

**Wall Street Reform:  
Bracing for Impact  
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Eric Sherman: Good morning, good afternoon, or good evening, depending on where you are in the world and welcome to today's webcast, Wall Street Reform -- Bracing for Impact, brought to you by Wall Street and Technology, IBM, and broadcast by United Business Media LLC. I am Eric Sherman, today's moderator.

We want to make sure this event is as interactive as possible so I'd like to make a few announcements before we begin. There are elements of this webcast that will appear as pop-ups and we want to make sure you can view them. At this time we recommend you disable any pop-up blockers if you haven't done so already. We encourage everyone to participate in our interactive Q-and-A session at the end of today's event. Please feel free to submit questions to our guest presenters anytime during the webcast.

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And now onto the presentation, Wall Street Reform -- Bracing for Impact. Joining me today are Dushyant Shahrawat, Senior Research Director of Securities and Investment at TowerGroup, and Joe Boissy, Business Agility and Industry Marketing at IBM.

Joe Boissy: Hello, everyone, this is Joe. Thank you, Eric. I'd like to start by saying something I think everyone would agree upon here. We know that the securities and investment industry is one of the most, if not the most heavily regulated industry in the world and I can assure you of something and you all agree with me that it's not going to change -- unlikely to change. We're going to have more and more regulations. So, we're delighted to have today with us from TowerGroup, Dushyant, and I'm sure many of you are familiar with Dushyant and I remember about 10 years ago when we were talking to Dushyant we were discussing Basel II and then later we talked about [inaudible] and things like that and I see ourselves now even talking today Basel III and Dodd-Frank Act. So, this is a very heavily regulated industry.

And so just to -- a couple of minutes on the program, the first half of the program will be Dushyant will give us his insights on the US regulatory reform in the securities and investment industry to understand better how these new regulations, implications of these regulations on the industry. And I'll wrap up towards the end with the IT view of the world and how IT can help in this regulatory reforms, maybe shedding some light with a couple of customer stories and we'll take it after that for question and answers.

So, Dushyant, I'm sure that many of you again are familiar with him. He is a Senior Research Director at the Securities and Investment practice at TowerGroup. Over the last 10 years, he has led research on strategic issues facing the global investment management and brokerage sector along with all the service providers that serve this market.

His current research is focused on the impact of the regulation on the securities and investment business and especially how it will impact the competitive positioning of various firms on both the buy side and the sell side. His research and opinions have been quoted extensively in major publications, including The Wall Street Journal and Financial Times and he has appeared many times on Bloomberg TV and CNBC. Dushyant is a CFA Charter holder and a member of the Boston Security Analyst Society. Without further adieu, the floor is yours Dushyant.

Dushyant Shahrawat: Thank you very much, Joe, and welcome, everyone, from here in Boston on a very cold day. Boston here is like, temperature is 35 degrees Fahrenheit. For those in Europe more used to Celsius, the high temperature is going to be three degrees Celsius. So, pretty cold out here. But I'm going to spend the next 30 minutes not talking about the weather fortunately, but about regulatory reform and particularly related to the securities and investments business globally.

I want to spend a fair amount of time talking about the Dodd-Frank Act in the States because obviously that's a big part of what is going to occupy definitely US securities investments companies as well as obviously the entire financial services industry. But also, I think it's got implications for global regulation because it sets the precedent for other things that might happen in Europe and Asia Pacific.

After the Dodd-Frank Act, we're going to spend some time talking about what some implications might be off not just the Dodd-Frank Act, but a couple other regulations that are on [inaudible] both in North America and in Europe.

So, let's get on talking about what's happening in the regulation space. At the highest level when you look at the Dodd-Frank Act, I think it's important to look at the relative impact on the investment management business and the brokerage industry compared to other types of financial companies that were impacted by the Dodd-Frank Act. So, on this slide very simply what we've done is try to lay out on a relative basis the relative impact of the Act on different types of financial companies.

So, you can see pretty clearly that in our view the most impacted forms are going to be broker-dealers and within that institutional brokerage guys are going to get impacted the most. Followed pretty closely by the retail banking industry, the hedge fund sector, private equity and commercial banks being in the center, and then the traditional buy side industries, the mutual fund sector as well as insurance companies would in our view be impacted the least because of regulation, particularly related to obviously the Dodd-Frank Act that we're talking about for the next couple of minutes.

When you look at what some of the major aspects are of the Dodd-Frank Act pertaining to securities and investments companies, I'd like to focus on seven things. Some of these are pretty straightforward, while others might have more in a downstream impact on the industry and impact may not be evident at first blush.

So, first clearly would be changes to regulators. You've already seen more power to the SEC. The SEC already expanded by about 490 people over 2010. So, at the end of the year close to about 4,000 people. They began the year at about 3,500 and they've got approval to hire another 500 people more next year. So, clearly the SEC is expanding a lot. You have similar expansion, not similar in terms of number of people, but in terms of greater amount of jurisdiction, clearly as far as Federal Reserve is concerned, other organization like the CFTC. Major agencies that are going to be created would be obviously the Consumer Finance Protection Bureau and the new Office of Financial Stability that is going to report into Treasury.

Within the Office of Financial Stability is going to be the Office of Financial Reporting or OFR, to which a lot of firms will need to provide data to and have reporting implications for definitely buy side and sell side shops. Second impact -- or second major aspect pertaining to the S&I business is going to be securitization. That's fairly straightforward. The biggest issue in securitization space is that firms will be required to maintain 5% of the assets that they are securitizing. In a sense the investment banks that securitize assets, for example mortgage pools, would have to keep some additional skin in the game.

Changes to compensation and governance are fairly straightforward. I'm not going to spend too much time talking about that. Number four is the reconciliation of standards for investment advisers and brokers. So, the reconciliation of the suitability standard under which brokers and advisers operate versus the fiduciary standard, which has long been the standard that investment advisers need to comply with.

FINRA has been asked to study how that whole issue of reconciliation between suitability and fiduciary should work out and they're going to report back to Congress I think towards the middle of next year with their verdict of that. Number five is still changes impacting all private pools of capital. And the two biggest being hedge funds and private equity and the biggest change there the hedge fund sector is obviously registration for hedge funds, which will have implications related to more reporting and overall greater scrutiny. Similar changes in private equity side even though it's not really on the registration side.

Number six is the Volcker Rule. I'll spend some time talking about it because I think it's very important to spend some quality time thinking about what the downside impact of the Volcker Rule might be. And the biggest aspect of the Volcker Rule obviously is restrictions on proprietary trading although there are two other aspects of the Volcker Rule related to involvement of investment banks and hedge funds and private equity.

And number seven is, not just only restricted to the Dodd-Frank Act but could also be implications of Basel III, would be limits on leverage and the amount of capital that banks

would need to hold related to the operations in the securities investments business going forward. So those are the seven major aspects pertaining to securities investments.

Let's look at what some of the observations might be in terms of what could come out of the Dodd-Frank Act. So, clearly I think at this point saying this is the biggest rewrite of financial rules since 1933 is pretty happy to say that - we all know that - sweeping change in rules. That's pretty obvious.

Number two just emphasizing the point that I started off with, that the impact on different types of financial companies is going to vary with brokers, retail banks being the greatest amount impacted along with the reformation of the credit rating process, so clearly the credit rating agencies would get impacted as well. Second would be commercial bank. And least impacted like I said would be traditional investment management firms, the mutual fund sector, as well as insurance carriers.

The major business impact, at least for the next two to three years, is going to be unfortunately bad news. Lower profitability, more capital requirements, and higher operating costs. Yes, there are going to be some silver lining to all of this. Hopefully lower risk. Better business practices, and hopefully helping investors regain some of the confidence that they lost in the markets as well as in the financial institutions over the last couple of years.

Number four, major overhaul of the derivatives business. Definitely and more importantly within the over-the-counter business, the OTC market. The implications of that are going to be -- it's going to hurt traditional ability of Wall Street firms to generate revenue from that and even more importantly profitability of the over-the-counter business, which has been fairly lucrative for the large brokers over the last couple of years. This Monday, New York Times here in the US had a cover story on the front page talking about the derivatives business and some of the politics behind the reform that is taking place in the OTC business. Highly recommend you read that.

And then like I said, the third bullet point under number four is that hopefully at least for the OTC business it could lead potentially to lower risk across the industry. Number five, the bill will come into effect slowly over time. So, you know that. That's no surprise there. Number six is that we need to clearly get used to new regulators and new powers in regulators. The Consumer Finance Protection Bureau will be a big deal overall in the industry, although the impact on securities investments companies will be somewhat less compared to the great amount of oversight that for example anybody in the retail industry, retail banks, consumer credit, anybody selling mainstream financial products to consumers is obviously going to feel the bigger brunt from the Consumer Finance Protection Bureau.

And number seven would be that I think it's very important to not just look at the direct implications of DFA in the short-term but looking at what the somewhat more longer-term consequences might be. And to the extent that it's going to alter the comparative positioning of firms that invariably new regulation tends to do. So, some firms will get hurt. Others will gain. That is obviously a work in progress for us from a resale standpoint to try to understand what the implications might be of the DFA going forward.

So, let's move on to the next slide talking about the Volcker Rule, which I think it's a very important part of the Dodd-Frank Act. This is a picture of Paul Volcker in the background here from the actual press conference where the Volcker Rule was first introduced by the President back in the first quarter of this year.

So, when you look at the Volcker Rule, let's look at some of the major implications of the Rule. So, the expected elimination of proprietary trading clearly would lead to a decline in a very profitable revenue stream for the large brokers. Unfortunately the large brokers don't really disclose the amount of revenue they've made from proprietary trading but we've got some estimates on how large this business may have been before some of the large investment banks began dismantling their proprietary trading desks, apparently dismantling, this summer.

We estimate right before that there were roughly about 750 proprietary traders affiliated with investment banks in the US before DFA got passed, which was in July of this year. And collectively they drove about 15% to 18% of market volume. So clearly were not an insignificant part of the market. And even more importantly like I said in point number one was they've been a very profitable revenue stream for the large brokers.

It could potentially lead to decline in trading volumes and less market liquidity. I'm saying "potential" because we're not really sure whether the dismantling of the proprietary trading desk is going to actually work out. In other words, a lot of large firms right after the passage of Dodd-Frank Act very publicly announced that they were shutting down the prop desks, but a lot of the prop desk business was actually moved into their other parts of the business, for example, the investment management businesses. So, Morgan Stanley as the management said, we are dismantling proprietary trading but a number of those traders have been moved over to Morgan Stanley asset management. Same deal with Goldman Sachs asset management as well.

Next could be that the shutting down of the prop trading businesses, if it continues over the next couple of years, could expose the tough economics in the agency business even more and force agency desks to restructure, like they did back in 2000, 2003 with the passage if you might remember of regulation fed disclosure as well as the global research settlement.

And the last point is that it might also force some diversified financial companies to spin off the brokerage subsidiaries to get around the Dodd-Frank Act or even think about more radical moves like moving registration overseas. So in effect when you think about investment banks not being allowed to do proprietary trading it's somewhat going back to the Glass-Steagall Act that separated commercial banks from trading actively as on their own behalf, on their own account, in the market.

So that's Volcker Rule. The other aspect of the Dodd-Frank Act that I think is particularly important to look at and investigate further is changes that it proposes to the OTC derivatives market. Within the OTC derivatives business the two biggest areas that are going to get impacted is going to be OTC trading and OTC clearing. And that all is going to start in 2011.

There are two major tenets of OTC derivatives regulation that regulators are basically trying to achieve. One is greater transparency and two is greater amount of standardization.

On the trading space the biggest change is going to be the creation of swap execution facilities or SEFs, which will essentially be responsible for trading OTC derivatives starting off with credit default swaps. It could potentially lead to over 20 SEFs being created over the course of 2011, which will be basically a major alteration of the market structure the way we've known that in the past in the OTC business.

On the clearing side the big change will be central clearing, which will change the economics of the OTC business we believe. And also could lead to a major overhaul of especially middle- and back-office processes. There are also going to be clearing center counter parties that might emerge. Different center parties for different asset classes as well as for different regions, which overall could add cost and complexity for investment management firms and sell side firms that operate in that space.

The implications of all this change to OTC derivatives could be that overall this could mean a major restructuring of the OTC derivatives business. Two, like I said before, that brokers and large banks that have long dominated this business -- so, JP Morgan Chase, Citi, Deutsche Bank, [inaudible], HSPC - firms like that, are clearly going to feel a jolt in terms of revenue from that and of course not to mention the large investment banks as well that have played a major role in the OTC business for long.

It could also open up the market to quite an extent for new entrants that have been trying to get into this business for a while, so, examples being firms like BNY and State Street. There's been talk about Bloomberg maybe have ambitions to BSF. So there might be new entrants that might emerge in the OTC business.

The opportunities for service providers to offer new services will be, starting off with basic things like connecting buy side and sell side desks and the order management systems to all these SEFs. That could obviously be a big driver of expenditure in that area. The last two points are more about looking at what the positive aspects or changes in the OTC business might be.

But with all this change it could lead to better price discovery, greater transparency, and overall lower risk. Price discovery and greater transparency would come from centralized trading of these -- on SEFs and the lower risk could come from centralized clearing of these instruments.

And clearly the entire OTC market could benefit from the great amount of automation and standardization that might take place in this space. If you look at the track record of the industry whenever it's automated, there is parts of the process, are automated trading in particular asset classes or products, it's usually after a certain adjustment period that could last between six and 12 months depending upon the kind of security being automated, it has led eventually to more volume, more transaction activity, and greater amount of breadth of participation in that asset class.

That happened -- that was true of equities, that was true of options, a lot of other asset classes. So, overall that could be true of the OTC derivatives business as well. So, I think even though we're going to go through a period of major change in the next 12 months as well as in 2012, hopefully for the long-term that could spell good news for the OTC business.

Just emphasizing the point that when it comes to the Dodd-Frank Act, the various parts of the legislation, will come into effect at different times. Like I said things like the credit rating agencies and how they're going to be reformed, the hedge fund process, all of that's going to see the light of day through 2011. The Consumer Finance Protection Bureau is expected to be fully up and running by the end of 2011. And then things like the Volcker Rule, the full amount of change in the OTC business as well as new capital requirements, that might be somewhat more pushed out to the next two to three years.

Collectively that means a lot of more rule making that's going to take place. The SEC alone is in the process of conducting 200 studies to come up with the actual rules that need to govern things like OTC derivatives for example or what leverage and capital requirements might be or should be for the industry.

Let's not forget obviously that then there's the issue of politics. With the change in Washington in November, that could also then obviously have major implications for the rule writing that's taking place right now as part of the Dodd-Frank Act. The two areas were already lobbying groups and there's been talk about some aspects of the Dodd-Frank Act that might be repealed are in the area of the Volcker Rule and as far as OTC derivatives is concerned. So, clearly it's not the Dodd-Frank Act passage and rule-making process is definitely alive and well and expect a lot more impact of -- political maneuvering impact in the process in 2011.

So, we've talked about the Dodd-Frank Act. There are several other regulatory initiatives. I'm not going to spend too much time talking about that because of constraints on time and I want to focus just on DFA because I think it's pretty important and something that there's enough out there to talk about and look at the impact of that. But here is a list of seven other things that are going to impact global securities investments companies.

First is market structure changes and trading amendments that are going to take place and I'll talk about some examples of what some of those areas might be. Second, the cost basis accounting whose genesis was back in the TARP program. That's clearly impacting broker-dealers as well as investment management companies already. A large number of our clients are very actively working on complying with cost basis accounting. So, that's occupying the attention of firms a lot.

Third is in the states changes to money market fund rules, that frankly were a lot more extensive than what firms had expected back in 2008 and 2009 when the people began talking about reformation of the money market business after the money market funds, a number of prominent money market funds, broke the buck back in -- through the financial crisis. So, changes to money market fund rules is obviously a big area of focus right now for

the industry. When it comes to Europe, there the big focus is on UCITS IV, Basel III, and the alternative investment fund managers directive. I would add to the list on there would be MiFID, too. So, clearly Europe is going to be pretty active when it comes to regulation as well.

And then coming back to the US very quickly is also going to be the US Foreign Account Tax Compliant Act, which is somewhat more narrow in focus but would have implications for regulatory compliance in the industry as well. So, clearly beyond the Dodd-Frank Act, there's a lot that firms will need to focus on. Let's spend a few minutes talking about some of the changes here and give a few seconds for these bills to work out because sometimes there's a lag between my click of the mouse here and you seeing the bills there.

So, let's look at some trading related regulatory issues that are still on the agenda. So, you can see that there's seven out here that have been listed, which is the short list. The long list could be as many as 15. The tick marks denote the two that have clearly have already -- regulatory action has been passed already. So, there are already restrictions on short selling in the states and in Europe. That's already done.

The final word on flash orders, actual IOIs, and the role of high frequency trading yet needs to come out. So those are still works in progress and expect regulators and the SEC in particular to act on those issues. Naked access, that's a no-no in the states so that was already passed. Fair access threshold, ATS trade reporting and commodity speculation are also going to be areas that are going to see the light of day in 2011. So, clearly when it comes to just trading itself, there's a lot of stuff that needs to see the light of day and expect more action on that in 2011 and stay tuned for what happens in those areas.

So, some salient points around what's happening in the trading space -- so, talking about what some of the issues might be in terms of trading and changes to market structure, point number one is that when we look at traders across the entire industry most traders that we talked to especially in the investment management side want greater transparency in the market. They also want a greater amount of clarification of the rules and responsibilities of firms that provide algorithms as well as the importance, the clarification of the role that high frequency trading shops play in the market.

Number two, the two areas being studied most right now by regulators are pre-trade risk management and the inter-market linkage. So, inter-market linkage refers to for example, the linkage between the cash equities business and the derivatives market that in part precipitated -- I'm saying only in part because of other factors as well -- the flash crash of May 6 this year.

Number three, two ideas gaining the most ground are the consolidated order trail and the trade reporting facility. Although obviously in the economic environment that we are in, there seems to be not a lot of support for the industry to be spending multi billion dollars on getting both of these initiatives up and running.



Number four, the flash crash particularly emphasized the importance of exchanges and SROs to have adequate capacity and the importance of modern trading infrastructure to manage high volumes.

Number five, that in the meantime like I said naked sponsored access and stub quotes are now not allowed, so hopefully at least are positively two of the issues that we had expected action on, that's already behind us. We know what needs to take place there. So, there's some stuff that are being taken off the table even though there are a lot of other issues that definitely as to works in progress.

So, just looking at the trading and the market structure space like I said, there's a lot of stuff yet to happen beyond the Dodd-Frank Act. In the meantime when you look at the list of the 10 biggest trading losses that have ever taken place in global markets, I think it's pretty telling that three of the 10 biggest losses took place in 2008 alone and almost none of them related to market structure problems or regulatory lapses but due to simply weak internal operations or weak internal controls.

So, as an industry we talk about changes in regulation having equally important reform to look at internal trading operations, back office operations, and make sure those are tied up pretty well, and complied with so we don't have these kind of massive multi-billion dollar losses that bring down not just firms, but really destabilize parts of the market.

Let's spend some time looking at what some of the implications might be of all this regulation on the industry. So, clearly when you look at the Dodd-Frank Act I think it's important to look at what the long-term impacts might be and some of the unintended consequences might be. On this slide I'm going to put out five potential unintended consequences. So, the first is the changes to the securitization market requiring investment banks particularly to hold securitized assets on their books, could essentially dampen some of the stupendous growth we've seen in the securitization market definitely in the last 10 years before the crisis hit. So from 1995 I'd say to about 2007, so about a 12-year period.

Second, changes to the derivatives business in the short-term could lower the ability of corporates and investment firms to perfectly hedge their exposure, so greater amount of standardization might also mean less amount of custom products being created for corporates and investment banks. That might mean that don't have the ability to exactly match their exposure with the OTC products they could historically have had banks deliver to them.

In a standardized market if you're trying to match precisely a three-year exposure, let's say you have to currency exposure the ruble, the currency swaps in a standardized market might only be available for a two- or a four-year horizon. You may not be able to match exactly a three-year exposure.

Third, the elimination of proprietary trading with the Volcker Rule like I said could lower brokerage profits, pressure agency brokers, and could have a knock on effect on the level of service that agency brokers offer out to the buy-sell clients.

Four, the reformation of the credit rating markets. The potential impact of that might be on hurting bond issuance and could also potentially hurt secondary trading at least in the short-term.

And number five, the reconciling of the fiduciary standard with the suitability standard for financial advisers, investment advisers, could mean more expense to investors as payment mechanisms shift more to a percentage of assets of the management.

Beyond all of that, I think without exaggeration the consequences of the Dodd-Frank Act definitely could be, could impact US competitiveness and not to again exaggerate, could impact GDP growth frankly going forward at least in the States.

When you look at what the SEC is doing in terms of gearing up, clearly one of the areas they're going to be deploying the thousand more people that they expect to get by the middle to late part of 2011, like I said 500 have already been hired in 2009, 2010, another 500 expected in 2011. One of the areas that clearly is going to feel the brunt of that is going to be hedge funds. I think the Maddox scandal particularly is not going to be something the SEC is going to forget anytime soon. And I think that you're going to keep seeing pressure on the SEC from that.

We've already seen a big uptick in the amount of hedge fund examinations. Our estimation is that those examinations are going to continue to go up. And by 2012 you're going to almost see the examinations double over a period of five to six years. Great amount of SEC registration is going to require firms to obviously focus more on greater amount of reporting, record keeping, disclosure, internal controls, and compliance.

The competitive impact of all of this might be that -- and this is more of like I said a work in progress for us and I'd love to see what folks on the phone feel as well -- is it how will the competitive positioning of different types of firms change because of all this regulation. So, if you look at just over a period of -- what that chart basically shows is over a four or five quarter period between Q3 of 2008 and Q3 of 2009, it actually shows you the list of the rankings of different types of investment banks and the lead table is based on the commissions that they generated.

And over that four-quarter period, there was a fair amount of firms that moved up and down that list. So, within four or five quarters essentially there was a big shift in the rankings of firms on the sell side. On the investment management side between Q4 of 2007, frankly that's turning out at least it comes out better in terms of format, so over a two-year period between 2007 end of year and 2009 end of year, you saw a big shift in who is on the top and who is in the middle.

State Street clearly went down from number one to number two, Fidelity stayed flat even though assets went up 50% and the biggest change obviously was the combination of BGI and BlackRock shooting up to number one and being almost about 50% more in assets compared to number two and number three, compared to Fidelity it's actually more than twice as much. So the question really is that with all this regulation that's going to come

down the pike, what's going to be the change in terms of competitive positioning of firms going forward? Who's going to win, who's going to lose?

Our view on who might gain and who might lose in the broader financial industry when it comes to investment banks, obviously there'd be weak revenue prospects for them. Some high margin businesses hurt for them, so, for example prop trading as well as OTC business.

We clearly think that Goldman Sachs and Morgan Stanley being the -- still being the dominant brokerage franchises in the states if not globally, are going to thrive and do pretty well. As well as some international banks might gain over US firms. You've already seen them gain a fair amount in terms of terms of market share in the last three to four years. Barclays for example being a fine example of that.

The retail brokerage space, even though this session today is not focused on the retail brokerage market, some bright spots there except that investment confidence in the retail investment market or the retail investment market still stays pretty low. Hopefully it's going to come back over the next couple of years.

There are four major winners in the retail brokerage space at least in the states, the combination of Morgan and Citi, Schwab, Wells Fargo, and BofA.

On the commercial banking side the most diversified commercial banks like Citi and HSBC and JP Morgan Chase, high capital charge is going to hurt their profitability and clearly they're going to feel the burden of more risk management and compliance expenditure. Having said that, we think large commercial banks are going to continue to do well, maybe not as well as they've done over the last let's say five years before the crisis.

The mutual funds sector like I've said twice now is going to be relatively unscathed from the financial crisis, or at least from regulations. Might be impact from the financial crisis as it pertains to loss of investor confidence. However there are some long-term challenges for the active management business on the mutual fund side. They are continuously obviously squeezed between passive management on one side [inaudible] index funds as are those pure alpha strategies like hedge funds.

On the hedge funds and private equity side, obviously major regulatory change might drive up costs but in our view the future is still pretty bright for the hedge fund sector and the assets and the management are going to continue to grow. Already in 2010 we've seen the hedge fund sector weaken -- a lot of the market share they lost -- a lot of the assets they lost between '07 and '08.

On the custodian bank and prime broker side and the fund admins, so all the people that service this market, that's pretty good news because I think they're going to be a lot more demand for their services to help buy side firms and sell side firms comply with all this regulation.

So, just a couple of quick points in terms of impact of all this regulation on IT operations, we think that clearly there's going to be more and more expenditure. We're already beginning to see happen in risk management and compliance. Four other spending areas are going to be on surveillance, all kind of surveillance from trade surveillance, employee surveillance, market surveillance. All kinds of reporting, client report, regulatory reporting, internal reporting for internal purposes. More focus on data management and then a great amount of demand for business rules management. It's something that IBM is going to talk about and Joe is going to talk about pretty shortly.

I think enhancing transparency and disclosure are major themes that are pretty evident through all of this regulation. Four, institutions I think in part because of all this regulation are going to reassess the service provider relationships, not just for the technology providers but for example asset managers looking at the outsourcing relationships, with the brokerage firms thinking about -- smaller brokerage firms thinking about using even more bulge bracket firms. So, almost outsourcing some of their -- some of the trading as well as middle- to back-office activities to large broker-dealers.

And then number five is that we still think that new regulations might drive some innovation and create some kind of a boost to things like ASP delivery and cloud computing.

Talking about risk we think I think clearly it's going to be a big focus on risk across the entire industry. This is a map of the way we look at risk, [inaudible] basically who's going to be focused on what kinds of risk most going forward on a relative basis.

Some quick conclusions, I think as I've said once and more than once today, despite the attention grabbed by the Dodd-Frank Act that a lot of other regulatory initiatives facing securities and investments companies, hedge funds and brokers especially institution brokers will face the brunt of most of this regulation with long-only managers coming out relatively unscathed.

Greater regulation unfortunately is the shock on bad news in terms of lower revenues, higher costs, and lower profitability. Like I said especially in the areas like prop trading and OTC derivatives. Hopefully that also means the long-term low amount of risk especially in the OTC business.

Regulation is going to cause a shift in the economic motivation of firms as well as the strategic positioning of firms not to mention the industry structure. And last, it's some good news for IT expenditure. We believe that IT expenditure might grow going forward a little bit, especially in the areas like reporting, compliance, surveillance, and risk management.

That's my part of the presentation. I'll hand it over back to Joe and hopefully we'll take some questions at the end of the session.

Joe Boissy: Sure. Will do. Thank you, Dushyant, that was a great insight on what's going on in this heavily again regulated market and you know it's kind of scary when we see all this list of things that are coming and we see the timeline even though the DFA will happen

gradually. There's a lot of things that are hitting us already today and certainly we need to brace for this impact.

I'm going to just wrap up with more on the IT side of the things and share with you some of the aspects of what we are seeing from an IT perspective in terms of the regulation and compliance. And I really like to tell this story because I keep remembering it, it's really a nice story. When I was talking to a head of compliance at an investment firm that was quite -- I think a couple of years ago, and he was asking me something. He said, "you know, Joe, what's worse than not being compliant in a particular regulation?" I said, "I don't know." He said, "what's worse is not knowing if you're compliant or not." And that's the -- really the scary part is that it's not being as compliant or not being compliant or being -- following the regulation, not following the regulation, it is do you really know if you are following the regulations or not.

So, I'd like to start by showing you this chart here that really shows the implication if you like. It's a span of many things -- a lot of things on this chart, but if you look at the trade cycle from inception to settlement, from the front office to the back office including the middle office, all the risk management, etc.

There's a lot of areas that needs compliance, that needs scrutiny, understanding, better looking at what's going on. And what's the central hub of this thing from an IT perspective is a way of managing, looking, understanding what's going on and monitoring. And typically the problem has been over the years is that of course typically what you have is a number of systems. Not even one bank has one system as you know. There's a lot of different systems either by merger and acquisitions or by legacy system, inheritance, and things like that and you end up with a very nice chaos if you like.

And on top of that you need something at the hub of that that can help you doing that. And what we advocate for is what we call the decision management and the decision management system is no more or less than a business tool at its heart, a business rule management system, or BRMS.

I know this acronym might not resonate for all of you but those of you who are not familiar with terminology; BRMS stands for Business Rule Management System. At the heart of this BRMS is a central repository where you have -- you can store all the rules, the regulations, the policies that mandate whatever you need to do in terms of at any point in time during the period cycle.

The challenge of course is typically these things do exist today. You have them somewhere in your systems, in your Excel spreadsheets, even in sometimes in the policies are written somewhere and the playbooks. The challenge is that these are scattered around. They're not centralized. Now what BRMS helps you do is on one side centralizing them and the other side it helps you writing them in a business language and that's very important.

We're not talking IT here anymore. We're not talking programmatic language. We're talking business language. By that I mean that a trader, a broker-dealer, a risk manager, a back office

clerk, these are the people who will be able to modify, change and author these rules. And of course there are ways of managing and governing these rules but the essence of the whole thing is that it's not giving any away, any more to the IT people because that creates a lot of additional issues, problems, and of course it lengthens the cycle to be compliant.

It gives you the possibility of being accountable directly at the desk. And so I'd like to share with you one example in fact of our customer, a customer here in Wall Street, and this customer in fact was typical in fact in facing the situation. They had seven trading desks in fact with different trading systems and of course different trading rules. It's a major financial services company here and they have -- and we're talking here about the global equity middle office, which handles roughly \$120 billion in stock.

So, having multiple equities trading means multiple processing platforms. So, what they did is they, again did what we advocate for, which is putting a centralized rules system where they have all the rules now of the regulations and the rules were doing everything from the validation, the pre-validation, the checking, the classification, the allocation, up to the exception management. And that gave them a lot of visibility in the system because as Dushyant was mentioning, it's not only about having being able to follow and have a surveillance system, but you need reporting.

What's more important? The SEC is beefing up their staff as you can see and you need to be able to show, to prove, that you are compliant. And a BRMS system with the press of a button can tell you exactly what is being acted as rules and what is being executed. So, this will ensure, and in this particular case in fact it was also related to a MiFID because they had a lot of operations in Europe so they were able to be clear about it, ensuring for example from the client order handling.

Ensuring that the firm is acting on the client's best interest, the full transparency when it comes to bids and offers, making sure that the market makers and everything is available. Again, post-trade transparency, making it public the price, the volumes and all the trades listed and all the shares and of course ensuring the best execution, which means that they're making all reasonable steps are shown to the customer to obtain the best possible results, the best possible execution for any order coming from a client.

And all that was shown using the rule system, which is able to showcase everything and making sure that not only you're able to show it, but you're also able to report it and you're able to audit to it. So, to finish, to wrap-up on that, I'd like to give you five points that why BRMS can help you in fact in your compliance journey if you like.

So, the first one is the decision automation. Dushyant mentioned something that is going inevitably go higher and it's the operating costs because of new regulations, because a lot of things. So, one of the easiest ways of reducing and containing this cost is automating as much as you can in these rules. And that's where a BRMS system can help you do, by automating most of the work and you delegate the work only with exceptions, you can go back to manual work, which means that you're now spending quality time having your individuals, the

traders spending their quality time and not spending things on regular stuff that can be automated.

The second piece is responding to change and you saw that from Dushyant's demonstration there's a lot of changes coming up down the road and inevitably every other -- around the corner there's a new regulation coming down. A BRMS system will help you immediately because of the fact that you don't have to go into -- through lengthy IT cycles you are now able to make the changes to the rules and some of these rules can be very, very simple yet we have a very harnessing system for making sure that the rules are being executed properly.

Third point is as I mentioned again, it's a multi-platform consistency. Again inevitably in any investment firm, any broker, you have a lot of different systems coming from a variety of different legacy systems, modern systems, acquisitions, things like that. A BRMS allows you to have a consistency because of the central repository allowing you to make sure that every single deal, every single trade regardless of the trading platform is using the same and following the same rules.

Testing and simulation, that's number four but it's very important. Again, you can return to a certain extent, I heard customers saying we are making -- trying to make this thing as much as possible proactive than reactive. By that when we know there's a DFA coming, when we know there is a new regulation coming down the road, when we know we're going to be eliminating proprietary trading by the Volcker Act, what do we do?

Well, we put together the systems, the rules that will enable us to make sure that this will not happen, or this will happen as we see in the rules. And from there you are able to simulate and run the whole system and decide before hand what are the changes that you have to make in your organization from a structural perspective and from the organizational perspective in order to cope with this coming change.

And last but not least, is transparency. This comes automatically with the BRMS because it gives you the possibility of any time to see what are the rules that are putting in place. But also you have the traceability, which means that every single time you can trace back a trade and have a full audited trail that gives you a possible [care] of tracing what where the rules that were executed to get to the point to get that execution in place.

Now, you are -- might probably a question, which is okay, so now the list looks very nice. I'm interested. What's next? So, we have something dedicated for that called a Discovery Workshop. It's a two-day workshop, free of charge. We have business people and IT people in the same room and we give you in fact the story of what we're doing. We showcase examples of how it -- and we put together a program or a project from which you can build up the story and tell the thing.

And that's really been very efficient. We've been doing that for the last two years and it's very successful in really ramping up sort of a quick kick-start in building a BRMS project. And there's -- here you see on this chart a number of literature that you can go to, white papers

and success stories that you can refer to to get better -- understand and educate better yourself on the BRMS.

I'd like to finish by inviting all of you to come to our Impact2011, which is our user conference. It happens once a year for IBM, for WebSphere, and this year it's in April. It's in Vegas. Over 6,000 people from multiple industries and certainly a lot come from the securities industry. We discuss -- this is an ability for you not only to meet with IBM and see the latest and greatest that we have, the announcement and the demos, and on the show floor, but certainly you'll be able to see what -- to meet with our partners and more importantly you also meet with your peers and the industry and mingle with them and see what kind of IT solutions they are putting together.

So, the deadline is for getting the super price for the early bird is February 18. I certainly encourage you to go and register to our Impact. With that, I thank you very much and now I think it's the Q-and-A. Back to you, Eric.

Eric Sherman: Thanks a lot, and before we begin with today's Q-and-A, we would ask you to please fill out the feedback form that has opened on your computer. To complete the form, please press the Submit Answer button at the bottom of the page. Thank you in advance for filling out the feedback form. Your participation in this survey helps us improve future webcasts.

And now onto the question-and-answer portion of our event. As a reminder, to participate in the Q-and-A, just type your question into the text box located below the media player and then click the Submit Question button. And our first question today is for Dushyant, referring to a Wall Street Journal article yesterday, Dushyant, someone's asking what is the impact of the federal government budget constraints and subsequent slow down in investigative work being done by the SEC on the implementation timeline of the DF legislation?

Dushyant Shahrawat: Well, thanks for your question. Anybody who could try to figure out the inner workings of Washington, I think is definitely -- could answer the question a lot better than I can because I can talk about what is part of the Dodd-Frank Act but in terms of wagering a guess in terms of what the push back might be or the time frames might slip because of either political issues or restraints or constraints on budgets that are offered for the rule making to take place, that obviously could throw a monkey wrench in terms of how the Dodd-Frank Act timeline actually lays out.

I frankly don't -- the bigger concern for me is not that the timelines might slip, which I think they might slip to a certain extent by about two to four quarters depending upon certain parts of the rule making, the biggest concern for me is that some of the rule making might change the tone and the intention of what was passed in the Dodd-Frank Act. So, for example, if there is some aspects of the OTC derivatives business, some of those rules are amended, or changed in some way, that could actually take us away from achieving the goals of greater amount of transparency and price discovery and lower risk in the OTC business.



That to me is a bigger risk in terms of political pressures, other factors, changing parts of Dodd-Frank Act or some other regulations so we don't really achieve what the true intention of all that rule making was. That's a bigger issue for me, a concern for me than the timeline slipping.

Eric Sherman: Dushyant, there's another question for you too. With the additional regulations do you believe the additional work will fall primarily on internal employees or external service providers?

Dushyant Shahrawat: Yes, now that's a question I can talk about. I think so the question very simply again to rephrase it is that with all this new regulation is it really going to be more work internally or is it going to drive more external expenditure? Clearly as a longer-term trend, both on the buy side and the sell side and particularly the buy side, expenditure has been shifting more to external service providers. That's true of software. That's definitely even more true of services.

Outsourcing, all of that is directly again in that direction. So, that longer-term trend in terms of less work done internally, more work done externally is going to continue. Within that when it comes to regulation, I think it depends upon what kind of firm you're talking about and what types of regulation you're talking about. So, for example when it comes to OTC derivatives a big part of that I think is going to be pushed out to external service providers for a myriad number of reasons.

One, because the complexity and the skill set required for firms to make changes in OTC derivatives may not exist in most firms themselves internally. So, definitely [inaudible] the large buy side shops, they might OTC derivatives trading desks, but all of that is going to be focused on -- not just currently focused on their current book of business, but also having adequate time and capacity to deploy those people for all that stuff that needs to be changed with all the rule making that is going to take place.

So, for example, all the SEFs that are going to come out, the Swap Execution Facilities, having to connect and route the management systems to those SEFs, I don't see the buy side firms being able to do that internally themselves. They're going to have to go out to external service providers for that. So, clearly I think the bulk of the work I'd say if I was to wager a guess, two thirds of the work is going to be more for external service providers helping firms like, or types of firms like custodian banks for example, as well as prime brokers. So it's good news overall for the external service providers and I think one third of the work pressure is going to be on internal employees.

Eric Sherman: All right. Joe Boissy, a question for you. What do rules look like in an IBM BRMS and how is versioning handled?

Joe Boissy: Can you please repeat? How is --

Eric Sherman: How is versioning handled?

Joe Boissy: Okay. Well that's a good question. The rules are -- they are presented in again in a language that is the closest possible to the business language. And by that I mean it is for example if the counter party we're dealing with exceeds that personal limit, then tell the trader you're exceeding the limits. Things as simple as that in plain English. So, that's the format you would see the rules. And that's why the traders, that's why the people on the business side can create the rules.

The versioning however, we have a full-blown governance system that allows you in fact to determine who does what. So, of course one of the questions that can typically come is that, okay, well, you now are asking people on the business staff to create tools. How do you guarantee that you're not creating chaos? Well, the system comes with a fully developed permissioning system, a governance system, that gives you in fact who and what and where. Which means that who can make rules, who can change rules, who can author rules and what kind of rules can you do and what kind of permission, what kind of tool you need to do that.

The basic difference is that you're not going to IT every single time so that makes you gain a lot of time. But still you have a full governance system, that means that you can decide who does what when. Now, when it comes to versioning, that means that you can decide on which version is going to be put in place and many of our customers what they do, they have a special versioning in fact that gives them the possibility of either retrofitting back and saying exactly for example, when you see what was the version of the rule that was in act two month ago when we were doing that particular, when we were still implementing that thing?

So, we give you that possibility and the versioning allows you again to have a number of systems. So you have a system for testing and simulation and a system for production and deployment.

Eric Sherman: All right. Joe, one more question for you, sort of somewhat connected here I think. You mentioned rule consolidation in a centralized rule repository, what safeguards, tools, and processes are available to avoid chaos and errors?

Joe Boissy: I think I partially answered that question already, again, we have a full blown governance system that is really built in a way and it's based on a very thorough methodology that allows you in fact to create the vocabulary from which you are going to be able to create the rules first, but also again deciding who is going to be doing what. So, this will give you the possibility of determining in fact the permissioning system, the hierarchy, how many approvals you need, and what kind of rules.

I mean, many times we have situations where rules are in fact created in separate buckets. So, they have the fundamental rules, the rules that are infrastructure and these are probably maybe still managed by IT. But then the bulk of the rules are business rules and the business rules are maybe bucketed in different types. There's the simple ones and there's the sophisticated ones. The simple ones for example everyone or a large number of people can modify, change the rules, ratings, etc., etc.

And there are the ones that are more fundamental that require more knowledge and these will be reserved to a certain number of people depending on their permissioning. So, this will give you the possibility in fact of deciding how and where you're going to do that. But more importantly I think above all that, you still have an audit trail. So, every single time a rule is changed, modified, or created, you have a trail that tells you who, when, modified that rule and who approved that rule. So, you can have a foolproof transparency and you can still do that in the reporting.

Eric Sherman: All right. Well, we seem to have come to the end of our time. Thank you for attending today's webcast, Wall Street Reform -- Bracing for Impact, brought to you by Wall Street and Technology and IBM.

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On behalf of our guests, Dushyant Shahrawat, and Joe Boissy, I'm Eric Sherman, thanks for your time and have a great day.