

THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

How the regulatory environment for derivatives is changing

J.P.Morgan

WHAT IS THE DODD-FRANK ACT?

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Dodd-Frank Act" or "the Act") was passed following the financial crisis of 2008. The Act is broad legislation impacting several areas of the financial services industry, including certain parts of the Over-the-Counter (OTC) derivatives and Foreign Exchange (FX) markets.

A WORK IN PROGRESS

The Act includes a number of new rules and regulations, some of which are already in force, while others have yet to be phased in. Full implementation will be accomplished gradually over the next few years, and the regulations may evolve as they are implemented.

While this booklet sets out the main requirements of the regulations, these are subject to change. We aim to keep you fully up-to-date at every stage, and we are working hard to streamline the way our clients trade the affected products. For your reference, we have included definitions of some of the terms you may encounter.

HOW WILL DODD-FRANK IMPACT OTC DERIVATIVES?

The Dodd-Frank Act covering OTC derivatives and FX products significantly changes how these instruments will be traded. These changes are intended to:

- Regulate the market to improve transparency and efficiency
- Reduce credit and settlement risk for buyers and sellers
- Reduce some of the systemic risks in the United States (U.S.) banking system

All parties trading OTC derivatives and certain FX products in the U.S. will be impacted by the new regulations.¹

Execution. Certain trades will eventually be executed on an exchange or an electronic platform known as a Swap Execution Facility (SEF).

Clearing. All parties, except those who are "commercial end users" or who enter into "bespoke" trades, will be required to clear certain trades. Trades requiring mandatory clearing will go through a Derivatives Clearing Organization (DCO), also known as a Central Counter Party (CCP). Effective dates for the clearing requirement will be phased in by product and type of market participant. While not finalized as of the date of this publication, we anticipate that mandatory clearing will start in March 2013 for Interest Rate Swaps (IRS) and Credit Default Swaps (CDS).

Margin and collateral. For cleared trades, clients will need to post margin and collateral to a CCP instead of to J.P. Morgan.

Reporting. Trades in the products impacted by the Act must be reported to a central Swap Data Repository (SDR) on a timely basis.

¹ Clients outside the U.S. may be impacted by some of the regulations. We will contact such clients separately as the rules are finalized.

Glossary

Swap Execution Facility (SEF):

A facility, trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by other participants.

Derivatives Clearing Organization

(DCO): Also known as a CCP.

A clearinghouse that is registered with and regulated by the U.S. Commodities Futures Trading Commission (CFTC).

Central Counter Party (CCP):

Also known as "Central Clearing," the CCP interposes itself between every buyer and seller. It streamlines and simplifies post-execution trade processing, sets trade margin requirements, ensures margin requirements are met and accounts are properly settled. Any derivatives trade transacted by a CCP is deemed "cleared."

Swap Data Repository (SDR):

This is a new entity created by the Dodd-Frank Act in order to provide a central facility for swap data reporting and recordkeeping.

Glossary

Executing Broker (EB): A trading member that executes trades on behalf of its clients. Many Executing Brokers are themselves Clearing Brokers, known as "self-clearing." J.P. Morgan is an Executing Broker for OTC derivatives and FX transactions.

Clearing Broker (CB): Also known as a Clearing Agent. A clearing house member that can clear its own proprietary trades, client trades (as agent or riskless principal), and/or trades executed by other trading members.

Futures Commission Merchant (FCM): All Clearing Brokers are required to be FCMs. FCMs solicit or accept orders for the purchase or sale of any commodity for future delivery on, or subject to the rules of, any exchange that accepts payment from, or extends credit to, those whose orders are accepted. J.P. Morgan is a registered FCM.

WHICH DERIVATIVES TRANSACTIONS WILL BE AFFECTED?

Various trades will be impacted. These include:

- Swaps
- FX, Commodity and Fixed Income Options
- Forwards²

EXECUTION AND CLEARING: HOW WILL THE PROCESS CHANGE?

How will products be executed?

It is anticipated that SEFs will be established to execute cleared transactions. Until then, financial institutions acting as Executing Brokers will execute these transactions.

How will products be cleared?

The Dodd-Frank Act will classify OTC derivatives and FX transactions into three categories: cleared, uncleared and exempt.

- 1. Cleared:** Most OTC derivatives will be required to clear through a CCP, which will streamline post-execution trade processing. The CCP becomes the counter party between every client and Clearing Broker for the cleared transactions, and also will hold all collateral posted by clients. A Futures Commission Merchant (FCM) will act as a Clearing Broker and will interact with the CCP.

All products within scope that the CFTC has mandated to be cleared will need to be cleared. Plain vanilla products such as CDS and IRS will be the first products required to be cleared by the legislation, followed by other products.

- 2. Uncleared:** In addition to those transactions entered into by "commercial end users," J.P. Morgan anticipates that certain complex or illiquid derivatives transactions will continue to trade over-the-counter. Certain "bespoke" transactions also will be uncleared.

- 3. Exempt:** Some products or transactions are exempt from the new regulations; for example, structured notes, most equity options, and FX and commodity spot transactions.

Note: Legacy transactions (any OTC derivatives transactions that you entered into prior to the effective date of the provisions) are exempt from the majority of the new Dodd-Frank requirements, but will be subject to the transaction reporting requirements. Rollovers, however, will be subject to all the requirements.

In summary, clients will execute trades with an Executing Broker, clear through a Clearing Broker, and their collateral will be posted to a Central Counter Party.

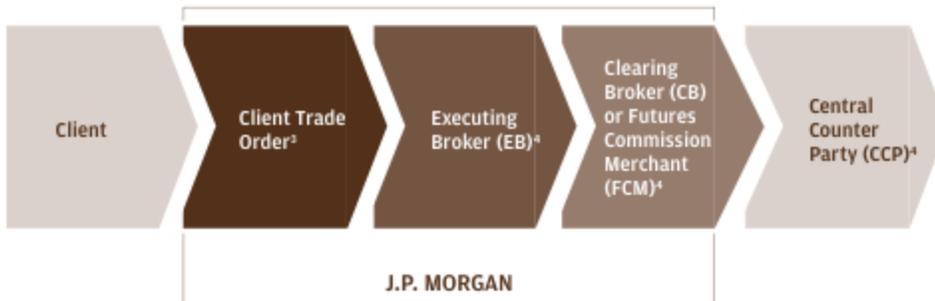
Clients can choose the Executing Broker, Clearing Broker and CCP they wish to use to transact derivatives.

J.P. Morgan is able to act as an Executing Broker for OTC derivatives and FX transactions, and the firm is also a registered FCM, enabling it to act as a Clearing Broker. J.P. Morgan will have separate teams to handle your derivatives execution and clearing needs.

² Certain forwards may be exempt from some of the requirements, subject to additional clarification by the regulators.

DODD-FRANK MODEL OF TRADE CLEARING

The diagram below shows the new trade execution and clearing process for J.P. Morgan clients. One key change from the current process is the role of the CCP. With these new requirements, a CCP sits between every buyer and seller, streamlining and simplifying post-execution trade processing.



J.P. MORGAN: A RECOGNIZED LEADER IN OTC CLEARING

Under the new legislation, clients are able to choose a Clearing Broker. In making this choice, clients should consider various criteria, including risk management capabilities; we believe there are a number of compelling reasons to continue your relationship with us.

J.P. Morgan is a recognized leader in OTC clearing, and was named **OTC Clearing Service of the Year** in 2012 by *Risk* magazine in its *Risk* awards. The firm provides clearing services through J.P. Morgan Securities LLC (JPMS), which is rated A+ by both Standard & Poor's and Fitch Ratings.

Risk management is of paramount importance in clearing, as in all of our other lines of business. We have dedicated teams managing the contingent market risk of each clearing client's portfolio on an intraday and real-time basis.

- We can offer our clients operational readiness, with continued investment in technology
- We are a top-tier futures and options broker, with 30 years of experience in providing our clients with research, sales, execution and clearing services
- We have cleared interdealer interest rate swaps to LCH since 2001 and have supported LCH, ICE and CME client clearing platforms since their respective launches

³ Will occur with J.P. Morgan Private Bank or J.P. Morgan Securities.

⁴ Clients can choose the Executing Broker, Clearing Broker and CCP they wish to use to transact derivatives.

General Definitions

U.S. Commodity Futures Trading

Commission (CFTC): The U.S. Congress created the U.S. Commodity Futures Trading Commission (CFTC) in 1974 as an independent agency to regulate commodity futures and option markets in the U.S. The agency's mandate has been renewed and expanded several times since then, most recently by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

LCH Clearent Limited (LCH): This organization operates the SwapClear service. It is regulated as a CCP by the CFTC, and recognized as a clearinghouse by the U.K. Financial Services Authority (FSA). LCH clears a broad range of OTC and exchange-traded cash and derivatives products, and is the largest global clearer of OTC markets, clearing for major international trading platforms and exchanges. It is owned 83% by users and 17% by exchanges.

Intercontinental Exchange (ICE):

Established in 2000, ICE is a leading operator of integrated OTC and futures markets, offering clearing, processing and data services for global derivatives markets. It is the global leader in OTC energy and credit markets, as well as listed derivatives in energy, agriculture, equity indexes and foreign exchange. ICE has five clearinghouses for OTC markets and listed derivatives in the U.S., Europe and Canada.

CME Group (CME): CME is one of the world's largest futures exchanges and most diverse derivatives marketplaces, formed after the Chicago Mercantile Exchange and the Chicago Board of Trade merged in 2007. The exchange focuses on four major sections, including commodities, FX, interest rates and stock indexes. It provides a wide range of benchmark futures and options products, covering all major asset classes.

Glossary

Initial Margin (IM): The percentage of the purchase price of securities (that can be purchased on margin) that investors must pay for with their own cash or marginable securities. Customers' funds are offered as security for a guarantee of contract fulfillment at the time a market position is established.

Variation Margin (VM): Payment made on a daily basis by a clearing member to the Central Clearing organization, based on adverse price movement in positions carried by the clearing member, calculated separately for customer and proprietary positions.

MARGIN AND COLLATERAL

How will the process change?

The Dodd-Frank Act will have a broad impact on the margin and collateral process for OTC derivatives and FX transactions. Namely:

- Clients must meet daily margin requirements by posting margin. The margin requirements are tightly defined under the Act and include only cash and certain cash equivalents, such as U.S. Treasury and U.S. Agency debt obligations. J.P. Morgan will require cash, and expects to include cash equivalents as acceptable collateral in the future
- All OTC derivatives transactions subject to the Act will be segregated by the firm in a separate derivatives account of the client to facilitate the margining process. Within the derivatives account, cleared and uncleared transactions also will be segregated
- Margin requirements will be computed daily, including an initial margin and variation margin, based on the daily mark-to-market value of outstanding positions
- These requirements will be set by J.P. Morgan Private Bank and J.P. Morgan Securities. One of the factors in determining the margin requirements will be the minimum requirements set by the CCP (for cleared transactions), and the regulations (for uncleared transactions)

In its role as Clearing Broker, J.P. Morgan will be required to post margin to the CCP on a daily basis on behalf of clients. As a result, margin will be held at the CCP instead of at J.P. Morgan.

For J.P. Morgan to facilitate the daily movement of collateral, clients will need to provide standing instructions. In addition, Uniform Commercial Code (UCC) filings will be made.

Central Counter Party

Clients will be able to choose the CCP they wish to use. There are many CCPs operating in the market, including CME, Options Clearing Corporation, EUREX, DTCC, LCH and ICE. For CDS and IRS, three of these CCPs—LCH Clearnet Limited (LCH), Intercontinental Exchange (ICE) and CME Group (CME)—will be available for J.P. Morgan Private Bank and J.P. Morgan Securities clients to clear trades in March 2013, when the new regulations are expected to become effective. The list of CCPs may change over time as the industry matures.

J.P. MORGAN'S ROLE IN EVALUATING CCPs

J.P. Morgan uses its extensive network and considerable global resources to evaluate CCPs, assessing them on a number of criteria, and only including those that reach our high standards. We look for excellence in the following areas:

Risk management	Default management	Operational capabilities
Margin calculation methodology	Protection afforded by loss waterfall	Ability to clear/register trades in real time
Frequency of intraday calls	Segregation of initial margin	Ability to process products
Liquidity of eligible collateral	Well-defined, documented and tested process	Trade event processing (for example, coupons, credit events, non-deliverable forward fixings, option exercises)
Guaranty fund-size and apportion among members	Timing and conditions of the CCP guaranteed to be in force	

COMPLYING WITH DODD-FRANK: SUITABILITY REQUIREMENTS AND TRADE REPORTING

In addition to the changed procedures, clients who wish to trade OTC derivatives and FX must meet certain suitability criteria and sign new documentation.

Eligible Contract Participants (ECPs)

Dodd-Frank requires clients engaging in certain OTC derivatives and FX trades to confirm their eligibility to trade these products by certifying as Eligible Contract Participants (ECPs). The main ECP criteria are as follows:

- An individual acting for his or her own account who has amounts invested on a discretionary basis, the aggregate of which is in excess of (i) \$10 million; or (ii) \$5 million, and who enters into transactions in order to manage the risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred, by the individual
- A corporation, partnership, proprietorship, organization, trust or other entity acting for its own account:
 - (i) that has total assets exceeding \$10 million
 - (ii) that (a) has a net worth exceeding \$1 million; and (b) enters into transactions in connection with the conduct of an entity's business or to manage the risk associated with an asset or liability owned or incurred, or reasonably likely to be owned or incurred, by the entity in the conduct of the entity's business

Legal Entity Identifiers (LEIs)

The Act requires legal entities (not individuals) who want to trade certain OTC derivatives products to obtain an identification number known as a Legal Entity Identifier (LEI), starting in late 2012. This will allow regulatory bodies to globally track market activity and financial risk in connection with transactions.

Until a global LEI system is established, the U.S. Commodity Futures Trading Commission (CFTC) is requiring a CFTC Interim Compliant Identifier, or CICI. This unique 20-character, alpha-numeric code will be attached to certain derivatives trades that will be reported to regulators.

Reporting of OTC transaction data to Swap Data Repositories

In an effort to increase transparency, Dodd-Frank regulations require information about derivatives transactions to be sent to a central Swap Data Repository registered with the regulators.

Keeping you informed

As the Dodd-Frank legislation progresses and evolves, we are committed to always keeping you fully informed. If you would like to find out more about the Act, you can visit:

The U.S. Commodity Futures Trading Commission website

<http://www.cftc.gov/lawregulation/doddfrankact/index.htm>

or

The SEC website

<http://www.sec.gov/spotlight/dodd-frank.shtml>

Your J.P. Morgan representative will be happy to work with you to enable you to continue to trade derivatives with J.P. Morgan under the new regulations.

NEW DOCUMENTS REQUIRED TO CONTINUE TO TRADE DERIVATIVES PRODUCTS

The new regulatory environment requires a different set of documents that you may need to read and/or sign to continue to trade derivatives products. Details are given below.

Forms you need to review, sign and return to us

Bilateral Agreement. This supplements the terms and disclosure provisions governing your trading relationship with us, and is an agreement to comply with Dodd-Frank regulations.

Client (Futures) Agreement. This agreement sets out the terms and conditions that will apply if you want to trade cleared derivatives transactions using J.P. Morgan as the Executing Broker and Clearing Broker.

OTC Addendum. This includes additional terms and conditions that will apply if you want to trade cleared derivatives transactions with us.

The Client (Futures) Agreement and the OTC Addendum contain terms and conditions that will apply to all cleared trades you enter into, and allows J.P. Morgan to be a designated clearing member for you.

Derivatives Account Application and Agreement: Swaps and Other Contracts. This form provides the basis for J.P. Morgan to transact on your behalf with SEFs and CCPs, and confirms your eligibility for derivatives trades under the new rules.

Standing Instructions Form. This form will allow J.P. Morgan to move cash balances from your designated account(s) to meet margin requirements.

FIA-ISDA Cleared Derivatives Execution Agreement. This outlines the terms and conditions if trades fail to clear.

Regulation T Account Opening Form. This allows you to establish a Reg. T lending facility, enabling you to borrow cash to meet each margin call, subject to credit approval. If you would like J.P. Morgan to draw on your Reg. T lending facility to meet derivatives margin calls, please select the appropriate options in the Standing Instructions Form.

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