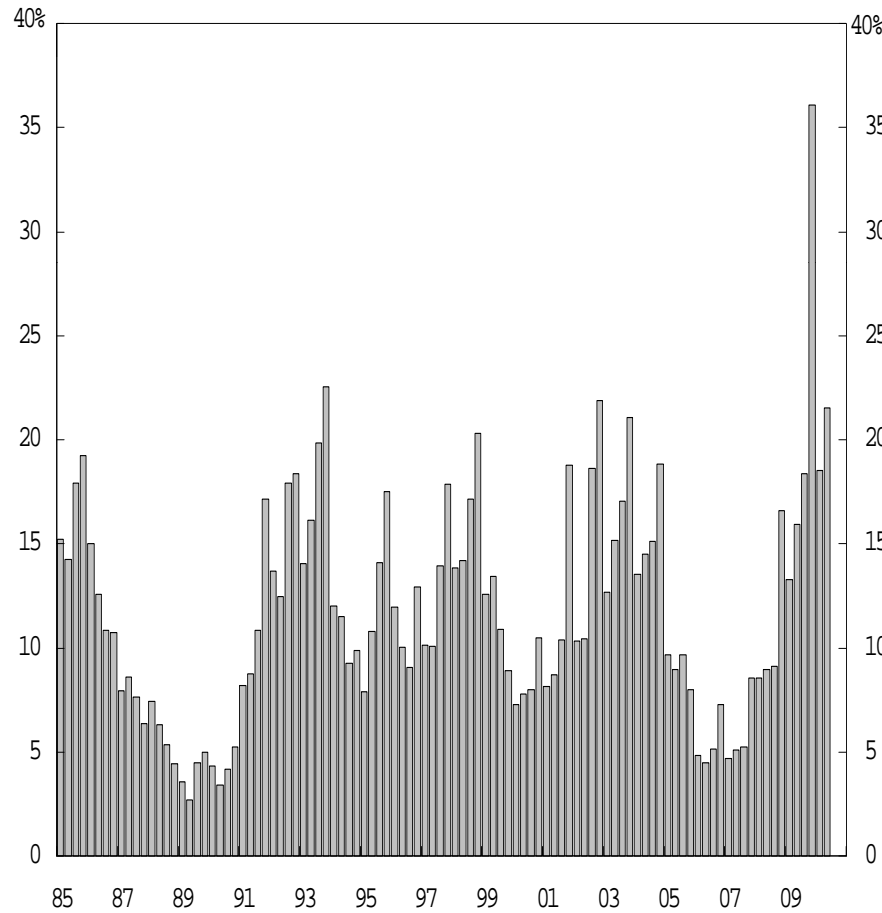


Debt to Disposable Income 1980-4Q 11F



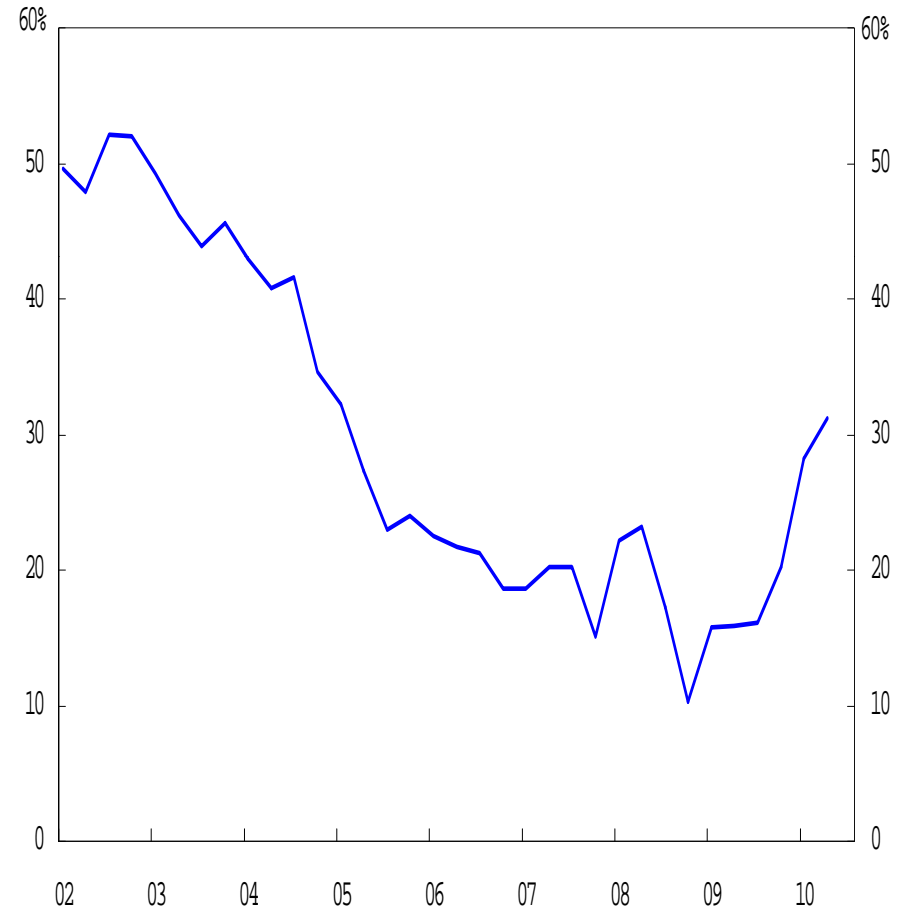
Refinancing Activity A Channel for Higher Saving

Percentage of Refinancings Resulting in a Lower Loan Amount, 1985-2Q 10



Source: Freddie Mac.

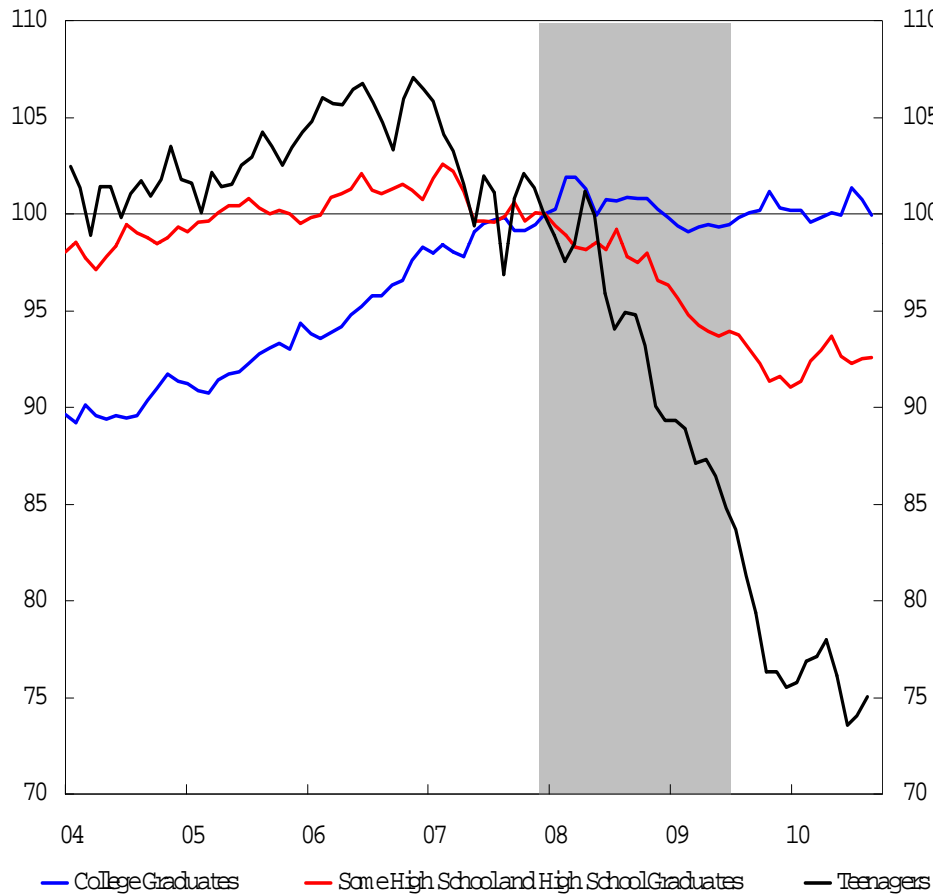
Percent of Refinancings that Shorten Mortgage Term, 2002-2Q 10



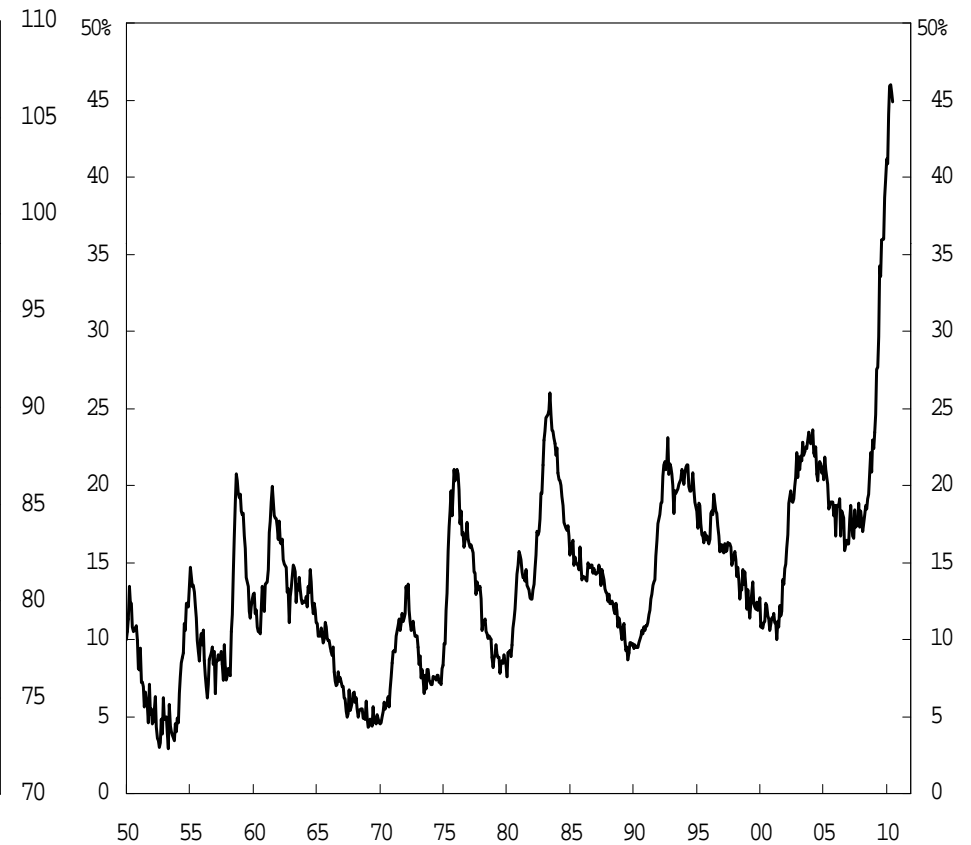
Source: Freddie Mac.

Structural Damage to the Labor Market

Total Employment by Demographic, Indexed to Dec 2007, 2004-Aug 10



Unemployed for 27 Weeks and Over as a Percent of Unemployed, 1950-Aug 10



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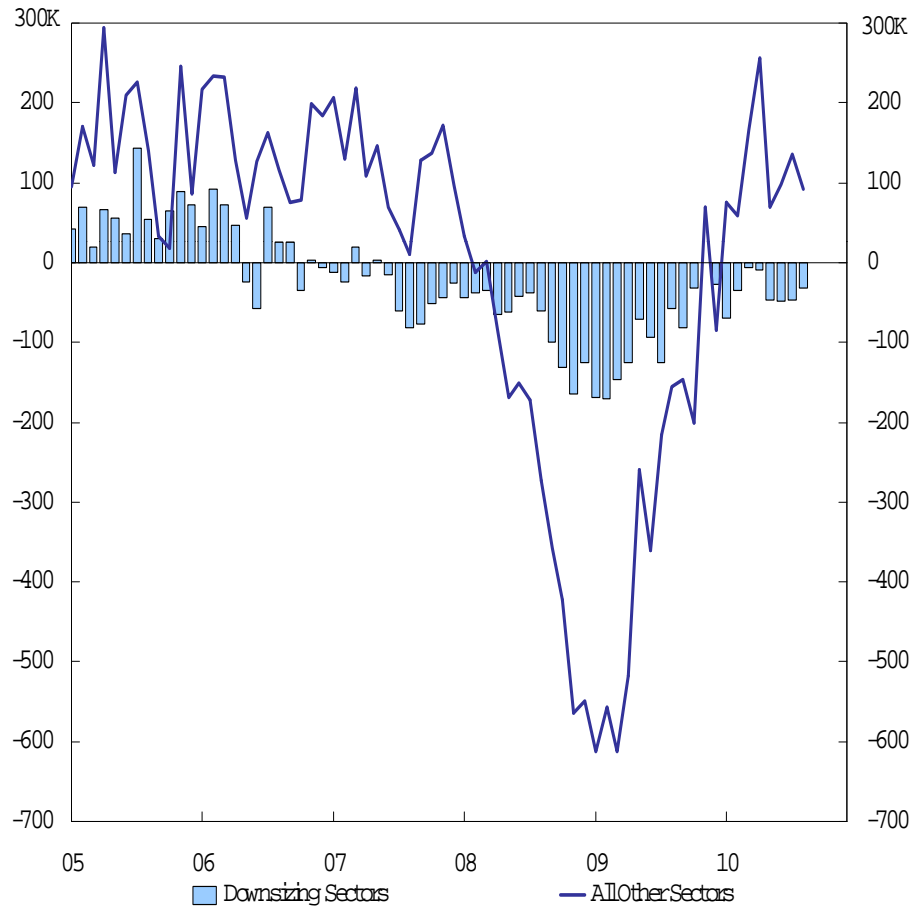
12 Source: Bureau of Labor Statistics.

Source: Bureau of Labor Statistics.



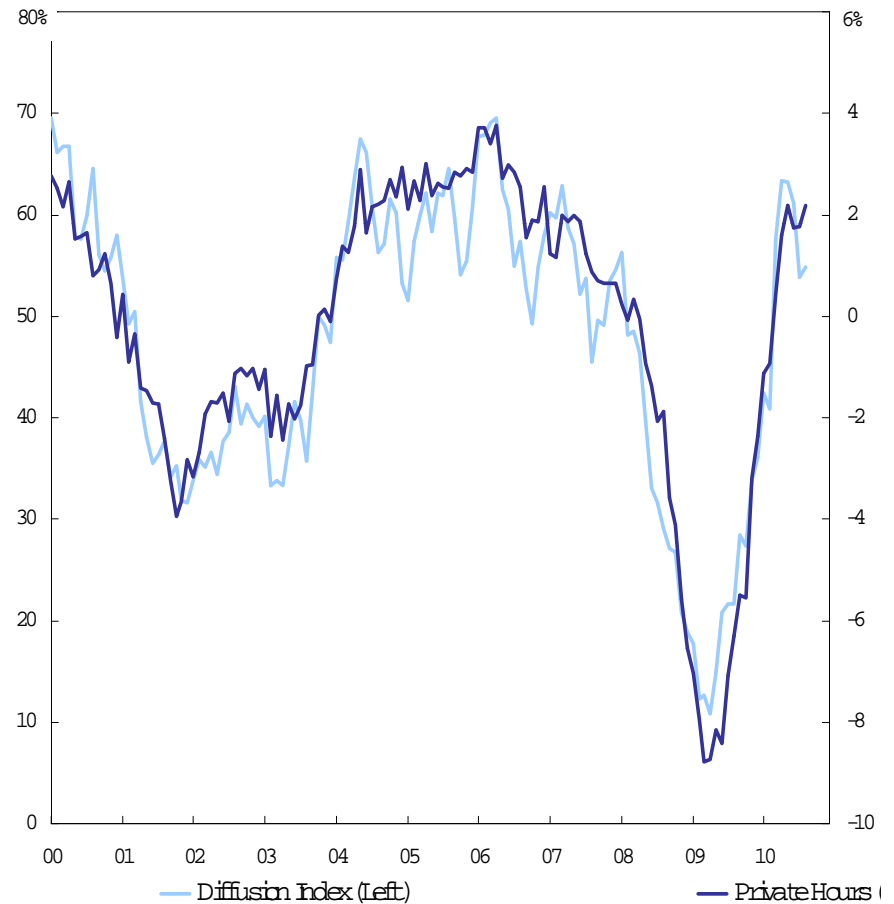
Job Losses Are Narrowly Based

Change in Employment in Downsizing Sectors and Change in All Other Sectors (Ex-Census), 2005-Aug 10



Note: Downsizing sectors include housing, finance and, state and local government. Source: Bureau of Labor Statistics.

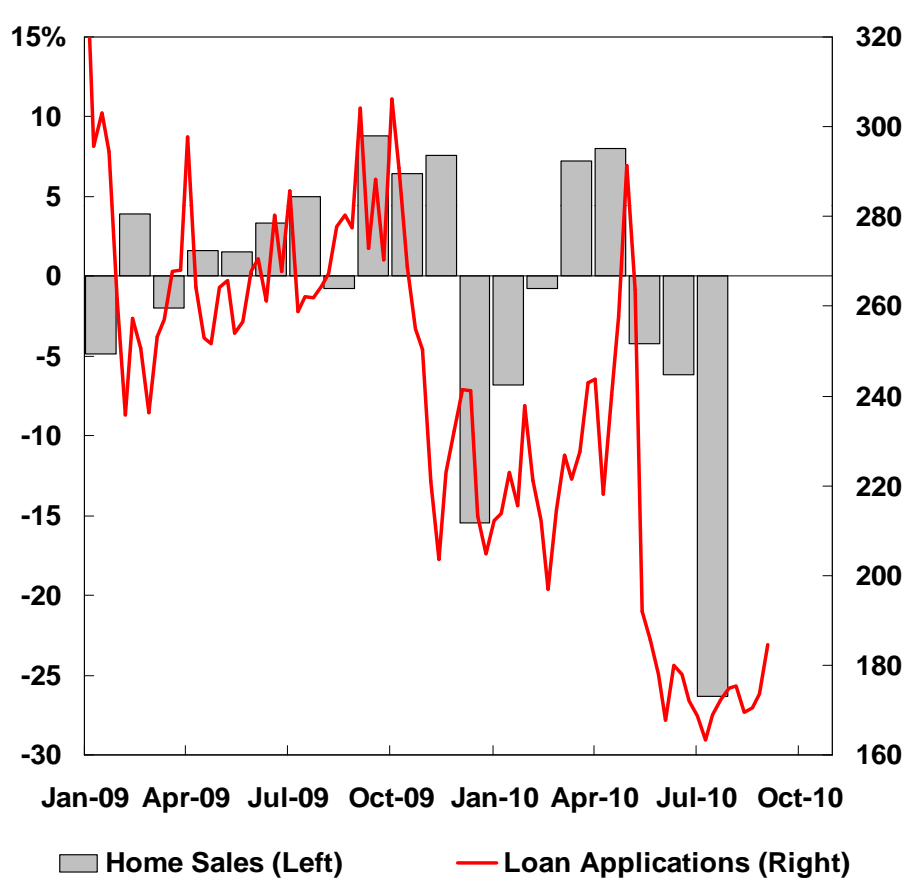
Three-Month Private Employment Diffusion Index and Private Weekly Hours (Six-Month Smoothed, Annualized Percent Change), 2000-Aug 10



Source: Bureau of Labor Statistics.

Near-Term Drag on Residential Investment...

Total Home Sales (Monthly Percent Change) and Mortgage Loan Applications for Purchase (March 1990=100), 2009-3 Sep 10



Single Family Housing Permits and Construction Spending on New Single Family Homes (Year-to-Year Percent Change), 2005-Jul 10



Note: Total home sales is the sum of new and existing home sales.

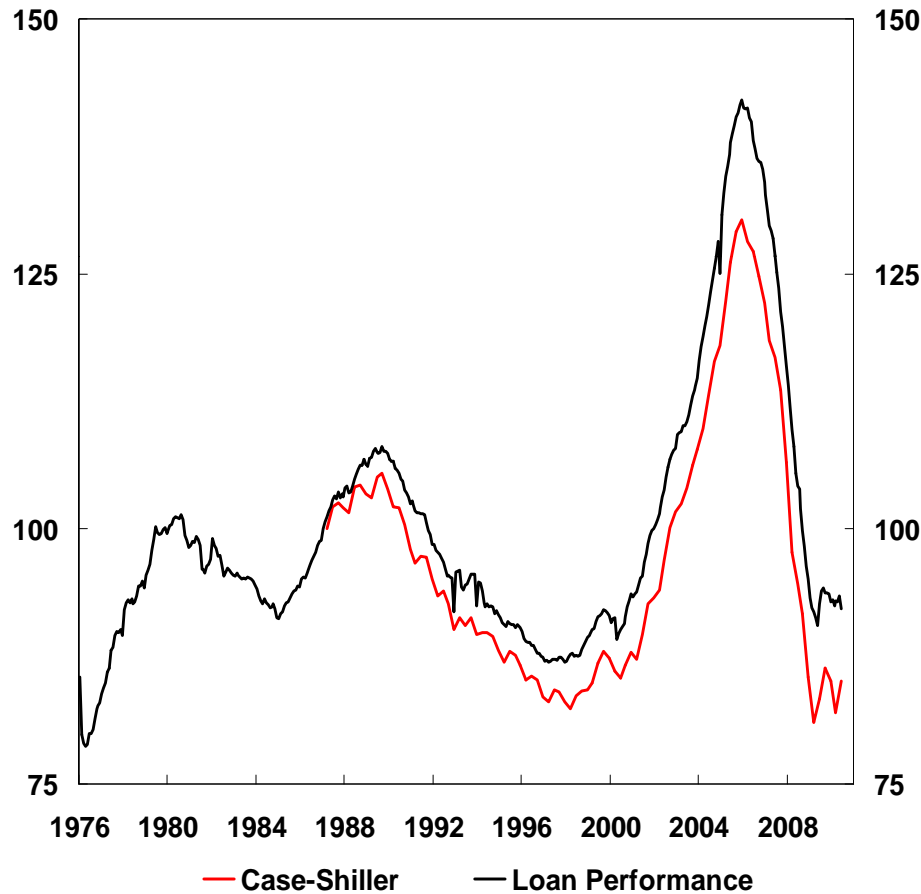
rd1464 Sources: National Association of Realtors, Census Bureau and Mortgage Bankers Association.

Note: Shaded region denotes recession.

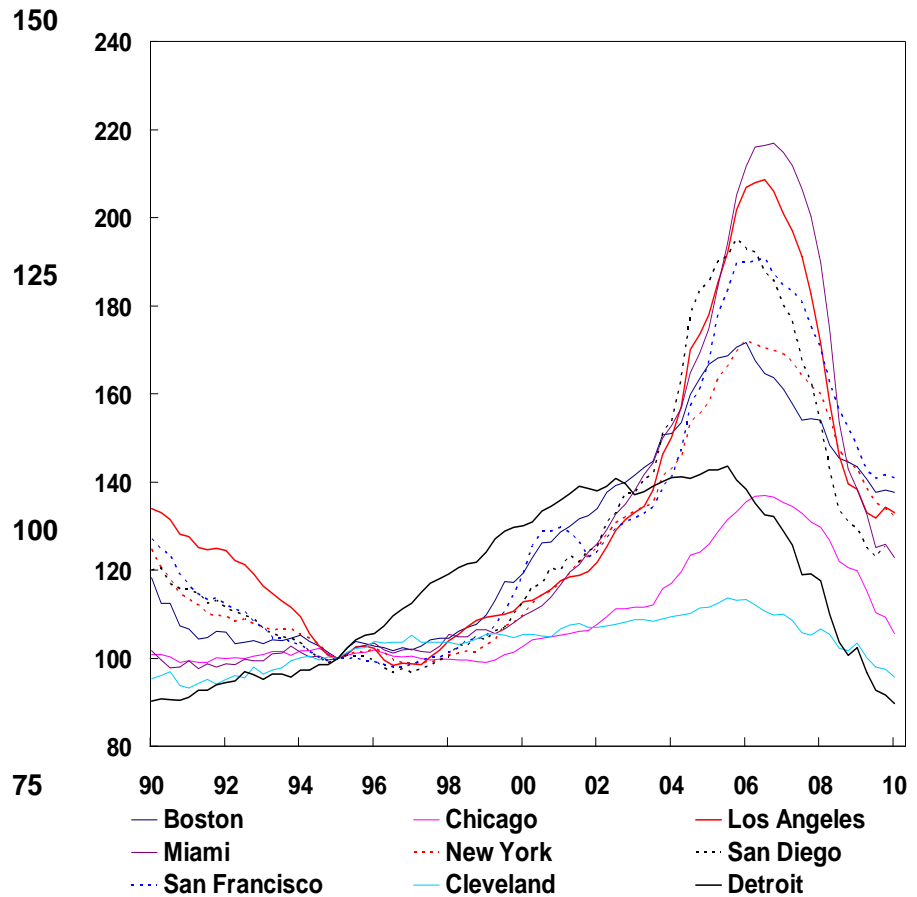
Source: Census Bureau.

...Belies Much Progress in Redressing Key Imbalances...

*Index of Home Price to Disposable Income Per Household
(1987 = 100), 1976-Jun 10*

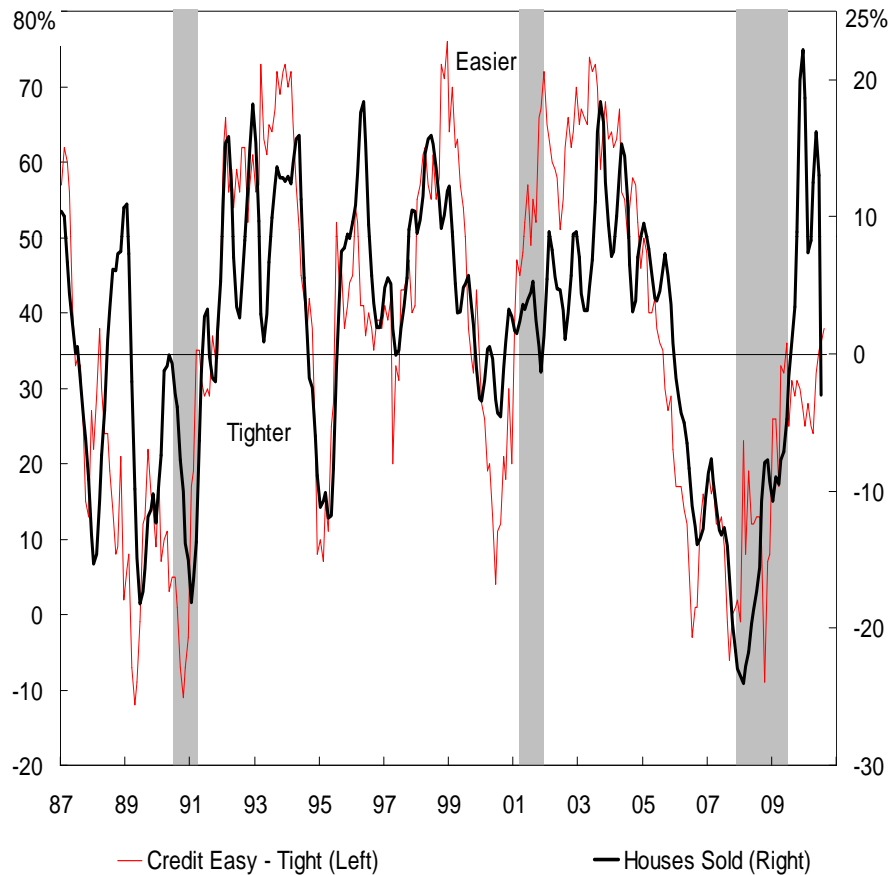


*Index of House Price to Rental Price Ratio for Various
Metro Areas, 1990-2Q 2010*

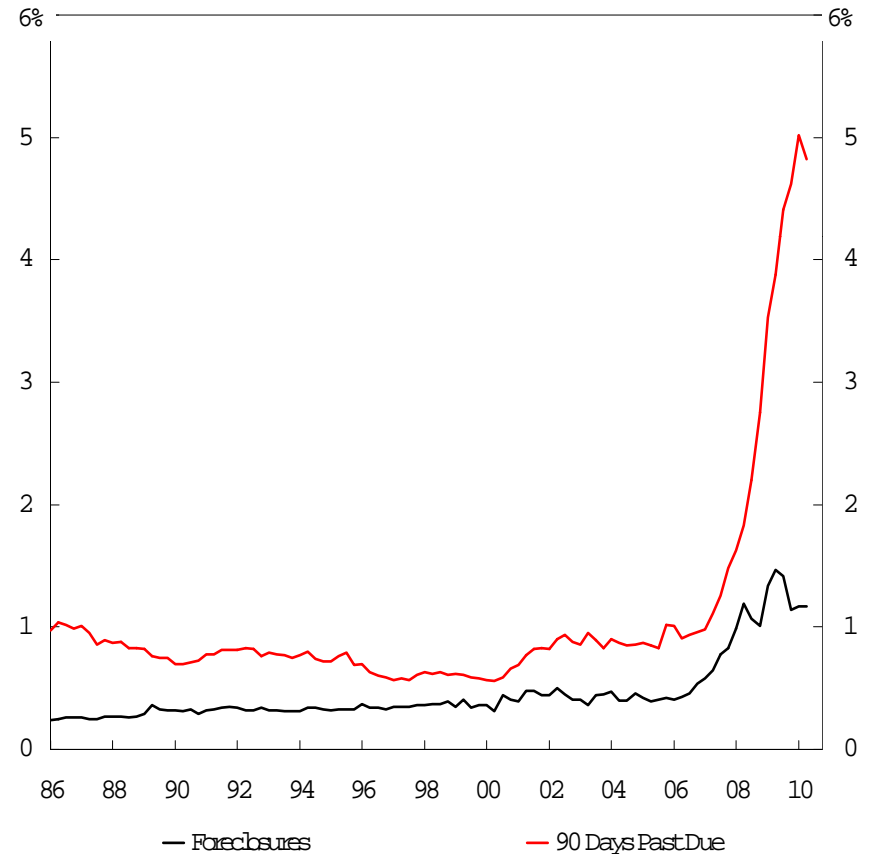


...But Financial Stresses Linger...

Household Perception of Credit Availability vs. Yr-to-Yr Pct. Chg. in Single Family Home Sales, 1987-Aug 10



Mortgages 90+ Days Past Due and Foreclosures Started (Percent), 1986-2Q 10

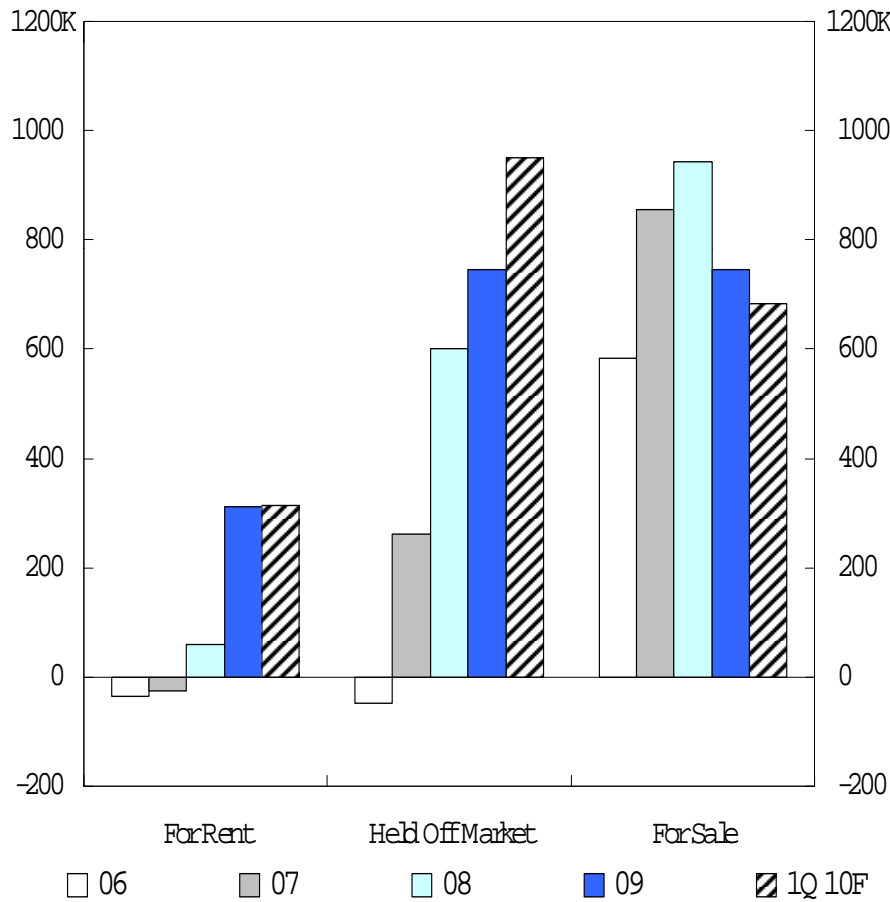


Note: Shaded regions indicate recessions. Sources: Census Bureau, National Association of Realtors and University of Michigan.

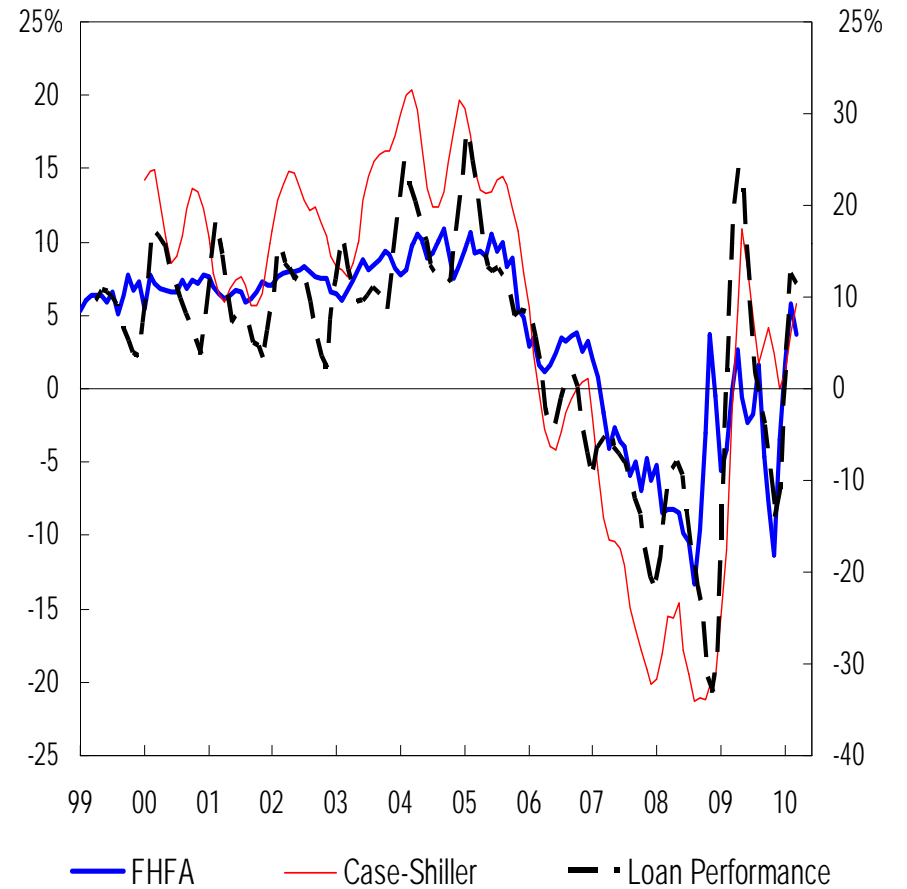
Source: Mortgage Bankers Association.

...Amid Slow Progress in Working off Excess Supply

Estimated Excess Vacant Homes, 2006-1Q 10F



Selected House Price Indexes (Three-Month Annualized Percent Change), 2000-Jun 10

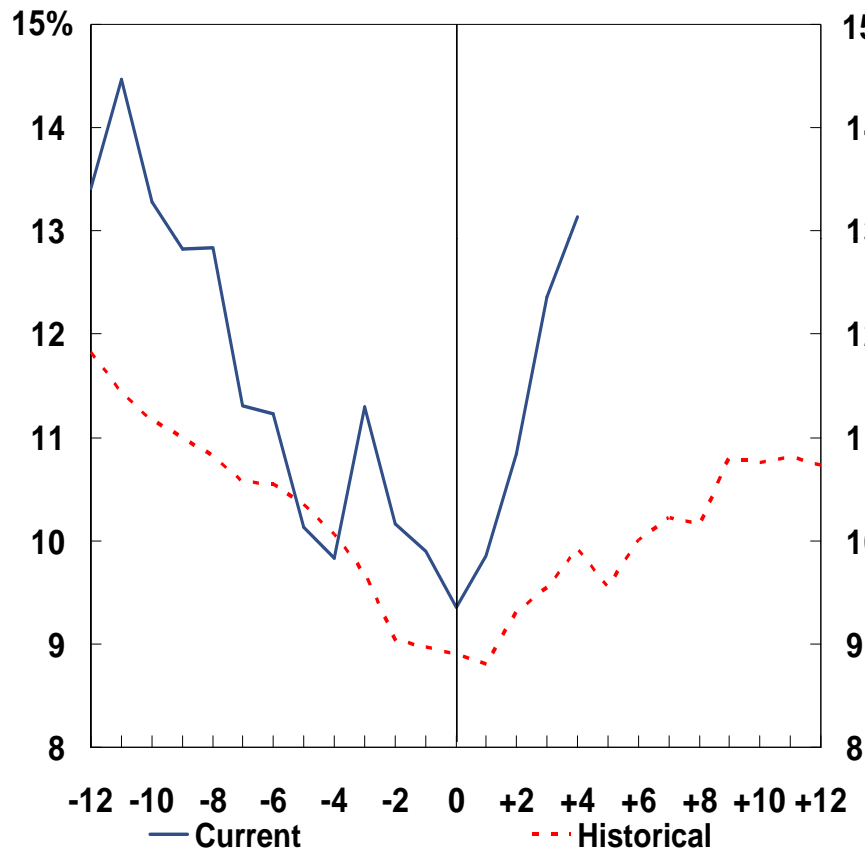


Sources: Joint Center for Housing Studies at Harvard, Census Bureau and Citi Investment Research and Analysis Calculations.

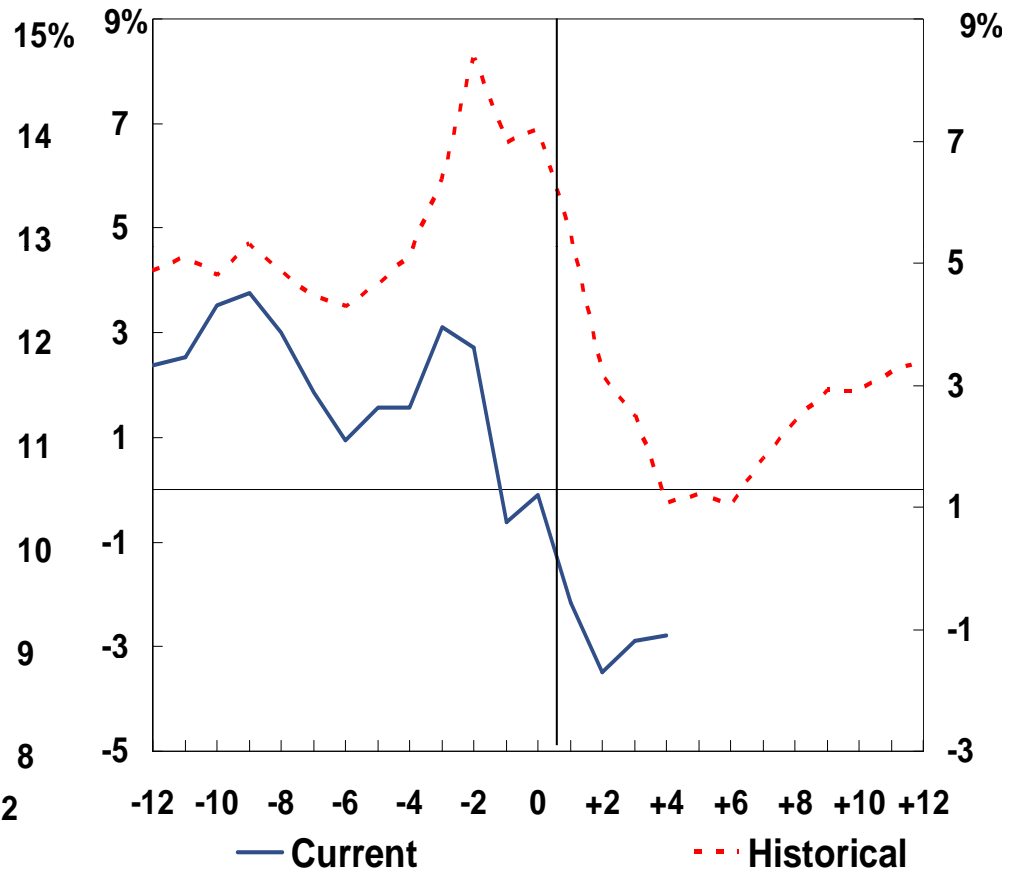
Sources: Federal Housing Finance Administration, S&P, Fiserv, MacroMarkets LLC and Loan Performance.

The Corporate Sector is Outperforming Cyclical Norms

Profit Margins in Current and Past Recessions

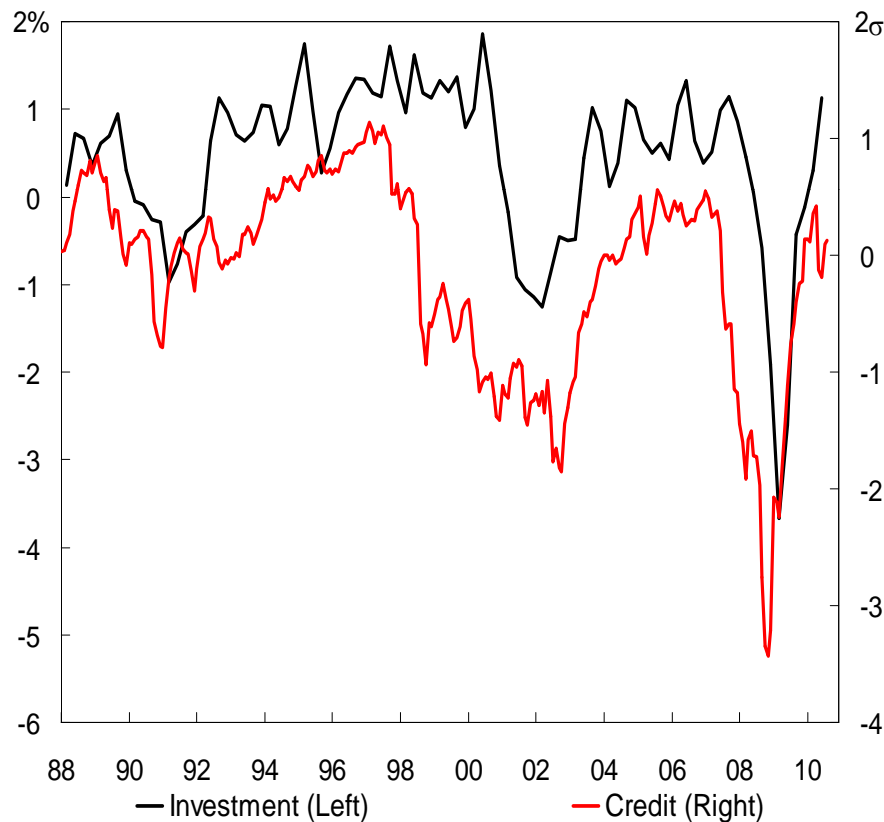


Unit Labor Cost in Current and Past Recessions



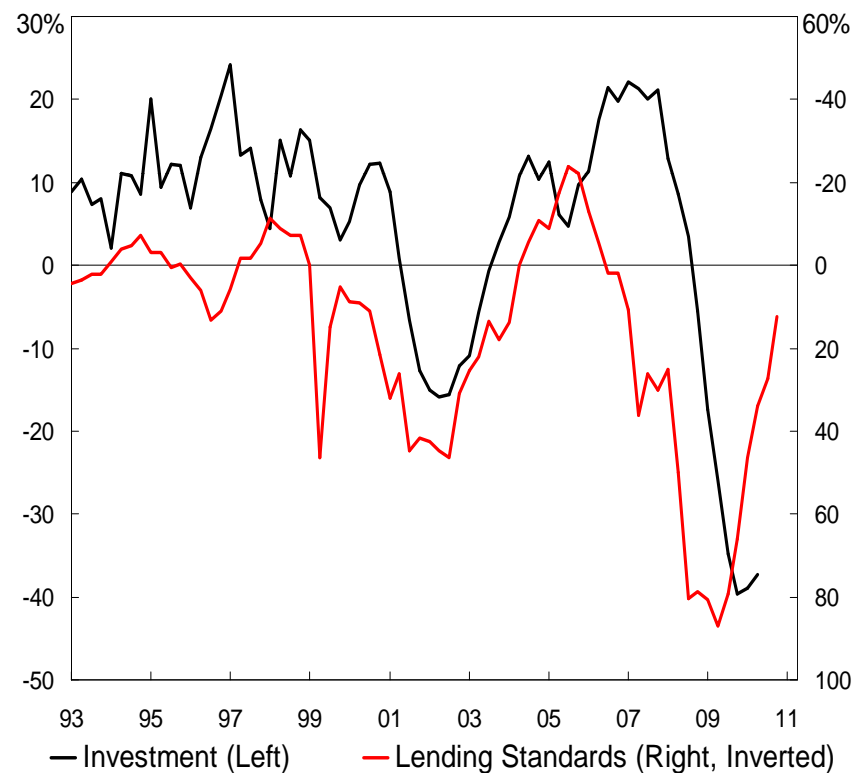
A Mixed Picture For Business Investment

Real Nonresidential Fixed Investment (Contribution to Real GDP Change) and Credit Component of Citi Financial Conditions Index (Standard Deviations), 1988-Aug 10



Source: Bureau of Economic Analysis and Citi Investment Research and Analysis.

Nominal Investment in Non-Residential Real Estate (Year-to-Year Percent Change) and Tightening Lending Standards for Commercial Real Estate (Percent, Six-Qtr Lagged), 1993-2Q 10



Source: Bureau of Economic Analysis and Federal Reserve Board.

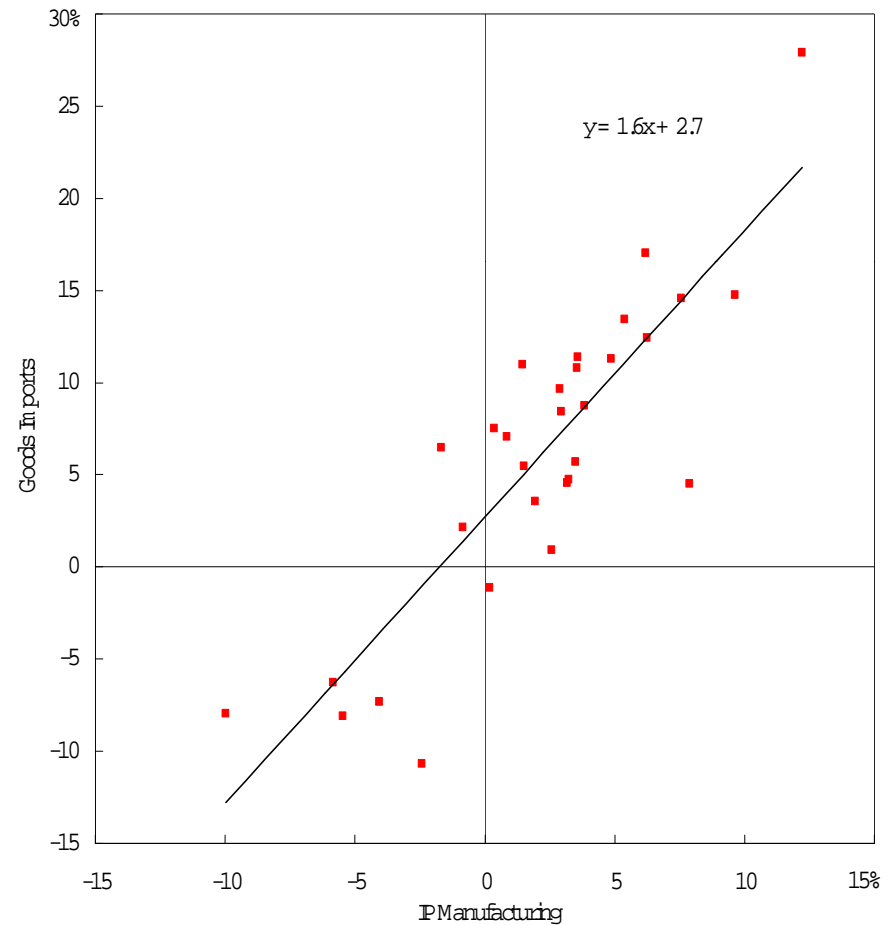
Limited Scope For Net Exports

Chinese Manufacturing PMI and ISM New Export Orders, 2005-Aug 10



Sources: China Federation Logistics & Purchasing and Institute for Supply Management.

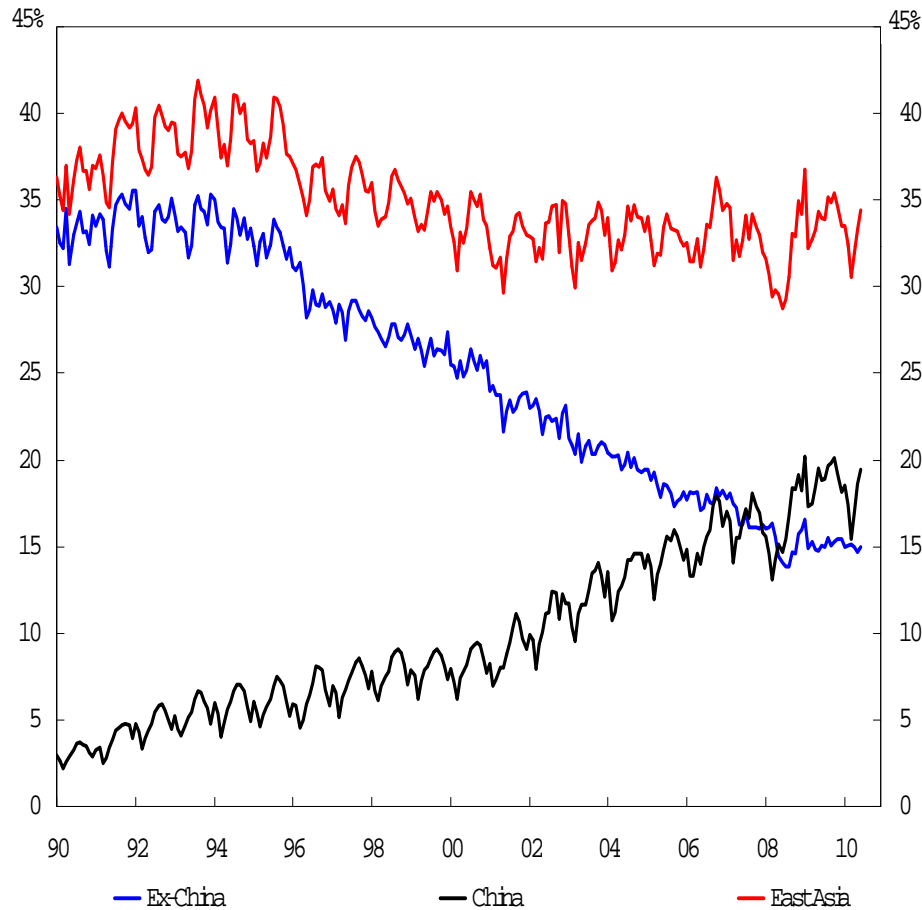
Manufacturing IP and Real Goods Imports (Fourth-Quarter to Fourth-Quarter Percent Change), 1980-4Q 09



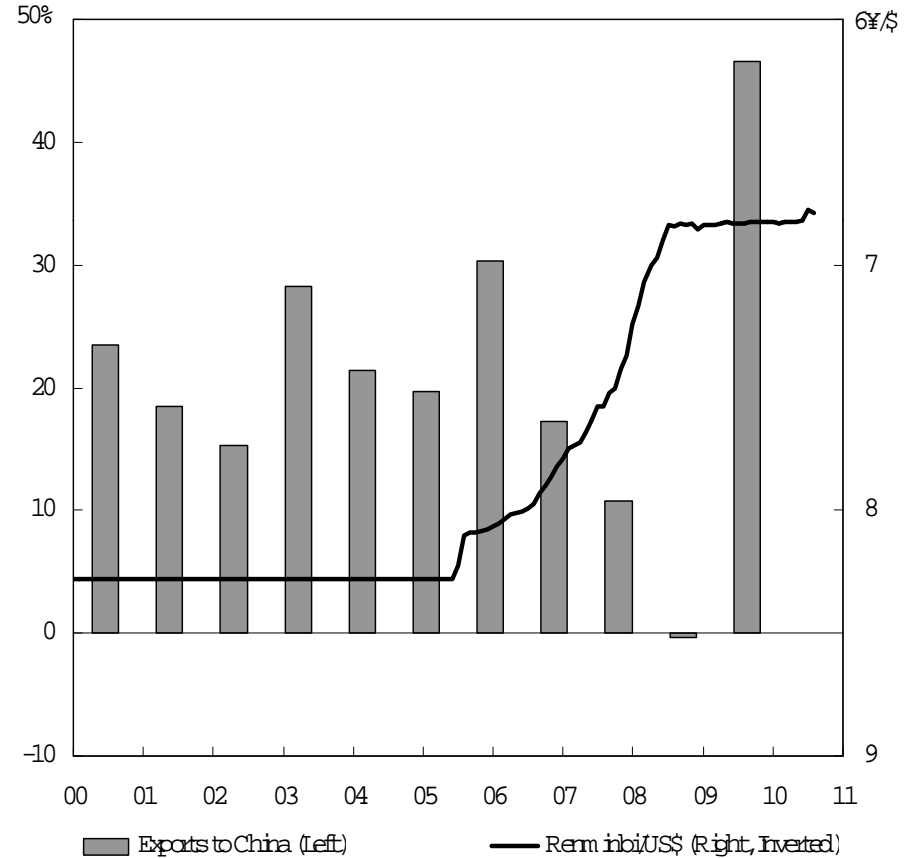
Sources: Federal Reserve Board and Bureau of Economic Analysis.

Weak Links to “Made in China”

U.S. Goods Imports from East Asia as a Share of Total Goods Imports, 1990-Jun 10



U.S. Goods Exports to China (Annual Percent Change) and Spot Exchange Rate, 2000-Aug 10



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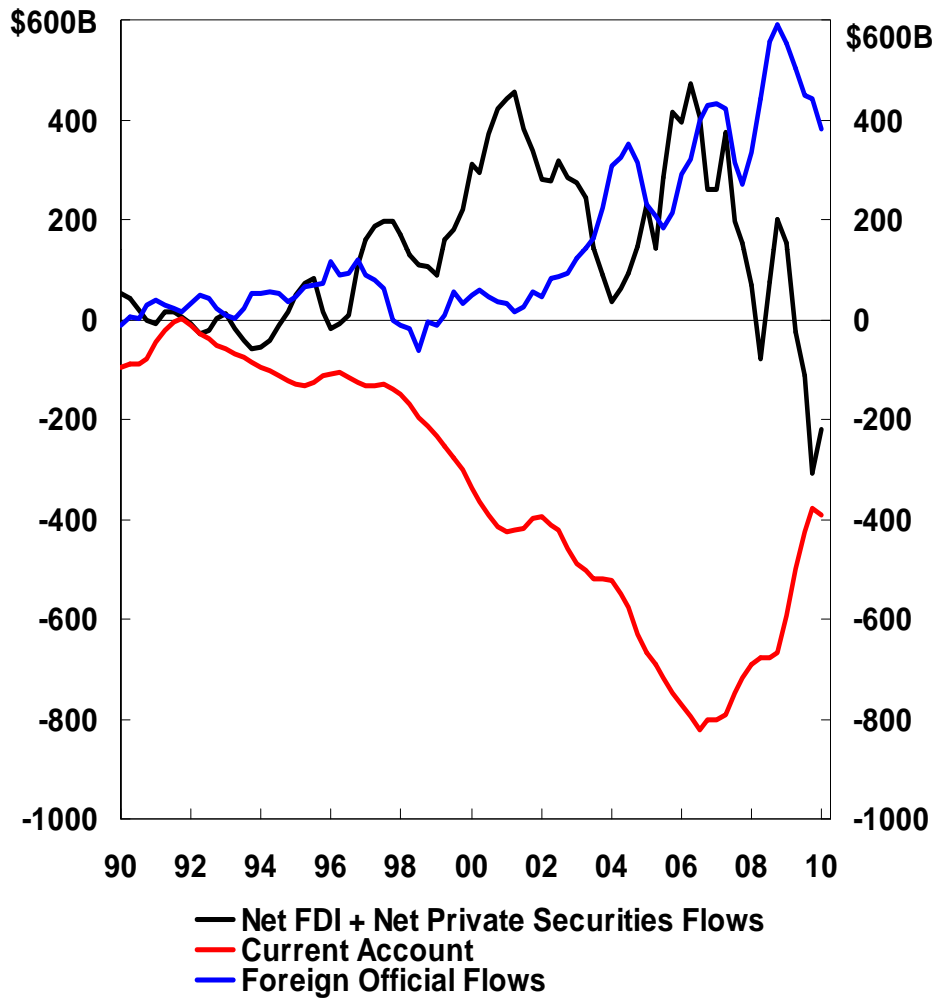
21 Source: Census Bureau.

Sources: Census Bureau and Federal Reserve Board.

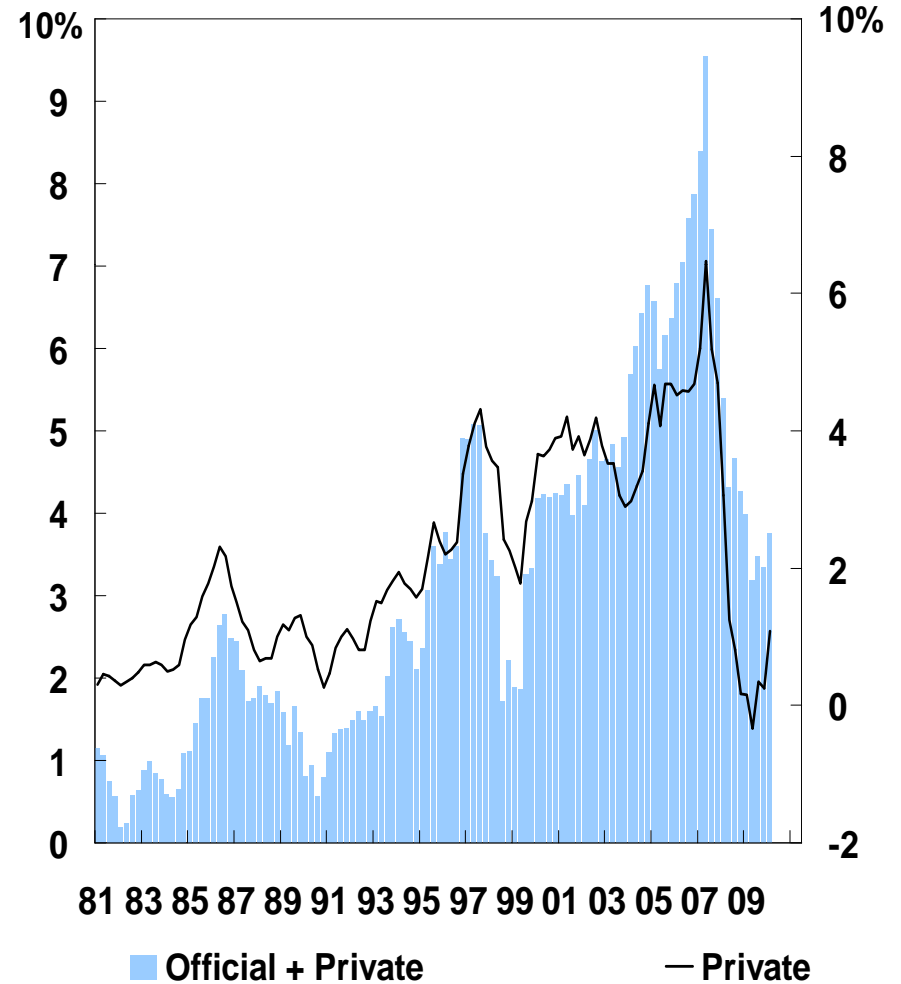


Smaller Current Account More Dependent on Official Support

Moving Four-Quarter Sum of Financing of U.S. Current Account



Securities-Related U.S. Capital Inflows, 1981-1Q 10



Inflation Has Threatened to Fall Below Desired Levels

PCE 12-Month Inflation, Dallas Fed Trimmed-Mean Headline, 1960-Jul 10

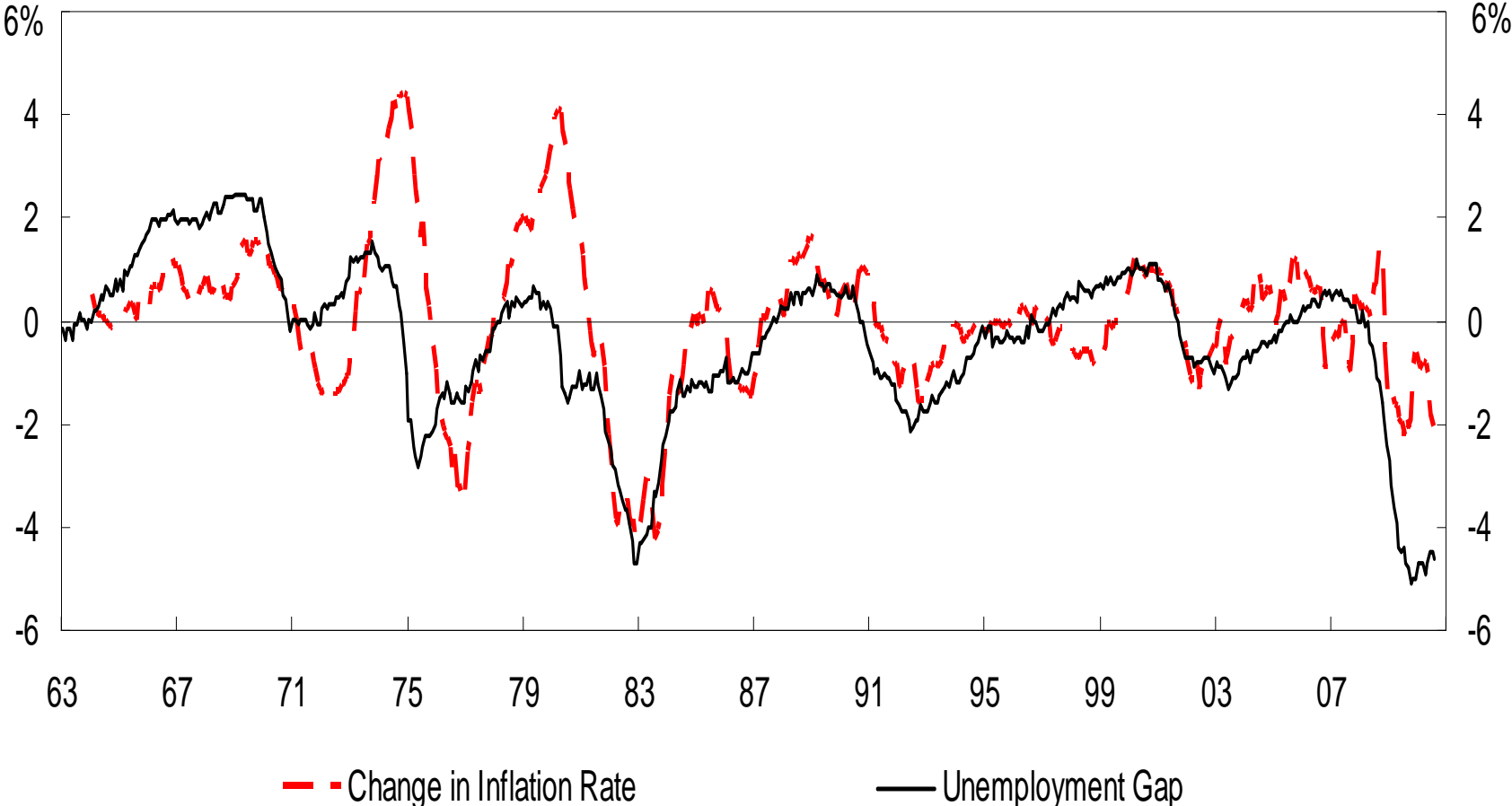


rd1426 Note: Shaded region is Fed inflation target. Sources: Bureau of Economic Analysis and Federal Reserve Bank of Dallas.



Flatter Phillips Curve – Will High Jobless Rate Pull Inflation Much Lower?

The Gap Between NAIRU and Jobless Rate vs. Yr-to-Yr Diff in Two-Yr Inflation Rate, 1963 – Aug 10

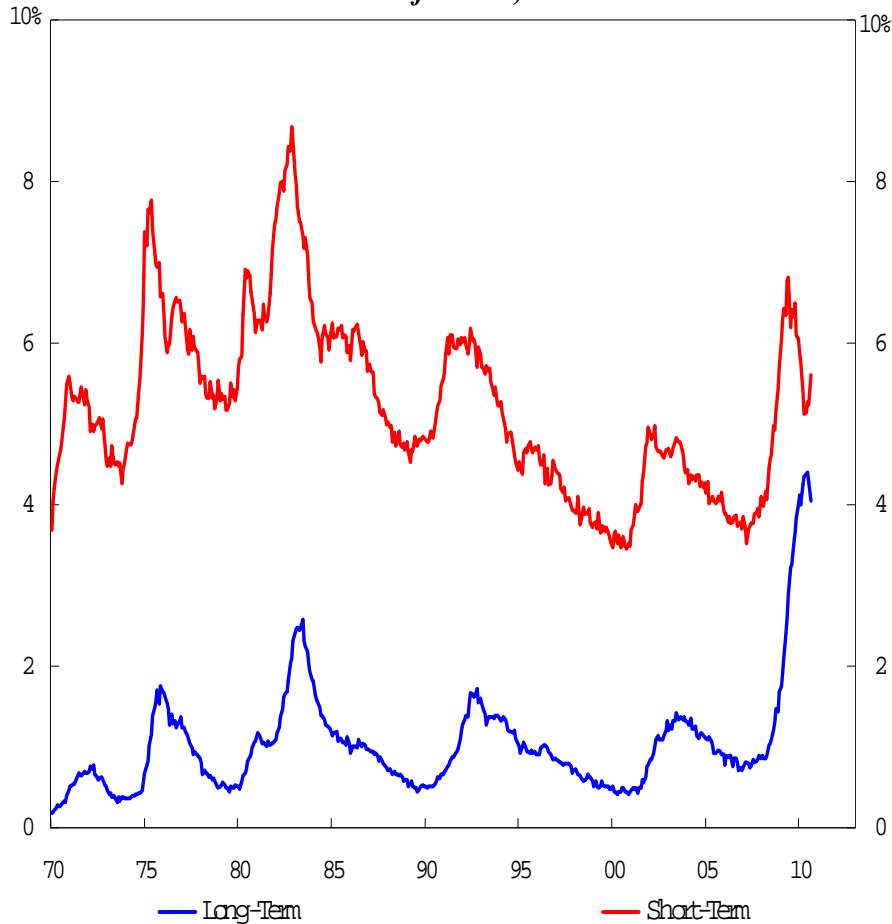


Note: NAIRU is the non-accelerating inflation rate of employment. Source: Bureau of Labor Statistics and Congressional Budget Office.



Short-Term Unemployed May Be Better Gauge of Cost Pressure

Share of Labor Force Unemployed for More than and Less than Half a Year, 1970-Jun 10



Source: Bureau of Labor Statistics.

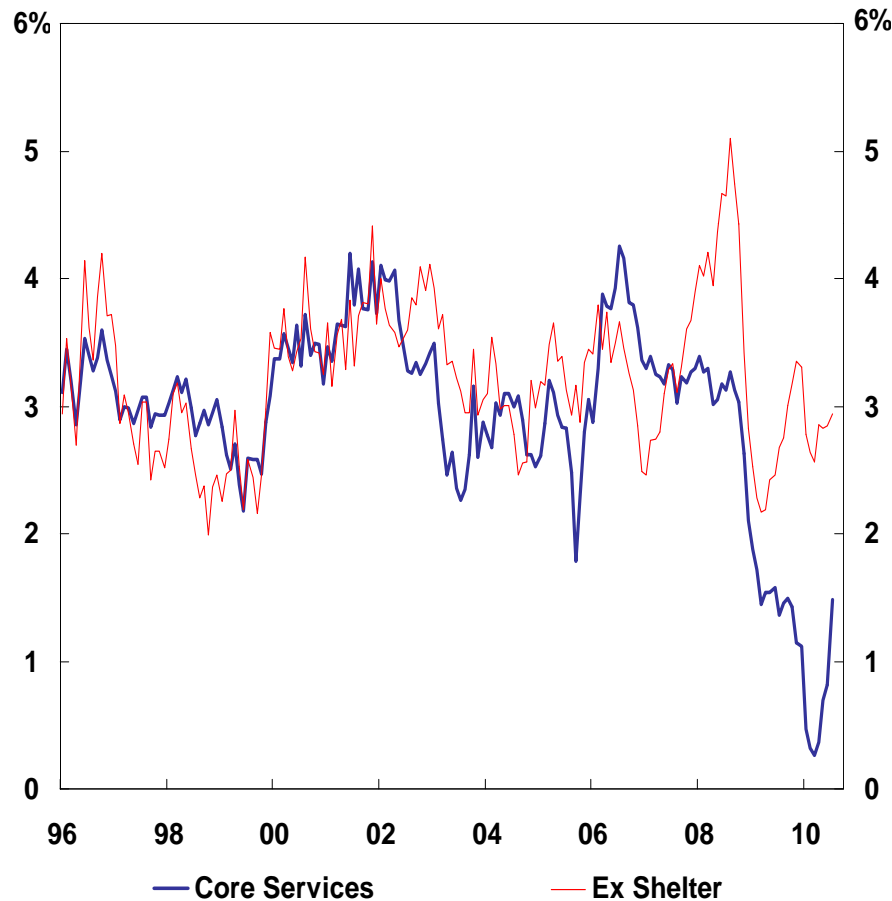
Short-Term Unemployment Gap Versus Change in Two-Year Inflation Rate, 1982-Jun 10



Note: The short-term unemployment gap is the difference between NAIRU and the proportion of workers unemployed for less than half a year. NAIRU is the non-accelerating inflation rate of unemployment. Sources: Bureau of Labor Statistics, Congressional Budget Office, and Citi Investment and Research Analysis.

Falling Housing Costs Mask Broader Stability

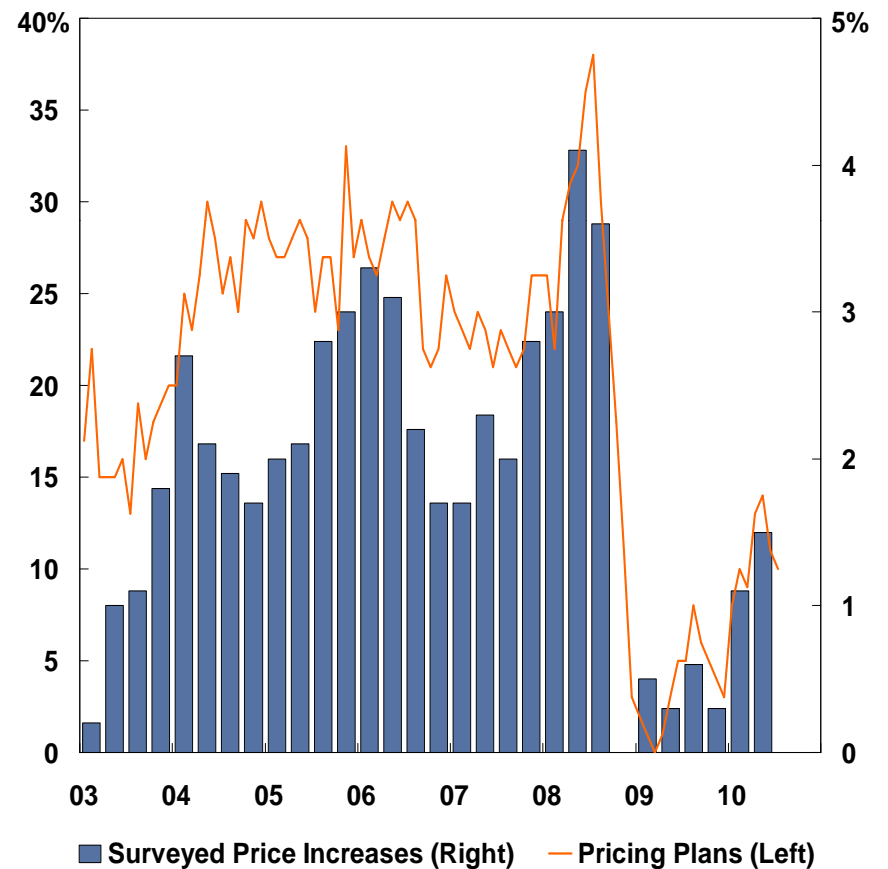
*Core CPI Services and Core Services Ex-Shelter
(Six-Month Annualized Percent Change)*



Sources: Bureau of Labor Statistics and Citi Investment Research and Analysis.

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*Small Businesses Planning to Raise Prices (Percent) and
Duke/CFO Expected Price Increases in Next 12-Months*



Sources: National Federation of Independent Business and Duke Fuqua School of Business/CFO Magazine.

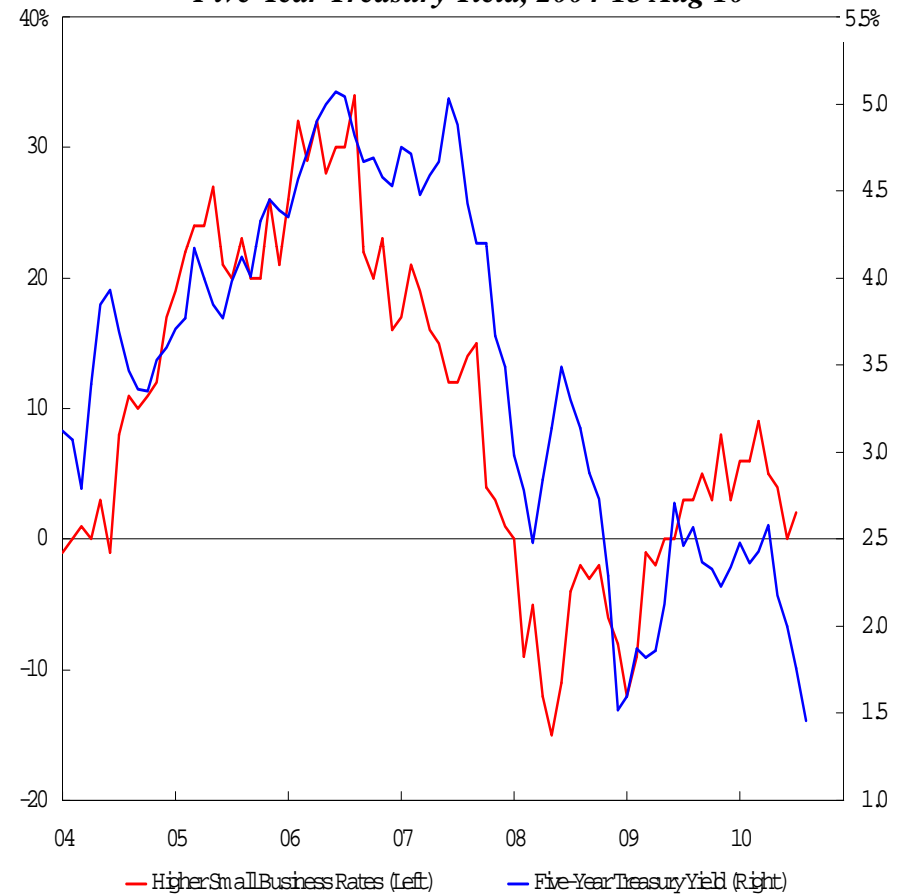
Lingering Credit Restraint for Consumers, Small Firms

Selected Consumer Borrowing Rates, 2000-Jul 10



Source: Federal Reserve Board.

Net percentage of Small Business Borrowers Paying Higher Interest Rates than Three-Months Ago and Five-Year Treasury Yield, 2004-13 Aug 10

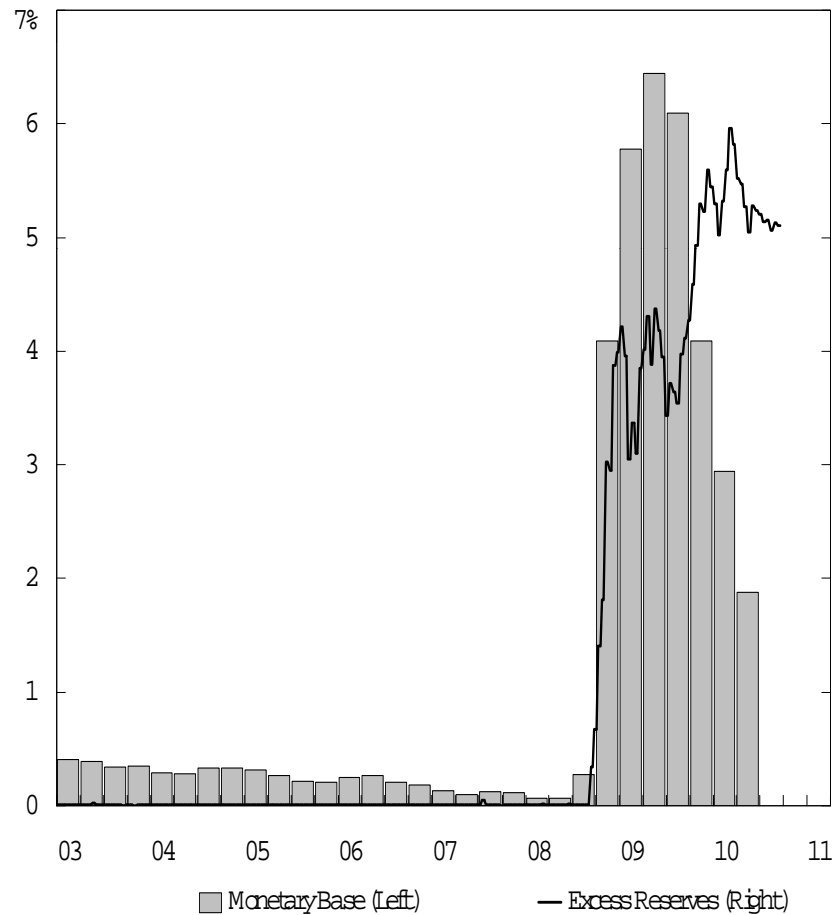


Sources: National Federation of Independent Business and Federal Reserve Board.

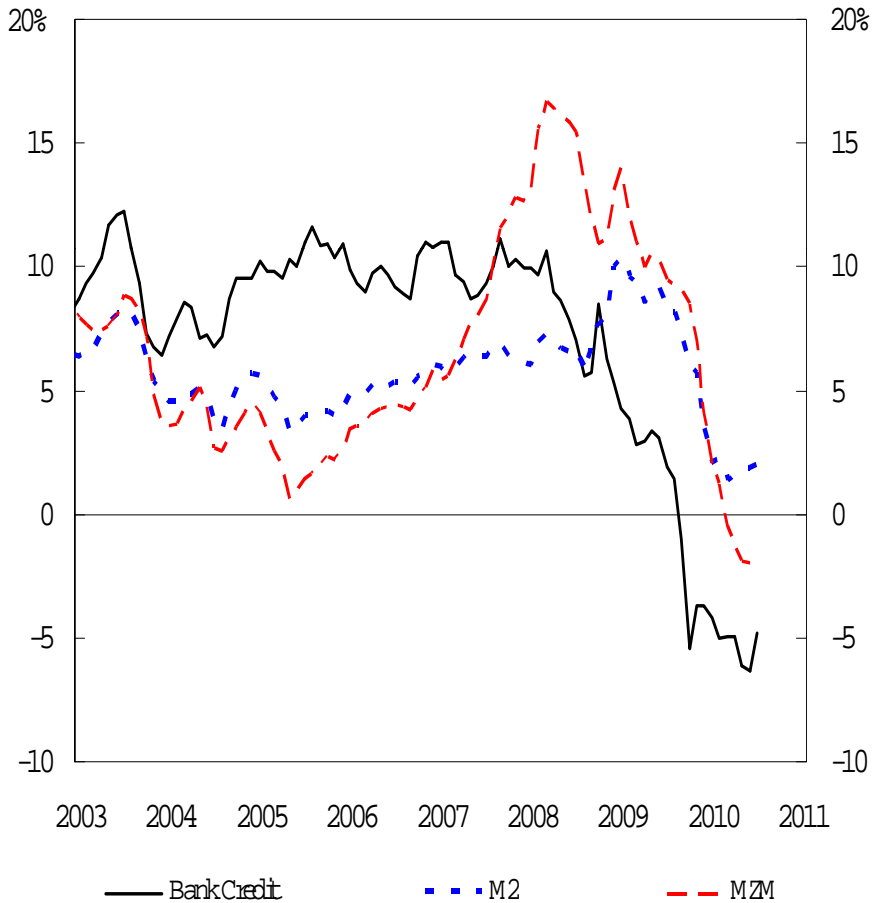


Policy Accommodation Has Not Fueled Rapid Money and Credit

Monetary Base Expansion Relative to GDP and Excess Reserves, 2003 – 25 Aug 10



Year-to-Year Percent Change in Bank Credit and Money Stock Measures, 2003 – Jul 10



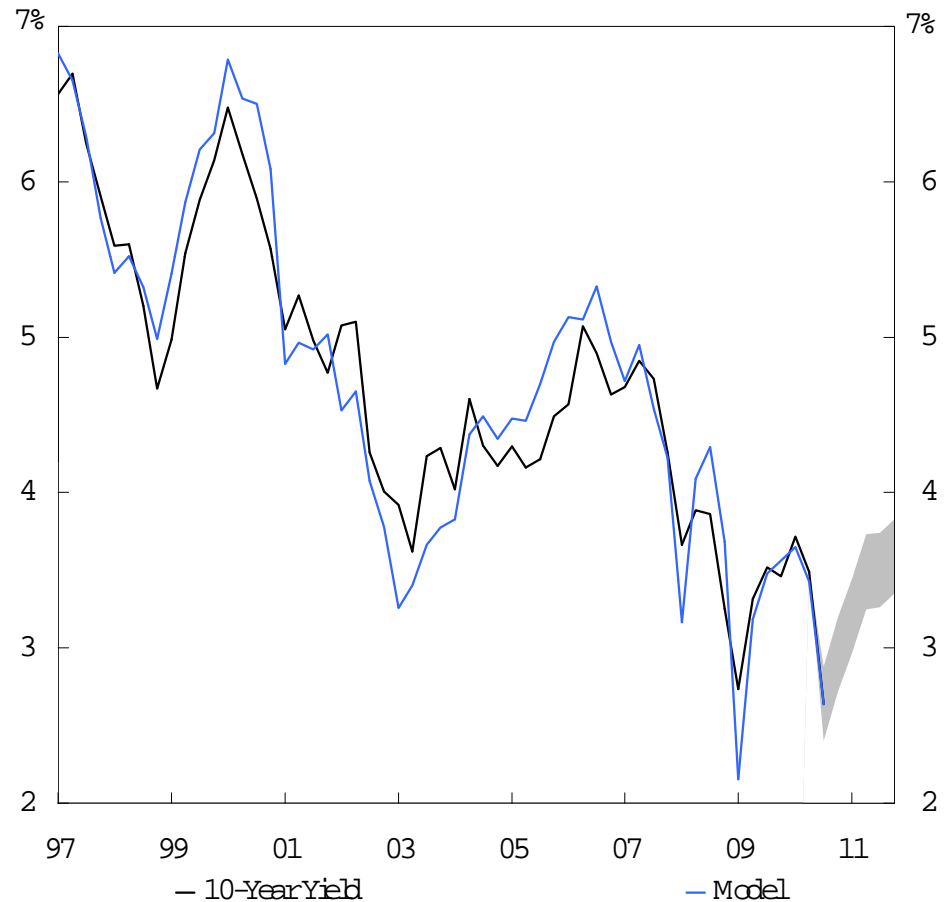
Sources: Federal Reserve Board, Bureau of Economic Analysis and Citi.

Note: Bank Credit is break adjusted data. Sources: Federal Reserve Board.

Slow Fuse on Rising Bond Yields

- Long-term benchmark interest rates remain anchored by elevated risk aversion, weak private credit demand and expectations for extended Fed accommodation.
- Recent sharp declines in yields reflected a substantial drop in distant inflation breakevens, possibly on perceptions that political developments could hasten fiscal retrenchment ahead of market pressures.
- Modest cyclical pressures on yields are expected only when financial stability is more secure, unemployment is in a clear downtrend and Fed officials become convinced that deflation

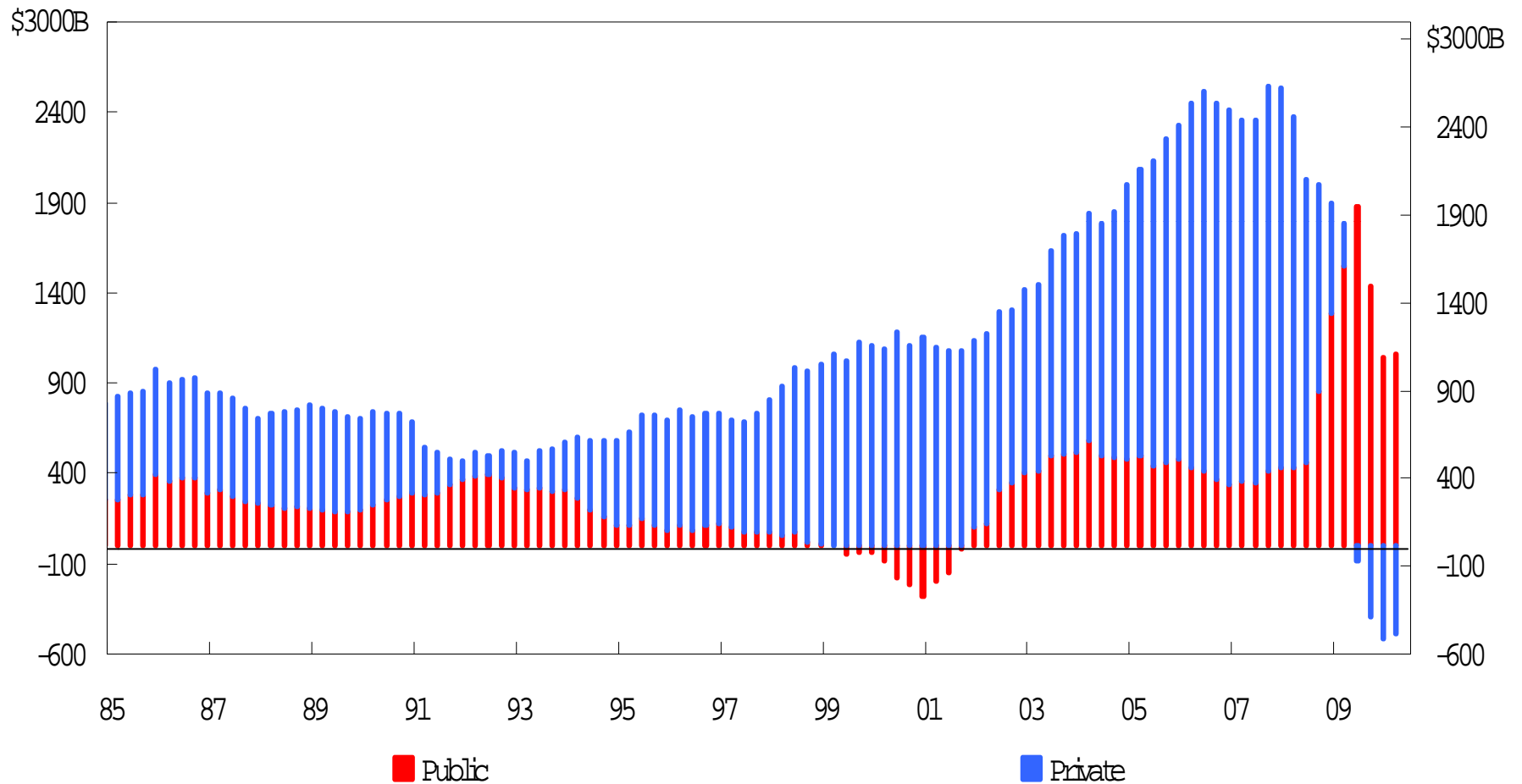
Ten-Year Bond Yield and Model Estimate, 1997-2011F



Source: Federal Reserve Board and Citi Investment Research and Analysis.

Collapse in Private Credit Demand Has Eclipsed Rising Deficits

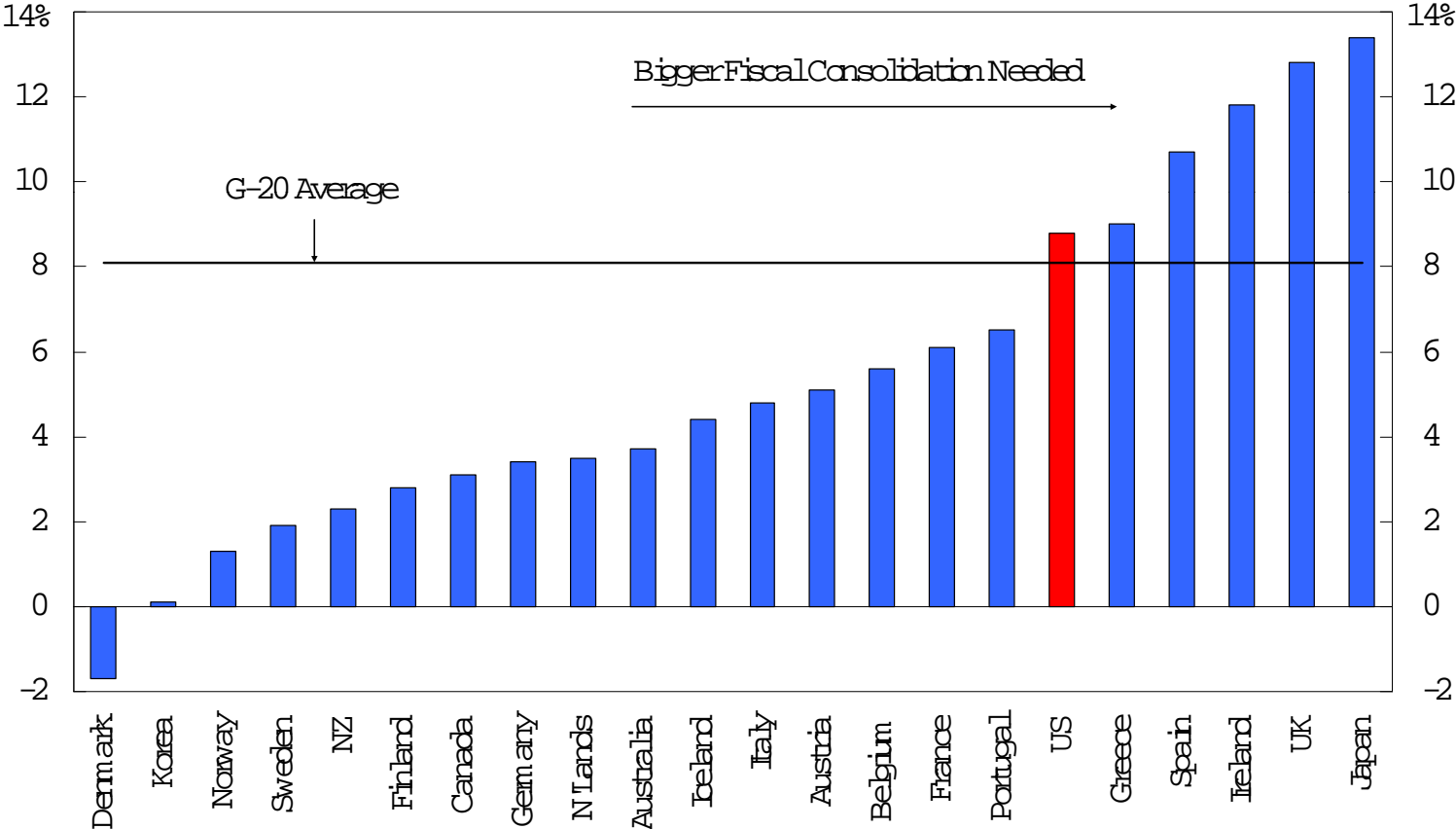
Yr-to-Yr Chg in Domestic Nonfinancial Debt, 1984-1Q 10 (Dollars in Billions)



Source: Federal Reserve Board.

The Need for Fiscal Consolidation

Fiscal Tightening (% of GDP) Needed Between 2010 and 2020 to Achieve Public Debt Ratio of 60% of GDP by 2030



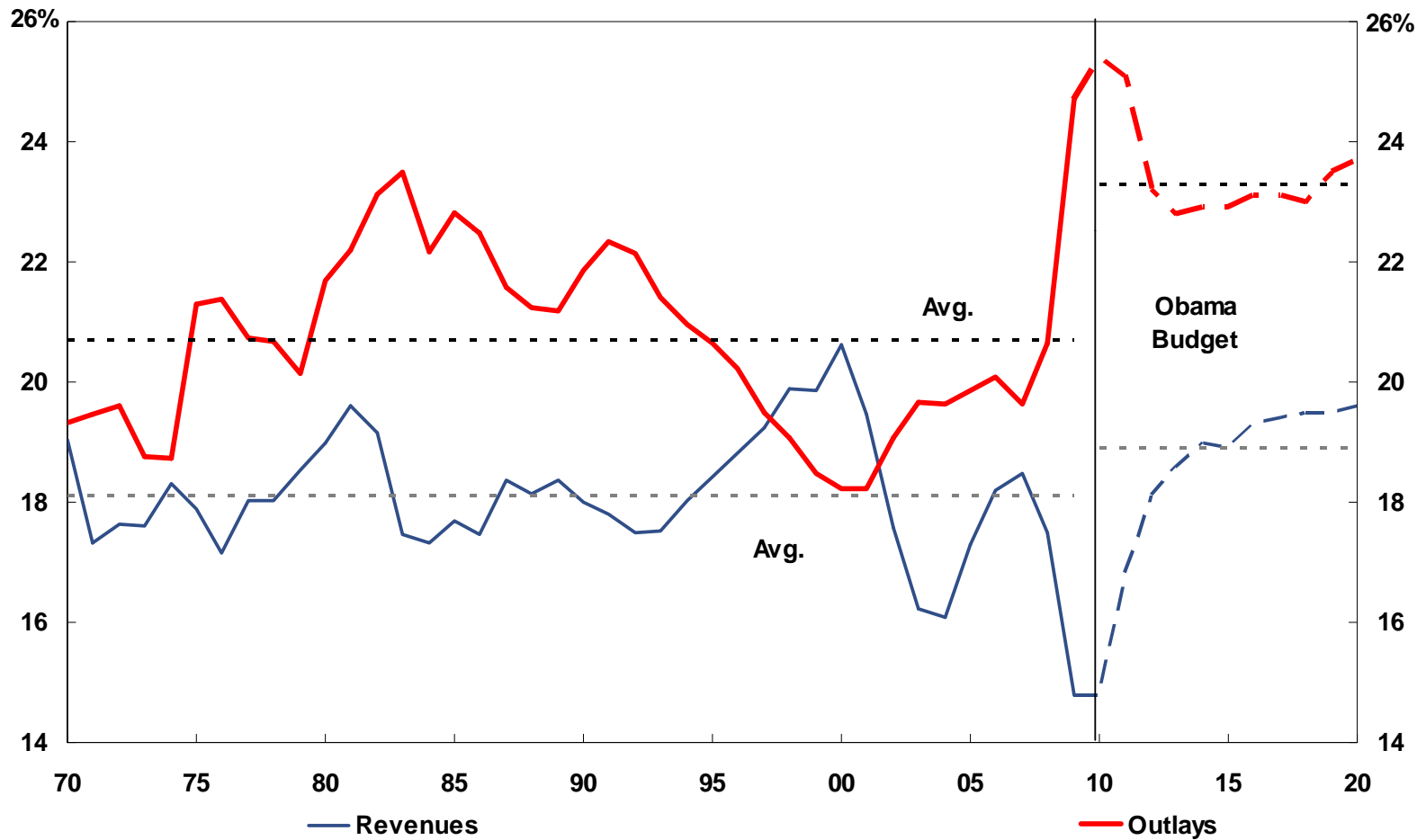
Notes: Primary balance improvement needed to stabilize debt at end-2011 level. Japan's target public debt ratio is 80% of GDP.

Sources: IMF and Citi Investment Research and Analysis.



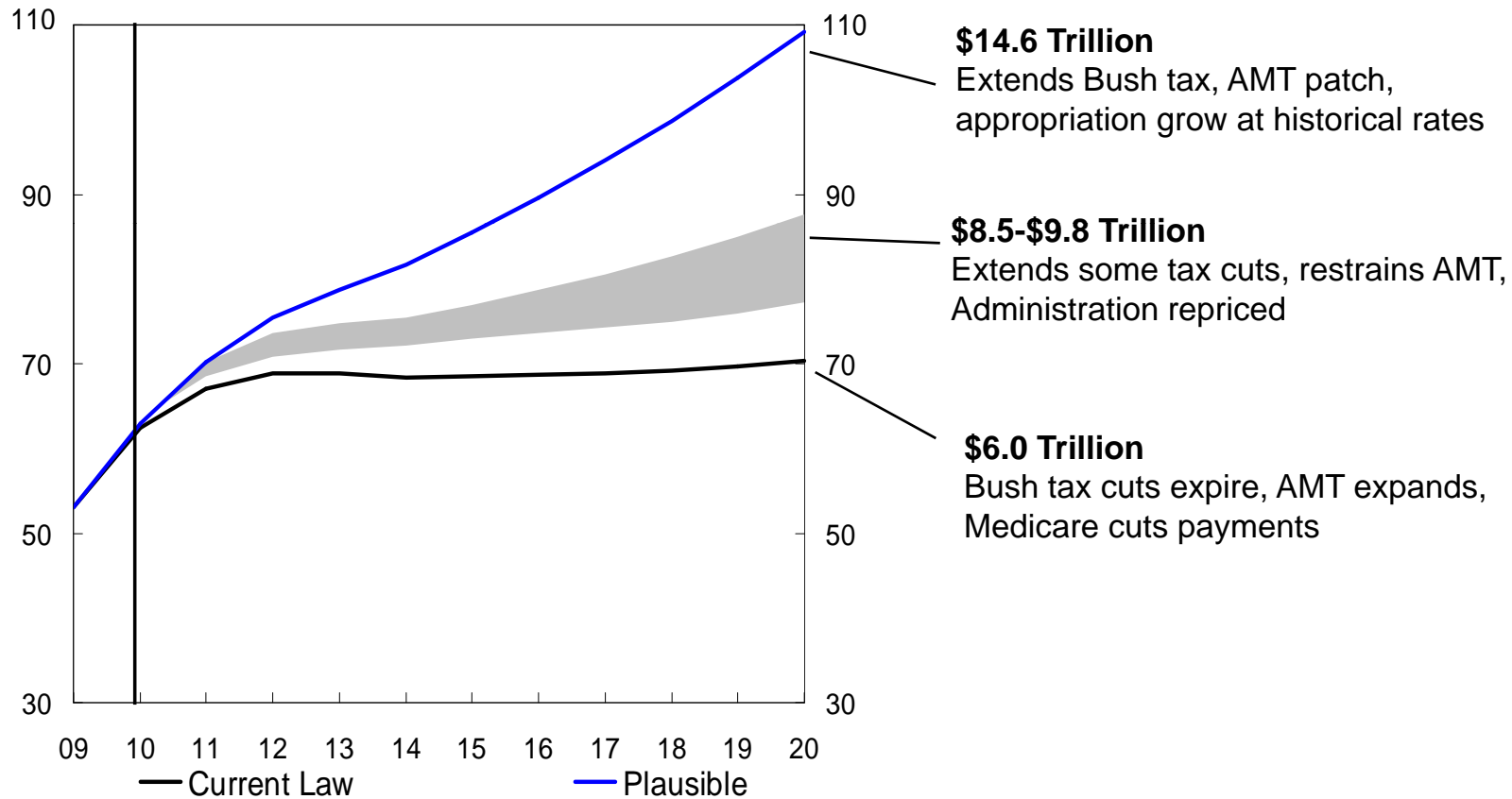
The Administration's 2011 Budget Plan

Revenues and Outlays of the Federal Government as a Percent of GDP



Prospects For Rising Public Debt Burden

*Federal Debt Held by the Public as a Percent of GDP,
2009-20F*

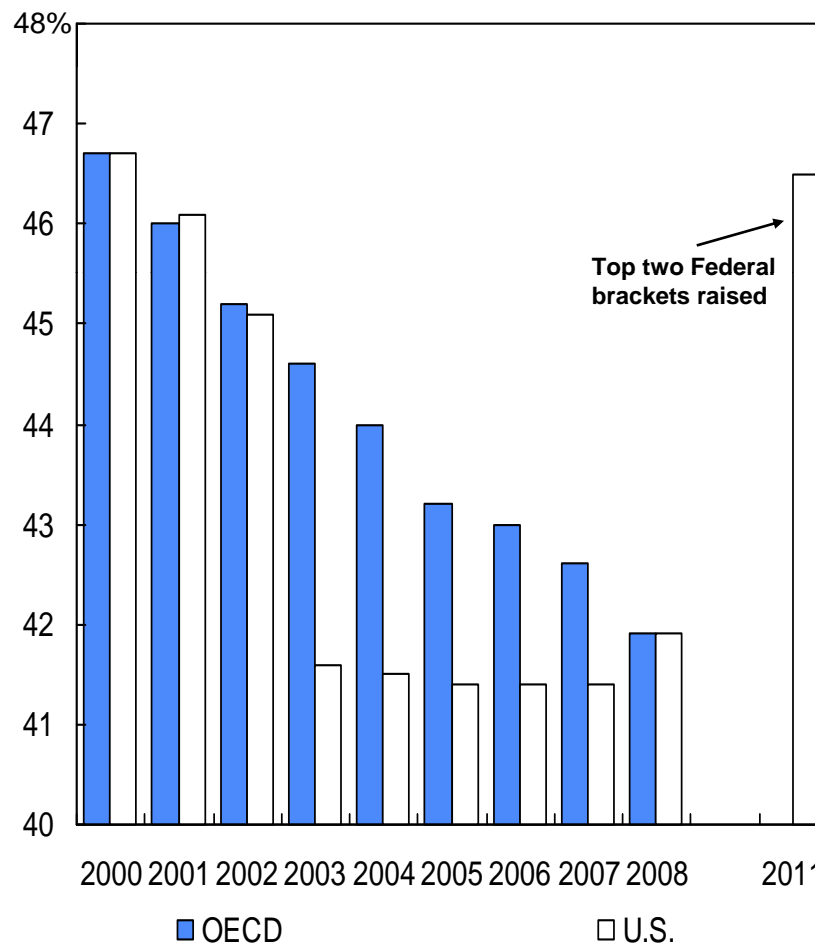


Sources: Congressional Budget Office, Office of Management and Budget and Citi Investment Research and Analysis.

Global Tax Competition in Reverse

- Average top OECD tax rate fell from 68% in 1980 to 42% in 2008. Prospective U.S. hikes would place it among high tax countries. N.B. one quarter of US tech startups have immigrant founder (Wadhwa, 2007).
- Five-point marginal hike would reduce reported income estimated 3% among affected taxpayers, offsetting 40% of static revenue gain (Tax Foundation, 2009).
- JCT analysis estimates 25mm returns with \$1 trillion in business income for 2011, of which \$437b or 44% would be taxed in top two brackets.
- Five-point marginal rate hike would reduce small business capex 10% (Carroll, Rosen et al) and lower likelihood of hiring by more than 8%.

*Top Individual Income Tax Rates
United States and OECD Average*

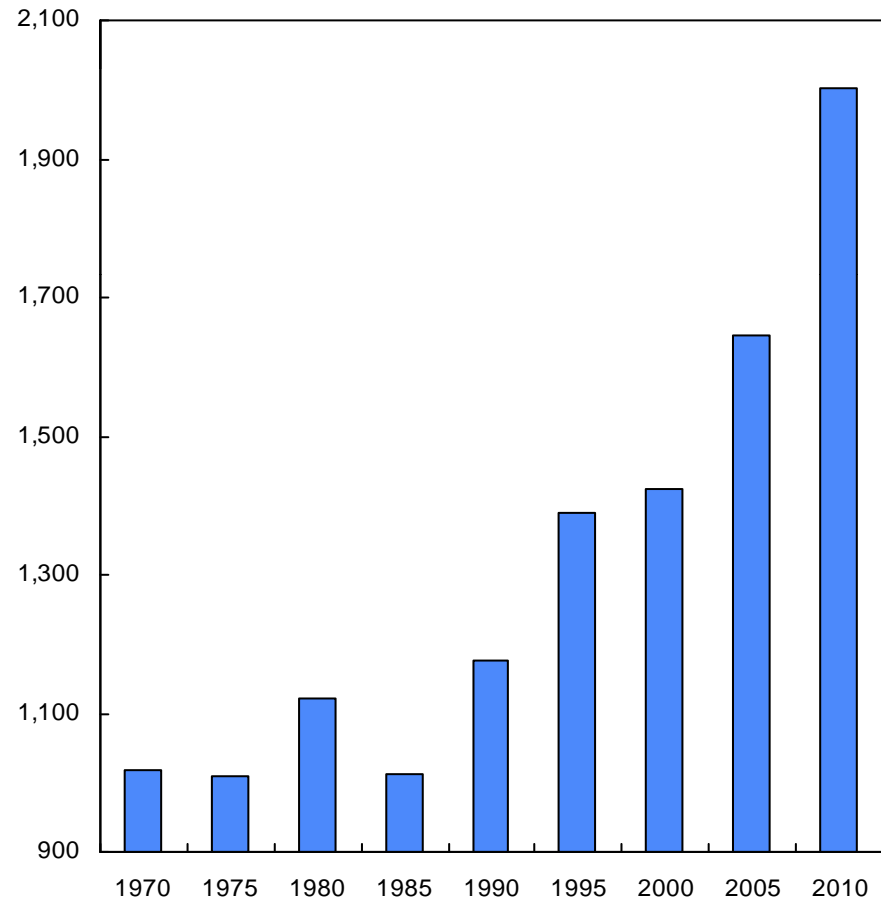


Note: Rates include income taxes at all levels of government.
Source: OECD Tax Database

Government Failure and The Culture of Spending

- Programs in every Federal department suffer from fraud, cost overruns, obsolescence or duplication, providing enormous scope for savings. Corporate welfare, special interest earmarks largely unchecked.
- Health care subsidies result in more than \$100b in fraudulent claims each year through phantom patients, procedures, hidden assets (Sparrow, 2008). Food stamps, housing, farm subsidies, disaster aid and EITC notable sources (GAO).
- Overruns common in highway construction, defense procurement of planes, destroyers, helicopters, energy projects and nuclear waste cleanup, Medicare Part A, NASA space station.
- Failing programs typically not closed but duplicated. GAO found 50 homeless programs in 8 agencies, 23 for housing across 4 agencies, 44 for employment in 9. There are 27 programs for teenage pregnancy, 130 for at risk youth, 17 agencies that monitor trade agreements, 10 to promote exports and 342 programs for economic development.

Number of Federal Subsidy Programs



Note: Includes grants, loans, insurance, scholarships, and other cash and noncash benefits. Source: Cato Institute and Catalog of Federal Domestic Assistance

Overview of the Dodd-Frank Act

Dodd-Frank Wall Street Reform and Consumer Protection Act

General Overview

- On July 21st, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law by President Barack Obama.
- Topics Covered by the Bill:
 - Regulation of Advisers to Hedge Funds and Private Equity Funds
 - SEC Enforcement and Broker Dealers
 - Volcker Rule
 - Derivatives
 - Credit Rating Agencies
 - Corporate Governance and Internal Controls
 - Insurance
 - Consumer Financial Protection
 - Banking

Today's Discussion

- Focus on:
 - Dodd-Frank Act Implications: Regulation of Depository Institutions & Impact on Transaction Accounts
 - Deposit Insurance
 - Interest Bearing Accounts (Reg Q Repeal)
 - Dodd-Frank Act Implications: Derivatives

Dodd-Frank Act Implications

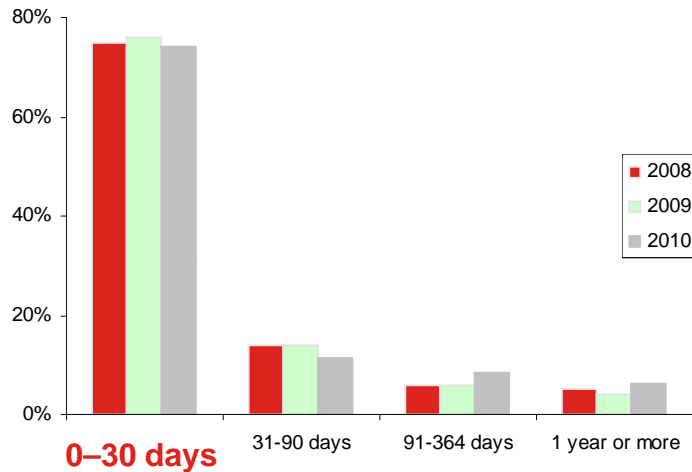
Transaction Accounts



Where have clients been investing?

From 2008 to 2010, there has been a continual shift in corporate investment behavior toward bank deposits, with decreasing but still high usage of Money Market Funds.

Average Investment Maturity



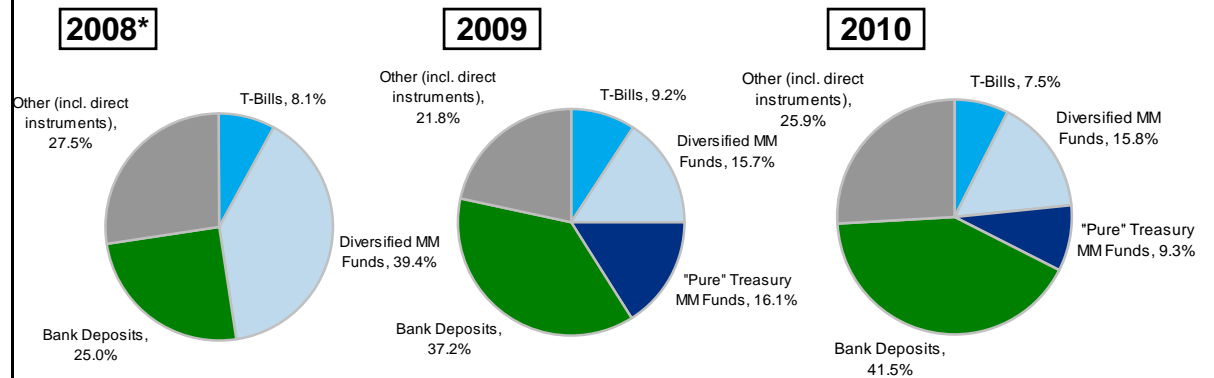
Source: AFP

Corporate investors have emphasized liquidity and capital preservation over yield:

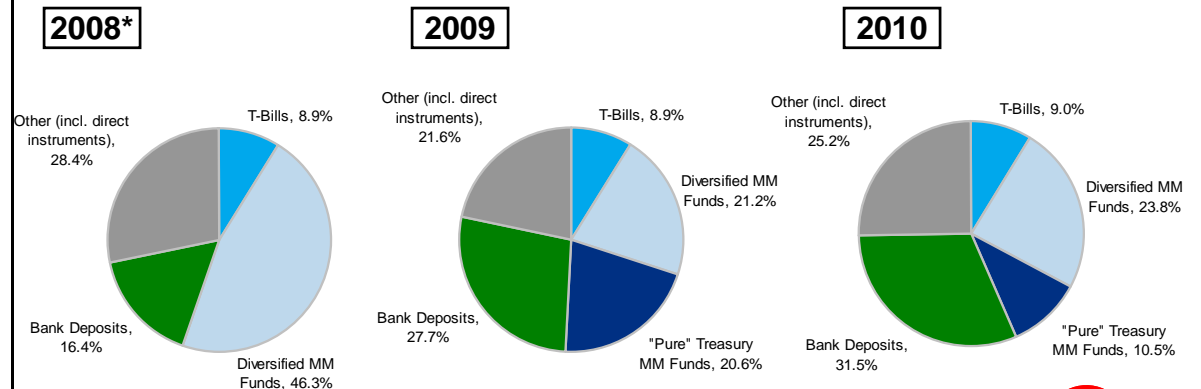
- Majority of cash has an investment horizon of less than 30 days
- Some increase in 2010 in usage of 91 day+ products
- Increased usage of high-quality bank deposits
- Decreased usage of Money Market Funds

Average Investment Portfolio Composition

All Respondents



Companies with Annual Revenue Over \$1Bn



* Note that the "Pure" Treasury MM Funds information was not available in the 2008 survey.

Source: AFP



Dodd-Frank Wall Street Reform and Consumer Protection Act

Impact on Transaction Accounts

- Changes that will have an impact on corporations' Transaction Accounts:
 - US Deposit Insurance:
 - Permanent increase of deposit insurance to \$250,000 per depositor per bank
 - Provide unlimited FDIC insurance on non-interest bearing (NIB) transaction accounts for all insured depository institutions for a two- year period from Dec 31, 2010 through Dec 31, 2012
 - Interest-Bearing Transaction Accounts:
 - Repeal of prohibition on payment of interest on business demand deposit accounts (commonly known as Regulation Q), effective July 21, 2011
- Implications and Considerations
 - US Non-interest bearing (NIB) transaction accounts will benefit from full FDIC insurance effective December 31, 2010 through December 31, 2012
 - Interest-bearing (IB) transaction accounts will be permanently available to all clients effective July 21st 2011, as permitted under the legislation
 - Depending on yield and liquidity objectives, clients may also continue to be well suited to Citi's other investment offerings such as Nassau/Puerto Rico sweeps, Time Deposits, Money Market Deposit Accounts and Money Market Funds

The repeal of Reg Q should not significantly impact corporations as they already have available a wide variety of interest bearing options both onshore and offshore.

From a transaction account standpoint, the Dodd-Frank Act will provide additional FDIC protection and a greater choice of short-term investments.

Pros and Cons of the Dodd-Frank Act for Corporations

From a transaction account standpoint, the Dodd-Frank Act will provide additional FDIC protection and a greater choice of short-term investments.

Transaction Accounts

Pros	Cons
<ul style="list-style-type: none">• Unlimited FDIC insurance for 2 years – provides additional guarantees to NIB transaction accounts• Permanent increase in base FDIC coverage to \$250,000• Additional short term investment options available• Creates more competition in the marketplace	<ul style="list-style-type: none">• Potentially higher funding costs for banks may eventually impact banking fee levels• Lack of clarity on new FDIC costs

Implications for US Investment Options

The Dodd-Frank act allows banks to provide additional investment options and more secure investment alternatives in the US.

US Investment Option	FDIC Coverage	Yield (net of FDIC fees)	Impact of Dodd-Frank Legislation
NIB DDA w/ ECR	Full FDIC Insurance	Highest	<ul style="list-style-type: none"> • Full FDIC insurance available 12/31/10 – 12/31/12
Offshore Sweeps	No	Medium to High	<ul style="list-style-type: none"> • Less necessary, but still benefit from lack of reserve requirement
Money Market Deposit Account (MMDA)	Yes – insured up to \$250M	Medium to High	<ul style="list-style-type: none"> • Permanent \$250M insurance • Rates likely to become closer to offshore alternatives • Still benefits from lack of reserve requirement
Puerto Rico Sweeps	Yes – insured up to \$250M	Medium	<ul style="list-style-type: none"> • Permanent \$250M insurance • Rates likely to become closer to offshore alternatives
Interest Bearing DDA <i>[New]</i>	Yes – insured up to \$250M	Medium	<ul style="list-style-type: none"> • Permissible in the US as of July 21st, 2011 • Permanent \$250M insurance
Time Deposits	Dependent on booking location	Dependent on Tenor	<ul style="list-style-type: none"> • Permanent \$250M insurance onshore
Money Market Funds	No	Prime (Medium) Gov't (Low)	<ul style="list-style-type: none"> • Increased competition from onshore bank deposits

Dodd Frank Act Implications

Derivatives



U.S Financial Reform Legislation—Overview

The Wall Street Reform and Consumer Protection Act demands changes that are far-reaching and will affect a wide range of market participants. The mechanics of implementation will be determined by the forthcoming rulemaking process, however, the broad implications of the Act are already apparent.

- **Derivatives**
- **Corporate Governance**
- **Regulatory Oversight**
- **Systemic Risk Regulation**
- **Consumer Financial Protection**
- **Fiduciary Responsibility**
- **Proprietary Trading**
- **Other**
 - Mortgage Lending
 - Rating Agencies
 - Hedge Funds

Title VII – Derivatives Overview

- **Regulatory Oversight**
 - The regulatory bodies primarily responsible for oversight of the derivatives market going forward are the CFTC, the SEC, and the Federal Reserve Board.
 - Responsibility is divided by type of derivative, though much of the authority is either shared, or rule making is predicated on joint decisions and/or consultation with the other parties.
- **Classification of Market Participants**
 - Swap Dealer
 - Security-Based Swap Dealer
 - Major Swap Participant
 - Major Security-Based Swap Participant
 - Commercial End-user
- **Infrastructure**
 - Execution venues – Designated Contract Markets and Exchanges; Swap Execution Facilities
 - Clearing Houses
 - Real Time Reporting
 - Swap Data Repositories
- **Capital and Margin Requirements**
 - Non-cleared trades are likely to have higher capital charges
 - Margin requirements
 - Segregation and Bankruptcy changes
- **Swaps Push-out**
- **Volcker Rule**

Title VII – Swap Definition

- **Swap definition**

- The statute establishes broad coverage by defining a “swap” as any agreement, contract, or transaction that is, or in the future becomes, commonly known as a swap, followed by specific examples.
- The statute also defines “security based swaps” as swaps based on a single security, a narrow-based index of securities, or the occurrence/non-occurrence of an event relating to an issuer.
 - There is an open question on the definition of “narrow-based index” and issues around arriving at definitions in the security futures area;
 - The overall jurisdictional split is a continuation of current schism of SEC/CFTC jurisdiction over stock index futures.
- Excludes from the definition of swaps sales of non-financial commodities for deferred delivery, so long as the transaction is intended to be physically settled.
- The definitions exclude transactions where one party is a Federal Reserve Bank or a government agency backed by the full faith and credit of the federal government.

- **Treatment of Foreign Exchange –**

- Spot transactions are specifically exempt
- Includes foreign exchange swaps and forwards in the definition of swap unless the Treasury Secretary makes a determination that they should not be included
- Treasury Secretary must consider
 - (1) whether the required trading and clearing of such swaps and forwards would create systemic risk, lower transparency or threaten the financial stability of the United States;
 - (2) whether such swaps and forwards are already subject to a regulatory scheme that is materially comparable to that established by the Act for other classes of swaps;
 - (3) the extent to which bank regulators of participants in the foreign exchange market provide adequate supervision, including capital and margin requirements;
 - (4) the extent of adequate payment and settlement systems; and
 - (5) the use of a potential exemption of such swaps and forwards to evade otherwise applicable regulatory requirements
- Notwithstanding any written determination by the Treasury Secretary to exempt foreign exchange swaps and foreign exchange forwards from the CFTC's jurisdiction, all foreign exchange swaps and forwards must be reported to a swap data repository, or, if there is none that would accept them, to the CFTC within such time period as the CFTC may prescribe.

Title VII – Regulatory Oversight

- **The CFTC**

- Must adopt rules for registered swap dealers and major swap participants, except for rules imposing prudential requirements on swap dealers or major swap participants for which there is a prudential regulator.
- Must adopt rules governing swap dealers' and major swap participants'
 - Reporting and recordkeeping;
 - Daily trading records;
 - Business conduct standards;
 - Document standards; and
 - Duties of such entities
- Exclusive enforcement authority over provisions of Subtitle A of Title VII, except for:
 - Enforcement authority of prudential regulators over capital and margin requirements applicable to swap dealers and major swap participants for which they are the prudential regulator and
 - Referrals or backstop enforcement authority of other regulators.

- **The SEC**

- Must adopt rules for registered security-based swap dealers and major security-based swap participants, except for rules imposing prudential requirements on security-based swap dealers or major security-based swap participants for which there is a prudential regulator.
- Must adopt rules governing security-based swap dealers' and major security-based swap dealers'
 - Reporting and recordkeeping;
 - Daily trading records;
 - Business conduct standards;
 - Document standards; and
 - Duties of such entities
- Exclusive authority to enforce Subtitle B of Title VII with respect to any person.

- **The Federal Reserve**

- Prudential regulators are granted exclusive enforcement authority over capital and margin requirements applicable to swap dealers and major swap participants for which they are the prudential regulator.

- **The CFTC and SEC, in consultation with the Federal Reserve, must adopt rules concerning**

- Books and records requirements for registered swap data repositories and the data elements to be collected and maintained by them and
- Books and records requirements for security-based swap agreements, including daily trading records, for swap dealers, security-based swap dealers, major swap participants and major security-based swap participants.

- **The CFTC and SEC must consult and coordinate with each other and with the prudential regulators to assure regulatory consistency before commencing any rulemaking or issuing any order**

Title VII – Market Participants

- **Swap Dealer** is any person who
 - Holds themselves out as a dealer in swaps other than security-based swaps;
 - Makes a market in swaps;
 - Regularly enters into swaps with counterparties as an ordinary course of business for its own account; or
 - Engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps.
 - Exception –
 - Does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.
 - De minimus exception.—The Commission shall exempt from designation as a security-based swap dealer an entity that engages in a de minimus quantity of security-based swap dealing in connection with transactions with or on behalf of its customers.
 - Must register with the CFTC
- **Security-Based Swap Dealer** is any person who—
 - Holds themselves out as a dealer in security-based swaps;
 - Makes a market in security-based swaps;
 - Regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or
 - Engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps.
 - Exception –
 - Does not include a person that enters into security-based swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.
 - De minimus exception.—The Commission shall exempt from designation as a security-based swap dealer an entity that engages in a de minimus quantity of security-based swap dealing in connection with transactions with or on behalf of its customers.
 - Must register with the SEC
- **Major Swap Participant/ Major Security-Based Swap Participant** is any person who is not a swap dealer, and
 - Maintains a **substantial position in swaps** for any of the major swap categories as determined by the relevant Commission, excluding positions held for hedging or mitigating commercial risk and positions held by any employee benefit plan under ERISA for the primary purpose of hedging or mitigating risk directly associated with the operation of the plan; or,
 - Whose outstanding swaps create **substantial counterparty exposure** that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or
 - A **financial entity** (other than, for CFTC-regulated swaps but not SEC-regulated security-based swaps, an entity predominantly engaged in providing financing for the purchase of an affiliate's merchandise or manufactured goods):
 - that is **highly leveraged** relative to the amount of capital it holds, and that is not subject to capital requirements imposed by a Federal banking agency, and
 - maintains a **substantial position in outstanding swaps** in any major swap category as determined by the relevant Commission.
 - Must register with the CFTC/ SEC as a Major Swap Participant
 - SEC and CFTC must consult/coordinate with each other to define key terms.

Title VII – Market Participants

- A person may be designated as a swap dealer or major swap participant for a single type or single class or category of swap or activities and not considered as such for other types, classes, or categories of swaps or activities.
- **Business Conduct Standards**
 - Swap dealers and MSP will be subject to new business conduct standards to be adopted by the applicable regulators.
 - Regulators have broad authority to set new business conduct standards that relate to: fraud, manipulation, and other abusive practices involving swaps, and otherwise to require diligent supervision of the swap dealer's or MSP business.
 - Regulators will require adherence to position limits.
 - Rules will require swap dealers and MSP to disclose to non-swap dealer and non-MSP: Information about the material risks and characteristics of the swap. Any material incentives or conflicts of interest that the swap dealer or MSP may have.
 - Upon request, swap dealers must provide the daily mark from the clearing organization for cleared swaps.
 - Swap dealers must provide the daily mark for non-cleared swaps (even if not requested by counterparty).
- **Exception to Clearing Requirement – Commercial End User**
 - The clearing requirements do not apply if one of the counterparties is
 - Not a "financial entity,"
 - Using the swaps/ security-based swap to hedge or mitigate commercial risk; and
 - Notifies the CFTC/ SEC how it generally meets its financial obligations under non-cleared security-based swaps.
 - The clearing exception is solely at the discretion of the counterparty qualifying for the exemption.
 - The CFTC/ SEC must consider whether to exempt small financial entities.
 - An affiliate of the qualifying counterparty qualifies for the exception if the affiliate is acting on behalf of the counterparty and uses the swap security-based swap to hedge or mitigate the commercial risk of the person that is not a financial entity, although this does not apply to certain types of affiliates (such as a security-based swap dealer).
 - Certain captive finance companies that are affiliates of companies that qualify for the clearing exemption but that do not meet the criteria for exemption above are exempt from the margin requirement described in Section 15F(e) of the Securities Exchange Act and the clearing requirement for not less than 2 years beginning on the "date of enactment of this paragraph" with regard to security-based swaps entered into to mitigate the risk of the financing activities.
 - The CFTC may adopt a rule to define "commercial risk" and any other term included in an amendment to the Commodity Exchange Act made by Subtitle A.
 - The SEC may adopt a rule to define "commercial risk" and any other term included in an amendment to the Commodity Exchange Act made by Subtitle B.
 - Are still subject to reporting and trade repository requirements

Title VII - Infrastructure

- **Execution Requirements**

- If a class of transactions is subject to clearing requirement, it must be traded on an Exchange, Designated Contract Market or Swap Execution Facility.
- Trading requirement does not apply if no exchange or execution facility makes the product available for trading.
- The bill defines a swap execution facility as a facility in which multiple participants have the ability to execute swaps by accepting bids/offers from multiple participants in the system.
- The CFTC and SEC are currently drafting rules that would define and govern a Swap Execution Facility
- No person may operate a facility for trading or processing swaps unless registered as a swap execution facility or as a designated contract market.
- Swap execution facilities registered with the SEC still must register with the CFTC.
- The CFTC/ SEC may exempt, conditionally or unconditionally, a swap execution facility from registration if that facility is subject to a comparable regulatory authority in its home country
- Core principles for a SEF include market surveillance, trade reporting, monitoring position limits for speculators and establishing conflict of interest rules

- **Clearing Requirements**

- All swaps must be cleared unless one party to the swap is exempted as a Commercial End-user or if there is no Clearing Organization that accepts the swap for clearing
- The CFTC/ SEC must adopt rules governing registered clearing agencies for swaps/ security-based swaps
- A derivatives clearing organization cannot be compelled to accept the counterparty risk of another clearing organization.
- A swap dealer is not permitted to act as a clearing member for customers unless registered as an FCM (for swaps) or a broker-dealer or security-based swap dealer (for security-based swaps). Clearinghouses will be subject to CFTC and/or SEC rules and oversight.

- **Reporting Requirements**

- The CFTC/ SEC must adopt rules requiring the real-time public reporting of swap transaction data, including price and volume, for
 - Swaps subject to mandatory clearing, including those exempted because the non-financial entity exemption applies;
 - Swaps not subject to the mandatory clearing requirement that are cleared;
 - Pre-enactment swaps that are reported to a swap data repository or the CFTC; and
 - Swaps that are required to be cleared but are not.
- The CFTC/ SEC must prescribe standards
 - That specify the data elements for each swap that must be collected and maintained and
 - For the collection and maintenance of data for swap data repositories.
 - The standards must be comparable to those imposed by the CFTC/ SEC on derivatives clearing organizations.
- The CFTC/ SEC must adopt rules governing swap data repositories.
- Parties to a swap are responsible for timely reporting to the appropriate registered entity and each cleared and non-cleared swap must be reported to a registered swap data repository.

Title VII – Capital and Margin Requirements

- **The prudential regulators in consultation with the CFTC and SEC, with respect to the swap dealers and major swap participants for which there is a "prudential regulator," and the CFTC, with respect to other swap dealers and major swap participants, must adopt rules imposing capital requirements and initial and variation margin requirements on non-cleared swaps.**
- **Prudential regulators are granted exclusive enforcement authority over capital and margin requirements applicable to swap dealers and major swap participants for which they are the prudential regulator.**
- **Segregation of Collateral for non-cleared Swaps and Security-based swaps**
 - At the request of the counterparty, the Swap dealer or MSP must
 - Segregate the funds for the benefit of the counterparty and
 - In accordance with CFTC/ SEC rules, maintain the funds in a segregated account separate from the assets of the Swap dealer and MSP.
 - These requirements only apply to a swap between a counterparty and a swap dealer or MSP that is not submitted for clearing to a clearing agency and do not apply to variation margin payments.
 - The segregated account must be at a third-party custodian and designated as a segregated account for and on behalf of the counterparty.
 - If the counterparty does not elect segregation, the swap dealer or MSP must report to the counterparty on a quarterly basis that the back office procedures related to margin and collateral requirements are in compliance with the agreement of the counterparties.
 - Dealers and major swap counterparties are required to notify counterparty that it has the right to require segregation of initial margin
- **A futures commission merchant, introducing broker, broker or dealer must comply with the stricter of any applicable capital requirement imposed under the Commodity Exchange Act or the Securities Exchange Act.**
- **Clearing houses will require margining of cleared positions.**

Swaps Push-out, Volcker Rule and Time Lines

- **Swaps Push-out Rule**

- Statute allows depository institutions to continue to trade those swaps related to traditional banking business, including interest rate swaps, foreign exchange swaps, cleared investment grade credit derivatives, and certain precious metals
- Other types of swaps activity, including un-cleared or non-investment grade credit default swaps, equity and most commodity derivatives must be pushed out to an affiliate.
- Banks are allowed to use derivatives to hedge their business

- **Title VI – “The Volcker Rule”**

- A banking entity may not engage in proprietary trading or acquire or retain any equity, partnership or other ownership interest in or sponsor a hedge fund or private equity fund, subject to permitted activities
- In developing and issuing rules, the appropriate Federal banking agencies, the SEC and the CFTC must consult and coordinate with each other, as appropriate, for the purposes of ensuring, to the extent possible, that such regulations are comparable and provide for consistent application and implementation of the applicable provisions of the Volcker Rule to avoid providing advantages or imposing disadvantages to affected companies and to protect the safety and soundness of banking entities and systemically important nonbank financial companies. The Chairperson of the Financial Stability Oversight Council will be responsible for coordination of regulations
- Effective no later than 2 years after enactment, and banking entities would have an additional two years to come into compliance, with the possibility of up to an additional three years in extensions.

- **Time Lines and ‘Grandfathering’**

- The derivatives subtitle generally takes effect 360 days after enactment. Many of the provisions require the applicable agency to implement regulations. Registration requirements for swap dealers and major swap participants take effect one year after enactment.
- The statute has more specific provisions that “grandfather” existing swaps:
 - Generally, swaps entered into prior to the effective date of the clearing requirement are exempt from clearing if they are reported to a registered swap repository or the CFTC/SEC.
 - Swaps entered into prior to enactment are exempt from clearing if they are reported not later than 180 days after the effective date of the clearing requirement.
 - Swaps entered into prior to the application of the clearing requirement are exempt if they are reported not later than the later of 90 days after the effective date, and such other time after entering into the swap as the CFTC/SEC may prescribe by rule or regulation.
- There is no express grandfathering with respect to margin or capital requirements on existing trades.

Conclusions

Takeaways

- The Dodd-Frank Act widens the range of investment options available to corporations and brings opportunities that corporate cash managers might take advantage of
- Ambiguities such as lack of clarity around the costs of the FDIC's new programs exist; the Dodd-Frank Act left much of the rule-making to be defined by individual agencies
- The increased FDIC costs that banks will incur could ultimately drive up banking fee levels
- Companies should talk to their banking and investment providers about the implications of the new regulations as well as other regulatory reforms that are in the works, such as Basel II and III

Q&A



Q & A

- **Will clients still be able to earn soft-dollar interest (ECR) on balances via Account analysis?**
 - Yes, clients will have the option to either hold their balances in an interest bearing DDA and earn hard dollar interest, or continue to hold balances in their NIB accounts and earn an Earnings Credit Rate (ECR) to offset their fees. Please note, that while currently DDA accounts earning ECR are considered NIB, the FDIC has not yet provided an opinion if DDAs with ECR will continue to be considered NIB under the new legislation and thus benefit from unlimited FDIC insurance.
- **What are the insurance implications of the Financial Reform bill?**
 - Clients with non-interest bearing transaction accounts will benefit from unlimited FDIC insurance on transaction accounts maintained within the U.S. from 12/31/10-12/31/12. Interest bearing US accounts, such as Money Market Deposit Accounts, Negotiable Order of Withdrawal Accounts and other US interest bearing deposit instruments, will be insured by the FDIC for up to \$250,000 per legal entity per bank.
- **Will there be additional FDIC fees assessed for the fully insured accounts?**
 - Under the current TAG Program there is a specific charge assessed to banks for TAG deposits. With the changes proposed under the Dodd-Frank bill there would no longer be any additional explicit FDIC TAG fees for fully insured transaction accounts.
- **When will the various changes be effective?**
 - Unlimited insurance on non-interest bearing (NIB) transaction accounts: December 31, 2010 through December 31, 2012
 - Repeal of prohibition on payment of interest on business demand deposit accounts: Effective July 21, 2011

Contacts

- Robert V. DiClemente – Managing Director, Citi US Chief Economist
Tel: +1 (212) 816-7942
Email: robert.diclemente@citi.com

- Michael Berkowitz - Head of North America Liquidity, Investments & Information Services
Market Management
Tel: +1 (212) 816-0981
Email: michael.n.berkowitz@citi.com

- William Hartnett – Managing Director, Citi Global Markets
Tel: +1 (212) 723-8534
Email: william.hartnett@citi.com

Disclosure Appendix

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