The Prime Brokerage Business:
An exploration of evolving standards – operational accountability, internal controls, and transparency

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The prime brokerage business:

An exploration of evolving standards – Operational accountability, internal controls, and transparency

As key stakeholders in the prime brokerage business demand higher standards for operational accountability and governance, KPMG’s depth of experience in performing Service Organization Control Report (“SOC,” formerly known as SAS 70 Reports) examinations can help prime brokers deliver on these expectations.

Background

The financial services industry has experienced drastic changes over the past few years. The global financial crisis has resulted in massive government interventions, uncovered major frauds, and caused uncertainty among consumers, investors, intermediaries, and regulators. The failures of several significant financial institutions have put greater focus on the important role that prime brokers play in the primary capital markets and the importance of enhanced transparency, strong custody, and internal risk management controls at prime brokers. Over the course of the financial crisis, the dangers that funds face when their assets are rehypothecated became painfully clear. Funds that tried to reclaim rehypothecated assets found themselves in the queue of general creditors, and usually received only a portion of their money back. Even those funds that had insisted that their assets not be rehypothecated had to endure long waits to get back securities they thought had been held in segregated client accounts.

These events have resulted in more scrutiny from investors, regulators, and auditors. The results of a recent global survey conducted by KPMG’s Investment Management practice indicate that trust in the investment management industry has suffered greatly.\(^2\) As the investment management community’s demand for prime brokerage services increases, prime brokers must focus on restoring this trust, and they can do so in part through a strong risk management and governance framework.

Regulators, clients, and investors demand robust internal controls

With the demand for greater transparency, oversight, and regulation, prime brokers are faced with increasing pressures to obtain assurance over internal controls:

- The International Organization of Securities Commissions’ (IOSCO) Technical Committee recently released suggested “guiding principles” for securities regulators in providing effective oversight to the investment management community. These principles also address the relevant regulatory and systemic risks linked to this industry. In turn, investment managers will be looking to their servicers to address risk management and internal controls.

- Regulatory demands include curbing short selling, enhancing custody control requirements, and improving transparency, all of which necessitate a strong risk management framework.

- In addition to increased regulation, prime brokers should expect increased scrutiny from their external auditors. There has been renewed focus on issues such as safety of client assets (custody, rehypothecation, segregation, and management of clients’ unencumbered assets), which has driven the need for improved transparency and risk and collateral management processes. Prime brokers will need to rethink the control environment that governs their operations and system platforms.

- Additionally, underlying investors want to learn more about both the funds and their administrators before they invest capital. In order to respond effectively to investor inquiries, investment managers are seeking servicers who can demonstrate strong operational practices.

- The increasing complexity of investment management products and services is also driving the need for enhanced operational control to facilitate effective information flow and on-demand reporting between funds and their servicers.

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1 KPMG’s Investment Management Global Thought Leadership Release, June 30, 2009: Renewing The Promise: Time to Mend Relationships in Investment Management

Prime brokerage market participant process/transaction flow*

1. Client sends trade instructions to executing broker.

2. Executing broker notifies prime broker of trade details. Relationship defined by a give-up agreement.

3. Prime broker confirms matching details and inputs back-to-back trades. Block trades broken down according to agreed-upon allocations.

* Pursuant to SEC’s Prime Broker No-Action Letter, which clarifies the division of responsibilities between the prime broker and the executing broker regarding such provisions. It should be noted that the No-Action Letter only permits prime brokerage activities between prime brokers and executing brokers who are U.S. registered broker-dealers, and who agree to communicate transaction information exclusively through the facilities of a registered U.S. clearing agency, such as DTC.
Expansion of prime brokerage services in response to recent regulatory changes

The derivatives market is now estimated to be over the $600 trillion. Banks now hold $234 trillion of the insurance-like contracts, which derive their value from another asset, like a foreign exchange rate or a package of mortgages. Four of the nation’s largest financial institutions—JPMorgan Chase, Citigroup, Bank of America, and Goldman Sachs—account for more than 90 percent of the banking industry’s activity in derivatives. In a June 2, 2009 letter to the Federal Reserve Bank of New York, the banking industry committed to a December 15, 2009 goal of providing customer access to interest rate swap (IRS) and credit default swap (CDS) clearing solutions, through either direct central counterparty (CCP) membership or customer clearing.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act. In addition to assigning regulatory authority of security-based swaps to the Securities and Exchange Commission (SEC) and swaps to the Commodity Futures Trading Commission (CFTC), this law mandates the central clearing of “standardized” swaps. IRS and CDSs are considered “swaps” within the legislation and will be regulated by the CFTC and cleared accordingly.

The prime brokerage service offerings are ever expanding, and another key focus has now become the derivatives clearing service. The derivatives clearing service has been shaped by rapidly evolving industry forces in response to these political and regulatory pressures to centralize the clearing of over-the-counter (OTC) derivatives for dealer-to-dealer and for dealer-customer business. One of the most widely used types of credit derivatives is the CDS, which has emerged as a powerful force in world markets. CDSs are bilateral contracts between the protection buyer and seller that can be customized along any dimensions to meet the needs of the particular counterparties in any given transaction. In the past, virtually all CDSs were negotiated OTC; however, given the recent regulatory reforms, CDSs are now offered through third-party central clearing counterparties (ICE Trust, CME, LCH, etc.). The SEC has taken multiple actions designed to help foster the prompt development of CDS CCPs including granting temporary conditional exemptions from certain provisions of the federal securities laws. In a release dated November 29, 2010, the SEC stated that each clearing member, in reliance on this exemption, receives or holds customer funds or securities for the purpose of purchasing, selling, clearing, settling, or holding. Cleared CDS positions for any other person must annually provide to ICE Trust a self-assessment of its compliance with certain conditions enumerated in the Order.

CDSs are not retail transactions. Most CDSs are in the $10–$20 million range with maturities between 1 and 10 years. Given the complex nature of these transactions across the industry, prime brokers have surfaced as a third-party player connecting clients with CCPs. These central clearinghouses will require margin from all participants and additional guaranty funds will be required from clearing members (prime brokers) to provide enhanced systematic protection. This is an improvement to existing non-clearing practices where many clients posted no initial margin. Rules will generally require clearing members to segregate the clearinghouse minimum for each client. Through Cross-Product Margining, clients of prime brokers will be able to benefit more fully from holding balance portfolios, as well as mitigate risks through cleared and uncleared transactions using a variety of methods.
Prime brokers are now offering derivatives clearing as well as derivative intermediation to meet clients’ requirements and expectations. The solution is designed to provide client access to clearing by providing nonparticipants with initial margin segregation and portability. The dealer founding member (DFM) participants (Barclays Capital, Bank of America, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan Chase & Co., Nomura, UBS) plan on providing client clearing as agent via these entities.

**Key risks**

So what are the key risks that the investment management community sees in its prime brokers? Based on the events of 2008, rehypothecation of clients’ unencumbered assets and prime broker insolvency (or, broadly speaking, Counterparty Credit Risk) would have to be the foremost.

Prime brokers are **self-funding businesses** that need very little access to the balance sheet of their parent bank, due to hedge fund cash kept on deposit and the rehypothecation of client assets. The prime brokerage model is built on this practice of rehypothecation, i.e., a proportion of assets used to back loans can usually be “rehypothecated” into the prime broker’s name, so the broker can use those assets to raise cash. This cash is then used to fund lending to funds for leveraged purposes and to support the borrowing of stock the prime broker can then lend to other funds that want to go short.

A prime broker’s **legal entity structure** greatly affects the risk its insolvency poses to its customers. U.S. prime brokers are required to register as broker-dealers under the Securities Exchange Act of 1934, as amended (34 Act) and to join, and comply with the rules of, self-regulatory organizations. For U.S. prime brokers, segregation of customer assets, rehypothecation, securities possession/control, and minimum net equity are all regulated under the 34 Act. Customers of U.S. prime brokers holding assets in the United States may be protected by the Securities Investor Protection Act of 1979, as amended (SIPA), which established the Securities Investor Protection Corporation (SIPC).

Generally, in an SIPC proceeding, customers of the insolvent party obtain priority over general unsecured creditors to recover from the prime brokers’ pool of customer property on a pro rata basis with other customers. A hedge fund customer would be an unsecured creditor to the extent of any shortfall. The protections of the U.S. regulatory bodies do not generally apply to non-U.S. affiliates of U.S. prime brokers or to assets held outside the United States. U.S. prime brokers commonly rely on such unregulated affiliates for margin lending or securities lending and/or to act as custodians in non-U.S. jurisdictions. This was the main reason why Lehman Brothers’ clients’ unencumbered assets were held up during the bankruptcy proceedings.

In response to demand from the investment management community, most prime brokers have started developing and rolling out prime custody products in conjunction with custodians like BNY Mellon, creating tri-party (prime broker – asset manager – custodian) agreements for pledged assets, and keeping unpledged assets with noncredit counterparties. All of these products are tailored to make client assets safe from a bank collapse by blocking rehypothecation and preventing counterparty claims altogether. In fact, multiprime relationships, increasing use of tri-party relationships with external custodians, and creation of prime brokerage houses with integrated custody capabilities have changed the marketplace.

In the **derivative clearing business**, the prime broker in essence becomes agent to a transaction between the nonparticipant and clearinghouse. Although the PB acts as agent for nonparticipant clearing clients, as is the case with futures clearing, it also has direct obligations to the clearinghouse to meet margin calls pursuant to its clearing agreement. As a result, the PB has what in effect is direct risk to nonparticipant clearing clients. That risk is expected to be mitigated by the PB’s security interest over client margin and their ability to impose position or margin level limits on nonparticipant clients. However, this risk remains, and adequate internal risk management safeguards and monitoring mechanisms are required to ensure exposure is adequately managed.

In order to gain advantage in such a competitive environment and attract new clients, prime brokers need to demonstrate a strong framework of internal controls. One of the most significant elements of this framework is transparency. Transparency has joined the top-five list of manager-selection criteria. Historically, investors have indicated the “3Ps”: Performance, Philosophy, and Pedigree to be the most important characteristics when selecting a manager. However, this year Risk Management has displaced Philosophy as the second most important criteria and Transparency is now fourth, pushing Manager Pedigree to fifth place.” This opinion was represented by a strong majority, as “78 percent of investors specified Risk Management as the second most important factor when selecting a manager.”

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1. 2009 Alternative Investment Survey – Deutsche Bank
2. 2009 Alternative Investment Survey – Deutsche Bank
How a SOC 1 examination (legacy SAS 70) demonstrates internal control transparency

To meet the demands of clients and regulators, investment managers want their prime brokers to demonstrate an effective and defined internal risk control framework. As a result, prime brokers now find themselves undergoing multiple audits and reviews at the request of their clients’ auditors and local regulators. In response, most prime brokers are engaging an independent public accounting firm to perform a SOC 1 examination. SOC 1 engagements, established by the AICPA, are performed in accordance with Statement on Standards for Attestation Engagements (SSAE) 16, Reporting on Controls at a Service Organization. SOC 1 reports focus on controls at a service organization that are likely to be relevant to an audit of a user entity’s financial statements and enables the prime broker to demonstrate that it has met control objectives that are important to its customers and that it has an adequate framework in place to be a stable counterparty, at least from the perspective of internal controls.

The SOC 1 examination can be set up to assess a broad set of controls across the diverse asset classes (EQPB, FIPB, FXPB, FuturesPB), product types, and the various geographies that the PB business operates, such as:

- Client Services Functions – New Account Setup and Maintenance, Fails Monitoring, Client Reporting, Client Billing
- Provision of Financing and Short Coverage Solutions to Clients – Securities Lending, Synthetic Financing, Repo Financing, Loan Financing, Equity Financing, Arranged Financing
- Provision of Credit/Margin to Clients – Reg T margin, Cross-Product Margining
- Middle-Office Functions – Trade Allocation, Trade Affirmation and Confirmation Securities Processing, Clearance and Settlement – Equities, Fixed Income, FX, Futures, Derivatives
- Securities Servicing – Corporate Actions, Dividends
- Pricing
- Derivatives Clearing and Intermediation
- Risk Management including Collateral Management
- Capital Introduction
- Relevant general information technology controls such as access to programs and data, program development, change management, and computer operations
- Investment Compliance Monitoring

Please see Appendix B for an overview of the globally recognized services in which prime brokers can engage.
## Overview of SOC 1 services: Pre-SOC 1 diagnostic review and SOC 1 examination reports

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<tr>
<th>Report</th>
<th>Description</th>
<th>Benefits</th>
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| **Pre-SOC 1 Diagnostic Assessment** (Nonattestation) | • Develops an understanding of procedures and controls relevant to a SOC 1  
• Identifies control weaknesses that should be corrected before a formal SOC 1 examination is performed  
• Compiles a list of control objectives and supporting control procedures                                                                                                                                          | • Provides an opportunity to evaluate and consider key processes and procedures  
• Serves as a foundation for a Type I or Type II examination  
• Allows the client to make necessary changes to its procedures and controls while creating a framework for establishing a strong control environment                                                                 |
| **SOC 1 Type I Examination**                  | • Report with an auditor’s opinion covering whether:  
1. The service organization’s description of controls presents fairly, in all material respects, the service organization’s controls which were placed in operation as of a specific date  
2. The controls were suitably designed to achieve the specified control objectives | • Describes the service provider’s control objectives and control activities  
• Provides an “auditor to auditor” communication detailing the design of the controls in place to achieve the specified control objectives  
• Serves as the foundation for subsequent Type II audits                                                                                                                                                                      |
| **SOC 1 Type II Examination**                  | • Report with an auditor’s opinion covering whether:  
1. A report on management’s description of the service organization’s controls presents fairly, in all material respects, the service organization’s controls which were placed in operation as of a specific date  
2. The controls were designed to achieve the specified control objectives  
3. The controls that were tested were operating with sufficient effectiveness to provide reasonable assurance that the control objectives were achieved during the period specified, typically 6 to 12 months | • Describes the service provider’s control objectives and control activities  
• Includes the auditors’ specific procedures and results  
• Provides an “auditor to auditor” communication detailing the design and effectiveness of the controls in place to achieve the specified control objectives  
• May address customer’s requirements for gaining assurance about the operating effectiveness of the service provider’s controls                                                                                                                                                   |
KPMG’s SOC 1 services
KPMG’s professionals have extensive knowledge and experience in delivering SOC 1 (formerly known as SAS 70) services within the financial services industry, particularly in regards to prime brokerage. Our experience includes SAS 70 examinations performed for leading prime brokerage clients over each relevant aspect of their business processes, operations, and IT.

KPMG has leveraged years of experience in serving global audit clients to align our legacy SAS 70 and new SOC 1 methodologies with the needs of our clients’ user organization auditors and external regulators. Based on our experience as external auditors, we have developed a repository of control objectives and control activities to guide clients through the process of identifying those objectives and activities that typically meet auditors’ and regulators’ needs. Furthermore, we have developed a globally consistent methodology and an automated SOC 1 engagement management tool to assist with increasing the efficiency of SOC 1 engagement delivery and reporting.

KPMG was the first, Big four firm to issue SAS 70 Type II (now known as SOC 1 Type II) reports for a global prime brokerage firm. Below we have described this work in detail:

• In March 2007, KPMG was engaged to devise a solution to address the growing number of client requests for an independent review of a Top 5 global prime broker’s control environment. KPMG quickly assembled a team of industry leaders and regulatory subject matter specialists to assist management, and within the next month, conducted a series of interviews with every function within the prime finance business. Our SAS 70 engagement commenced in May 2007 and by November 1, KPMG had issued the first SAS 70 report for the industry. The report now provides coverage over prime brokerage services over all asset classes, product types, and geographies.

• KPMG has subsequently been engaged by a large majority of the Top 10 global prime brokerage firms for various attestation and advisory engagements given our demonstrated knowledge in this field. Refer to Appendix A for KPMG service offerings for the prime brokerage business.

Updates to the current SAS 70 attestation standard
In December 2009, the International Auditing and Assurance Standards Board issued a new international standard on Assurance Engagements: ISAE 3402, Assurance Reports on Controls at a Service Organization. In April 2010, the AICPA Auditing Standards Board published Statement on Standards for Attestation Engagements—SSAE 16, Reporting on Controls at a Service Organization—that is similar to the international standard and will supersede the SAS 70 standard. Both standards are effective for reports for periods ending on or after June 15, 2011, with early adoption permitted. While both standards must be implemented by 2011, firms considering a SOC 1 should understand the impact the changes will have on how they prepare their reports.

Technical standards of SSAE 16 will focus on Service Organization Controls reports, which will be identified simply as SOC 1, SOC 2s, and SOC 3s. SOC 1 is related only to Internal Controls over Financial Reporting (ICOFR) which will be significantly similar to the focus of SAS 70 reports. SOC 2s and SOC 3s, however, will be related to controls at the service organization that relate to operations and compliance.
The new standards allow firms to provide additional coverage to stakeholders in areas that were previously outside of the SOC 1 report’s scope. Some of the key differences to consider and discuss include:

- **Management’s written assertion.** This will be the most visible change in the report. Similar to what a public company prepares as part of its assertions related to internal controls over financial reporting, this assertion is a separate component of the report, typically on the service organization’s letterhead and signed by a member of management. The assertion communicates the service organization management’s responsibility for the description of the system and asserts to the achievement of the evaluation criteria of the description of the system.

- **Description of the system.** Under the new standards, a service organization provides a description of its system as designed and implemented. While “system” has many different definitions, a common and useful definition is “the procedures, people, software, data, and infrastructure organized to achieve a specific objective.” Controls are only one aspect of a system.

- **Risks that threaten the achievement of the control objectives.** Under the current standard, the auditor is responsible for determining if the controls identified by management sufficiently mitigate the key risks to achieving the control objective. Under the new standard, this responsibility shifts to the service organization. Management must identify their risks and determine that the controls in place would sufficiently mitigate the risks, or the impact of the risks, to achieve each control objective in the report.

In the relatively short time that prime brokers have been obtaining SAS70 reports, feedback from their respective stakeholders has been positive. By proactively providing transparency in controls to their stakeholders and thereby helping to satisfy both increasing investor and regulator demands, such prime brokers have differentiated themselves from their peers. Moreover, these prime brokers have also realized internal efficiencies such as gaining an independent evaluation of their processes and controls. One prime broker, which recently issued a SAS70 on its operations, commented that once external stakeholders fully understand the value of the report, it will become the industry standard within the community, he added, “that previously the SAS 70 was viewed as a competitive advantage, but now it is increasingly becoming a competitive necessity.” SOC 1 reports, along with other targeted third-party reporting, continue to build and maintain the trust required by investors and regulators in the alternative investment management community.
KPMG: The right choice

KPMG can provide independent and objective advice to your organization as you look to gain efficiencies and differentiate your business. We work hand in hand with members of your senior management team as you seek to make informed decisions, taking into account the associated costs and benefits. We possess the professional attributes you expect from an auditor:

- Objectivity and impartiality
- Global breadth, local knowledge
- Deep knowledge and experience in financial, regulatory, IT, risk, and control
- Experience serving market-leading clients across industry segments

As key stakeholders demand higher standards of operational accountability and governance within the prime brokerage business, KPMG, with the depth of our experience in performing global SOC 1s for prime brokers, can help you deliver on these expectations.

Given the breadth and depth of our industry and functional experience, KPMG can provide an array of services in addition to SOC 1 services: please see Appendix B for some examples of these. Note: Certain services are not permissible for audit clients.

Leadership serving the prime brokerage business

Global Financial Services
For decades, KPMG’s Global Financial Services practice has been recognized for its presence in and its commitment to the industry. Through our international network, we have the global reach and experience to serve clients anywhere in the world. Our strength in the marketplace is why 73 of the 100 largest financial services companies have chosen KPMG as their professional services provider. Worldwide, KPMG International member firms serve more than 20,000 financial organizations: more than half of these financial organizations are U.S.-based. Our global team of professionals has extensive experience with all market participants supporting the investment management community and leverages the firms’ industry knowledge and resources in order to best serve clients’ needs.

Banking and Finance
KPMG’s Banking and Finance practice is the firm’s largest industry practice. Our more than 4,500 experienced industry professionals, including 400 partners, help provide audit services to 50 percent of the top 10 banks, as ranked by American Banker, and 40 percent of the world’s largest 500 banks. Our expansive client base and close working relationships with industry leaders enable our professionals to provide insights and perspective to address the key challenges affecting the industry.

Alternative Investments
KPMG has dedicated considerable resources to become one of the leading providers of audit, tax, and business advisory services to the alternative investments industry. Globally, the Alternative Investments segment includes approximately 1,800 Audit, Tax, and Advisory professionals (including 160 partners) from KPMG International member firms dedicated to alternative investments such as hedge funds, fund of funds, private equity, venture capital, infrastructure funds, structured products, commodity pools, and hybrid products.
Appendix A: KPMG service offerings for the prime brokerage business

KPMG provides an array of services to financial services companies, including assistance with the challenges associated with emerging market trends and developments.

Our core competencies include the following offerings:

- Perform and issue SOC 1 internal control reports on the effectiveness of internal controls
- Perform internal audit
- Design business, IT, and operations strategy to support expansion of service offerings
- Create future-state operating models, including middle-office services
- Streamline operations master data management architecture
- Provide spreadsheet management and enhancement
- Develop information security strategy, architecture, and testing
- Provide access and procedure analysis for credit, market, liquidity, and counterparty risk management
- Develop policies, procedures, and supervisory controls
- Assess technology providers and advise on selection (e.g., risk, collateral management providers)
- Provide regulatory and compliance advice
- Analyze exposures to failed financial institutions
- Review internal control policies and procedures over collateral management and safekeeping/custody of client assets

Note: Certain services are not permissible for audit clients.

Other areas: Administrators/Liquidators of LBHI bankruptcy in Asia
KPMG in * Hong Kong was appointed administrators of the Lehman Brothers Holdings Inc. (LBHI) bankruptcy and liquidation in Asia Pacific, in charge of managing the estate of the Hong Kong–based hub of the bank. In addition to valuing and quantifying the billions of dollars of claims that the Lehman companies owed each other that had arisen from the highly complex trading and financing structures operating across borders, KPMG’s role specifically encompassed unwinding the prime brokerage clients’ positions, settling claims, and reuniting HF clients with their assets.

Other areas: Self-Assessments of dealer founding members for OTC derivative clearing business
KPMG continues to work with our large banking/swap dealer clients to formulate a global systematic approach to addressing Dodd-Frank implications. One of the biggest areas of impact with these new regulations will be moving all OTC derivative clearing to CCPs. Clearing will be mandated for standardized swaps as determined by the CFTC and SEC. Clearing members are now required to provide an annual self-assessment on each of its CCPs (ICE, CME, LCH, etc.). KPMG is leading the audit industry’s response to these needs: through our chairmanship of the AICPA Broker-Dealer Expert Panel, we lead the industry’s response to these newly required SEC annual self-assessments for all our CCP DFM clients. We have used our expansive knowledge of the financial services industry to help our clients formulate their response and maintain compliance with the recent and continuing political/regulatory reforms in this space.
### Appendix B: Overview of the types of globally recognized services in which prime brokers can engage

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<thead>
<tr>
<th>Service offering</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Sales, Transition Services, Onboarding</strong></td>
<td>The Sales/Account Management team is responsible for bringing new clients onto the prime finance platform. The Transition Services department assists with setting up new accounts, maintaining existing accounts, and removing terminated accounts for both internal and external users. It acts as the intermediary between Sales/Account Management and Client Services.</td>
</tr>
<tr>
<td><strong>Client Services</strong></td>
<td>The Client Service Group is the primary interface between the client and the prime finance unit. The Client Service Group is responsible for maintaining client accounts after transition services finalizes client setup, both in the business and on the systems. Client Service representatives are also responsible for Client Reporting and Billing functions.</td>
</tr>
<tr>
<td><strong>Financing Solutions</strong></td>
<td>Securities Lending, Synthetic Financing (TRS, CFD), Arranged Financing, Repo Financing, Loan Financing, Arranged Financing, Repo and Synthetic Access via Swaps and CDS</td>
</tr>
<tr>
<td><strong>Provision of Credit</strong></td>
<td>Reg-T Margining, Cross-Product Margining (CPM) – Prime brokers now offer portfolio margin to their customers, in compliance with NYSE Rule 431(g). The CPM platform uses a portfolio margining approach, which results in enhanced* initial margin requirements across eligible product classes. (Equities, Fixed Income, Derivatives)</td>
</tr>
<tr>
<td><strong>Risk Management including Collateral Management</strong></td>
<td>Inadequate Risk Management/Collateral Management practices at a prime broker can create increased counterparty credit risk exposure to its clients. The Risk Management department is responsible for delivering daily static risk reports utilizing risk management tools to measure value at risk, as well as applying stress scenarios. The Risk Management team works with Prime Broker Control and Client Service team to address any unsecured exposure.</td>
</tr>
<tr>
<td><strong>Trade Execution</strong></td>
<td>High-frequency trade execution capabilities, single stock and basket-level algorithms, complete confidentiality, and the ability to provide access to PT, cash, DMA, and algorithms</td>
</tr>
<tr>
<td><strong>Trade Processing, Clearance, and Settlement</strong></td>
<td>Traditional Prime Finance activities such as clearance and trade settlement processing are typically handled within B/D Operations under the following departments for equity, fixed income, foreign exchange, derivative, and futures products: Purchase and Sales, DTC Settlements, Governments/Mortgage-Backed Securities Clearance, Mortgage Allocation, International Clearance, Buy-ins, Segregation, Reconciliations, Treasury Operations, and Pricing (all types of equities and fixed income products could be traded ranging from straight buys and sells of debt securities to mortgage-backed securities, futures, derivatives, interest rate swaps, and repos).</td>
</tr>
<tr>
<td>Service offering</td>
<td>Description</td>
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<tr>
<td><strong>Derivatives Clearing and Intermediation</strong></td>
<td>Through derivative intermediation offering, clients have the ability to execute derivative transactions with multiple counterparties while prime brokers act as the sole counterparty for margin, settlements, clearing, and confirmations. Cross-Product Clearing with connectivity to viable CCPs.</td>
</tr>
<tr>
<td><strong>Prime Finance Middle Office</strong></td>
<td>Prime brokers have gradually moved beyond providing only traditional back-office services to enabling middle-office solutions. Prime brokers to specific funds (accounts) perform an array of functions to ensure that the funds are properly serviced, including Bank Reconciliation, Balancing: Reconciling Customer Accounts, Repo: Away Instruction Processing, Fails Management, Customer Payment Request Instructions, and Customer Inquiries.</td>
</tr>
<tr>
<td><strong>Futures PB and FXPB</strong></td>
<td>Prime brokers are increasingly providing Futures PB and FXPB in order to enable a full suite of service offerings across all product types and asset classes; essentially providing Foreign Exchange and Futures Trading and Clearance facilities.</td>
</tr>
<tr>
<td><strong>Custody</strong></td>
<td>When a client establishes a prime broker agreement for margin trading with a prime broker, the document contains clauses regarding custody and rehypothecation. The document gives the prime broker certain rights while acting as custodian, and privileges to rehypothecate collateral. For nonmargin customers, the prime broker, in its role as custodian, ensures that the securities for which the clients paid are appropriately segregated. In addition to reconciling customer security holdings with the external depositories, the prime broker tracks and monitors breaks.</td>
</tr>
<tr>
<td><strong>Product Development</strong></td>
<td>The Product Development Group is responsible for strategic product enhancements and technology budgeting. This group works in close coordination with business and stakeholders and technology groups to help ensure proper analysis and requirements are gathered for new technology solutions.</td>
</tr>
<tr>
<td><strong>Capital Introduction</strong></td>
<td>Capital Introduction is a service that facilitates the introduction of fund managers to potential fund investors. The Capital Introductions Group introduces clients to potential external and internal investors by hosting regular investor conferences and networking events. Capital Introduction services include data mining to facilitate the appropriate pairing of funds and investors, making third-party introductions, assisting with the overall appearance and presentation of marketing materials, and facilitating networking among fund managers and investors.</td>
</tr>
<tr>
<td><strong>Business Consulting Services (BCS)</strong></td>
<td>The BCS Group assists the prime brokers’ clients in managing and growing their business. BCS assists its clients, from start-up to growth and maturity stages, in solving business issues in operations, technology, fund structuring, real estate, human resources, and global deployment.</td>
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