

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

Summary of Joint SEC-CFTC Roundtable on Dodd-Frank Implementation May 2-3, 2011 Washington, DC

Background

The Commodity Futures Trading Commission (“CFTC” or the “Commission”) and the Securities and Exchange Commission (“SEC”) staffs held a two-day public roundtable to discuss the schedule for implementing final rules for swaps and security-based swaps under the Dodd-Frank Wall Street Reform and Consumer Protection Act on May 2-3, 2011 in Washington, DC. Prior to the meeting, the CFTC staff circulated concepts related to sequencing rules:

- Staggering effective dates for the new Dodd-Frank rules will facilitate implementation of the regulation.
- The first step is to insure the market infrastructure is in place for clearing entities, trading platforms and data repositories.
- Swap Dealers could first register and develop policies and procedures by a particular date, and comply later with respect to transaction rules.
- Swap Dealers that have been previously regulated, such as those within bank holding companies, are likely to be able to comply more quickly than non-financial Swap Dealers.
- The statute provides for some natural sequencing. A clearing requirement cannot go into effect until the CFTC reviews the swap or group, category, type, or class of swaps. Additionally, the Commission must determine if a swap is required to be cleared and whether a trading platform(s) has listed the swap for trading, before that the swap can be traded.
- Additional investments in technology will likely need to be made by market participants. A rule’s effective date should take into account the time and resources needed to achieve the needed technology connectivity.
- The regulation could be staged according to asset classes, beginning with those where a certain amount of market infrastructure may already be in place and market participants may have already developed procedures that could be adapted.

Agency and Industry Perspectives

Having set the stage, agency representatives engaged the public on May 2-3, 2011 on how rules should be sequenced. Attendees at the two-day roundtable included representatives from large energy companies, lobbyists and trade associations, large utilities, and law firms.

The Agencies’ Perspective:

- Sequencing the regulation is anticipated, given the wide range of rules and markets.



- Rules need to be coordinated between the agencies.
- U.S. regulation should align with concurrent international regulation. The CFTC and the SEC do not want Dodd-Frank to become a trade disadvantage for U.S. companies. Misalignment between U.S. and international derivative regulation could result in a fragmented market, possibly inadvertently creating systemic risk.

Industry Perspectives:

- Industry participants need to know the rules before they can provide meaningful input to the question of timing of implementation.
- Sequencing for implementation requires a careful, phased-in approach that does not create a competitive disadvantage for any given market participant.
- Companies are reluctant to get too far down any one path with respect to technology, policies, and procedures, without better insight to the final rules.
- Many industry participants do not know if they qualify as Swap Dealers or End-users. This makes every step of the compliance process all that more challenging.
- Companies are trying to determine how affiliates will deal with one another. Some are considering corporate restructuring to facilitate compliance.
- The greatest challenge is not in the standardized swaps that clear, but in the large number of bilateral transactions that are “un-cleared swaps”.
- Parties may need to re-negotiate significant numbers of bilateral agreements.
- The regulation requires market participants to create special reporting systems, and re-design credit risk analysis to separate physical and financial transactions.
- Mandated changes in business processes can present real challenges that will require a longer implementation.

Staged Approach

There was general agreement among meeting attendees that a phased-in or sequenced approach would be required. There was also consensus that the Central Counterparty Clearing Houses (“CCPs”) and Swap Execution Facilities (“SEFS”) could be ready by the end of 2011.

The staging of asset groups was proposed. The asset groups where the current trading and clearing practices most closely mirror the new proposed regulations are: credit default swaps, interest rate swaps, foreign exchange swaps, and standard commodity swaps (that are already automated and cleared). Another suggestion for sequencing was to prioritize markets posing the greatest potential system risk. There was also general agreement that the banks, which already comply with the prudential regulators’ capital requirements, might have the internal processes and systems to implement more quickly than non-financial Swap Dealers or Major Swap Participants.

End-users will require a longer implementation period as the impact of Dodd-Frank compliance will reach across the organization impacting: risk management, trading, treasury, IT, accounting, audit and corporate governance. End-users require clarity so that they can direct resources appropriately as they will be required



to identify cleared versus un-cleared swaps; address system requirements for margining, trading, and transaction reporting; and revise policies and procedures associated with new business and hedging practices.

Overall, the single greatest compliance challenge lies in the transmittal and processing of data. Standardization of data and protocols is needed, as well as new technology solutions to send and receive data. Industry participants universally urged the agencies to allow enough implementation time to facilitate the development of software solutions to comply with the regulation.

End-user Exemption

The CFTC is sympathetic to the concerns of End-users and does not want to discourage hedging, nor increase market risk by imposing unduly burdensome costs and reporting requirements. Nevertheless, End-users will have to comply with documentation requirements for the annual end-use exception and for reporting individual swap transactions to a Swap Data Repository (“SDR”). Participants will be allowed to engage a third party to assist with their reporting requirements.

Energy industry participants explained that End-users enter into a significant number of bilateral swap transactions with other End-users. The majority of these deals are transacted with no collateralization or margining, are not settled daily, and are highly customized to serve the hedging purpose. Generally, credit risk is managed between counterparties through credit thresholds (limits), where letters of credit serve as collateral when potential risk exposure exceeds a threshold level.

The CFTC’s proposed rules require End-users to report roughly a dozen items of information each time they elect to rely on the End-user clearing exception. Industry representatives proposed satisfying a portion of the required documentation with a standing report and a “check the box” approach to annual updates. It was also proposed that a detail of a company’s hedging program, that lists each swap transaction, could serve to document hedge transactions.

End-users will also have to comply with reporting transaction details. Although End-users can rely upon the Swap Dealer or Major Swap Participant to report the transaction, an End-user doing business with a non-U.S. counterparty, or an End-user transacting with another End-user, will need to report a transaction. Therefore, End-users will either have to be ready to comply with reporting rules or structure transactions so that they are relieved of the transaction reporting responsibilities.

In terms of sequencing, End-users tend to have fewer resources to dedicate to Dodd-Frank compliance and are consequently the least prepared to comply. However, there is concern that their interests will not be served if they are “phased-out” of the developmental stages of the sequence. Many End-users look favorably upon a prolonged beta period, where compliance is optional, where they can test systems and processes prior to the deadline for mandatory compliance.

Next Steps

On April 27, 2011, at its last open meeting, CFTC Chairman, Gary Gensler, announced that as of this date, all proposed rules had been released. . Additionally, to enable industry participants to respond to the proposed rules in aggregate, the CFTC has extended the comment period on rules for which the comment periods had already closed for another thirty days, until June 3, 2011. Comments on proposed margin and capital rules are due June 27, 2011.



Introduction to Concentric Energy Advisors

Concentric Energy Advisors (“Concentric”) is a management consulting and economic advisory firm focused almost exclusively on the North American energy industry. Headquartered in Marlborough, Massachusetts, with an office in Washington, DC, Concentric specializes in energy market and regulatory strategies, market assessments, regulatory and litigation support, transaction-related financial advisory services, energy commodity contracting and procurement, economic feasibility studies, and capital market analyses and negotiations. The firm’s principals and affiliates have held executive positions with management consulting firms, utility companies, regulatory agencies, accounting firms, competitive energy suppliers and investment banks. Clients have included electric utilities, natural gas distribution companies, gas pipelines, gas producers, oil producers, large energy consumers, governmental and regulatory agencies, trade associations, independent energy project developers, engineering firms, and gas and power marketers.

How Concentric Can Assist Clients with Dodd Frank

Strategic Issues – Concentric can assist clients with reviewing their hedging and wholesale procurements activities, including:

- Assess strategic issues in electing ‘End-user exemption’ versus Swap Dealer
- Review client’s current wholesale market activities in light of CFTC rules
- Consider impact of proposed rules on client’s regional markets and counterparties
- Compare CFTC “Bona Fide” hedging to client’s actual hedging to identify potential gaps
- Identify hedging alternatives that address commercial risks and regulatory framework
- Review a client’s preparedness for complying with new regulation

Policies and Procedures – Concentric can assist clients with developing new policies and procedures to educate internal and external stakeholders, including:

- Review governance issues
- Adapt internal policies for new CFTC rules
- Develop internal controls that support policies



Related Staff Bios

Julie Ryan, Vice President, is an energy industry executive with expertise in risk management and strategic planning. Ms. Ryan provides advisory services to energy industry executives in the areas of risk management, strategic planning, wholesale trading and marketing, M&A due diligence, and business integration planning. Ms. Ryan has over 25 years of direct experience in the energy industry. Prior to joining Concentric, she was Managing Partner of Aether Advisors LLC and Vice-President, Risk Management and Strategic Planning at Puget Sound Energy. Ms. Ryan also held officer positions at Merchant Energy Group of the Americas and Louis Dreyfus Energy Corp. Ms. Ryan is a volunteer member of the Seattle City Light Review Panel, which oversees its strategic planning process, financial activities and rate reviews. She has spoken at numerous industry conferences on the topics of hedging and risk management, and has been a guest instructor at Willamette University's Atkinson School of Management since 2006. Ms. Ryan graduated Cum Laude, and was elected to Phi Beta Kappa, from Smith College in Massachusetts. (jryan@ceadvisors.com; 206.329.0424)

Julie Lieberman, Project Manager, is a financial and economic consultant with over 25 years of experience in the energy industry. Her broad base of experience includes: financial and economic consulting in the energy sector, risk management, asset valuation and modeling, wholesale and retail energy trading and operations, energy procurement and scheduling, hedging strategies, regulatory policy and compliance, utility ratemaking, due diligence and litigation support and analysis. She has performed a variety of economic analyses, extensive regulatory research and assisted in the preparation of testimony and research reports in both regulatory and non-regulatory proceedings. Ms. Lieberman is versed in option theory and option modeling, portfolio theory and optimization, financial engineering, Process and Monte Carlo simulations, and VAR analysis. Prior to joining Concentric, Ms. Lieberman served in the financial and risk related fields in the unregulated energy trading and marketing sector. She holds a Masters in Finance from Boston College, a B.S. in Accounting from Indiana University, and is a FINRA licensed securities professional (Series 7, 63, and 79). (jlieberman@ceadvisors.com; 508.263.6223)