

FINANCIAL REFORM

Dodd-Frank Central Clearing



The Dodd-Frank Wall Street Reform & Consumer Protection Act sets out that certain derivatives contracts must be cleared through a Central Clearinghouse (CCP).

Impact

Central clearing is designed to standardize certain swaps, promote transparency, and allow market participants to mitigate their counterparty credit risk to dealers.

Currently, most swaps are traded on a bilateral, principal-to-principal basis with your ultimate counterparty being the entity with whom you executed the trade. Under the new mandatory clearing regime, your ultimate counterparty with respect to cleared swaps, will no longer be the entity with whom you traded. Rather, your transactions will be submitted through a clearing member, acting in an agency capacity, to a Central Clearinghouse (CCP) for clearing. (The trade flow for cleared swaps is similar to that of futures.) Once cleared, the Clearinghouse is the counterparty to all trades, and the regulatory bodies (CFTC and SEC) require that the Clearinghouse has appropriate tools and procedures for risk mitigation. Uncleared swaps will continue to be traded on a bilateral basis with a swap counterparty under an ISDA Master Agreement between the parties.

Which regulatory authorities will govern swaps?

Regulatory Authority	Products
SEC	<ul style="list-style-type: none"> ■ Security-based swaps, which reference single-name debt or equity instruments or narrow-based indices
CFTC	<ul style="list-style-type: none"> ■ All other swaps, such as swaps on all rates and commodity products ■ Broad-based indices ■ FX options ■ Non-deliverable FX forward contracts
SEC and CFTC	<ul style="list-style-type: none"> ■ Mixed swaps, security-based swaps that also have a commodity component

Timing

It is expected that clearing of credit default swaps and interest rate swaps will become mandatory in the US as early as the fourth quarter of 2012, likely followed by non-deliverable FX forwards.

Currently, it is expected that certain interest rate swaps will be cleared through LCH.Clearnet and CME Group (Chicago Mercantile Exchange Group) and credit default swaps will be cleared through ICE (IntercontinentalExchange) and CME Group. Each of these CCPs has submitted applications to the CFTC with a list of proposed credit and rates related products to be subject to mandatory clearing. We believe CCPs would also likely offer to clear non-deliverable FX forwards in the near future.

Dodd-Frank Central Clearing



GSAM's Readiness

GSAM has been actively preparing for mandatory clearing on behalf of our clients. We have been building out internal systems as well as establishing connectivity to the CCPs, clearing members, and middleware (matching and affirmation tools) providers and negotiating credit limits and clearing documents with clearing members. We will continue to conduct extensive tests with clearing members and CCPs through the third quarter of 2012. We will be ready by the implementation deadlines for mandatory clearing.

The primary documents required for central clearing include: (1) a Clearing Agreement with each clearing member, (2) a Give-Up Agreement with each executing broker, and (3) OTC Clearing Addendum with each clearing member (which incorporates by reference the rules of each of the CCPs).

GSAM is actively negotiating clearing agreements with multiple clearing members who were selected based on a number of criteria including, but not limited to, business, economic and legal terms, documentation and onboarding process, operational readiness and counterparty credit worthiness. GSAM is also a participant in the industry working groups that are developing standardized templates for the Give-Up Agreement and OTC Clearing Addendum.

Client Considerations

Margin

The CFTC has outlined an initial margin methodology framework which CCPs must adhere to for cleared swaps. To date, the SEC has not released its margin requirements yet in relation to cleared security-based swaps. Collateral would be agreed with the clearing members on a daily basis. The GSAM collateral management team would confirm margin calls and collateral movements as part of our best practice procedures.

Fees

It is anticipated that fees associated with cleared swaps will include: (1) a clearing member fee, (2) a clearinghouse fee, and (3) an execution fee (should the instrument be traded on a swap execution facility). The pricing structure will likely be per million and vary by product and clearing house. Uncleared swaps are not subject to such fees.

Clearing Member Selection

Where we have been authorized by clients, GSAM will elect a primary and secondary clearing member based on our selection criteria and clear trades utilizing GSAM negotiated clearing agreements.

Credit Risk

Central clearing is intended to reduce credit exposure for clients by making the clearinghouse (CCP) the ultimate counterparty. It is important to note that we have undergone a rigorous selection process and are negotiating with several clearing members and CCPs to further minimize risks for our clients. GSAM is making arrangements to have secondary clearing members in place in case the primary member rejects the trade or defaults. In case of a default of a clearing member, GSAM will look to port our clients' trades to another available clearing member.

For more information on Central Clearing, please contact your
Goldman Sachs Asset Management Relationship Manager.

This material is provided for educational purposes only and should not be construed as investment, legal or tax advice or an offer or solicitation to buy or sell securities. The information that was discussed concerns general market activity, industry or sector trends, or other broad-based economic, market or political conditions.

This material has been prepared by GSAM and is not a product of the Goldman Sachs Global Investment Research Division and should not be construed as investment research. The views and opinions expressed may differ from those of the Global Investment Research Division or other departments or divisions of Goldman Sachs and its affiliates. This information should not be relied upon in making an investment decision. The regulatory landscape relating to this material continues to evolve and remains subject to further changes and developments. GSAM has no obligation to provide any updates or changes.

Confidentiality: No part of this material may, without GSAM's prior written consent, be (i) copied, photocopied or duplicated in any form, by any means, or (ii) distributed to any person that is not an employee, officer, director, or authorized agent of the recipient.

© 2012 Goldman Sachs. All rights reserved. 4672.OTHER.MED.TMPL/6/2012