

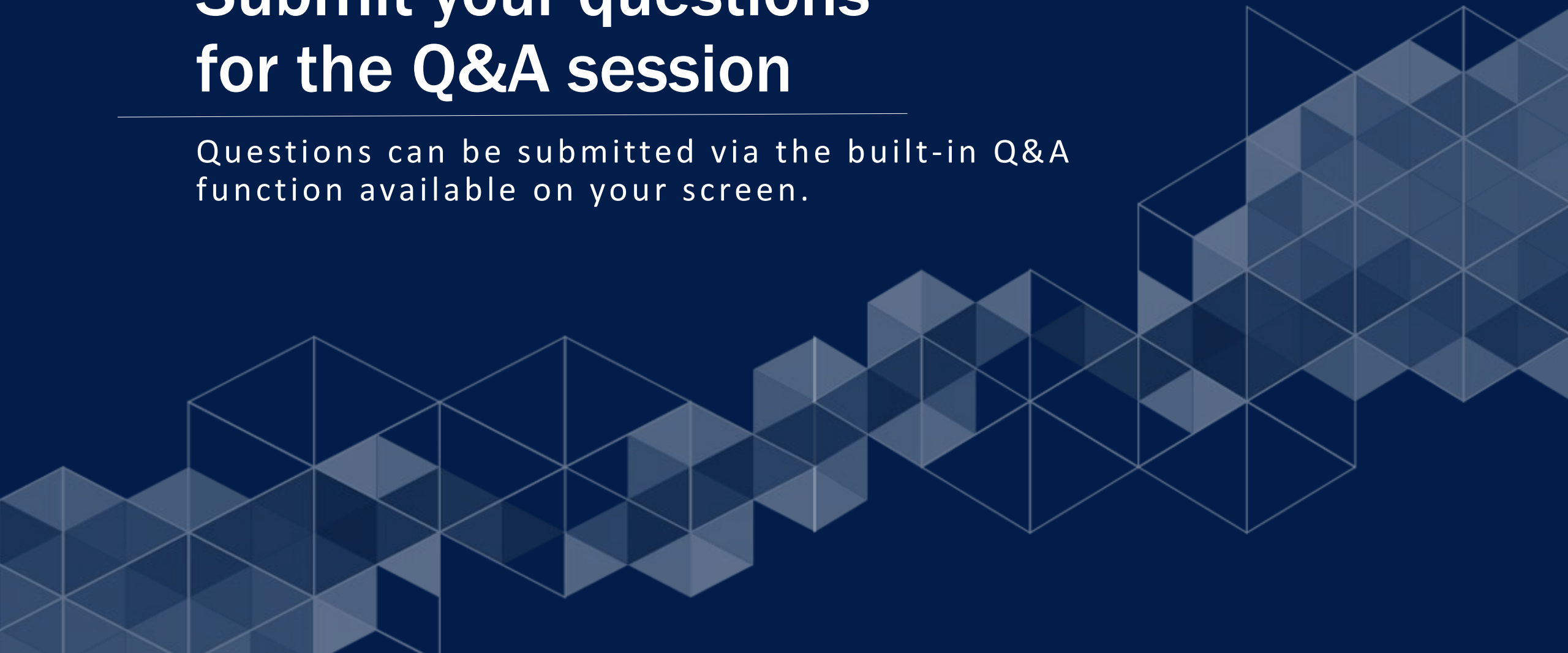
Swap Dealer Capital Updates

June 2, 2022



Submit your questions for the Q&A session

Questions can be submitted via the built-in Q&A function available on your screen.



Swap Dealer Capital Updates

An archived version of today's session, along with all other sessions for the Member Regulatory Workshop, will be available on NFA's website in the coming weeks.

Swap Dealer Capital Updates

Member Regulatory Workshop 2022



Swap Dealer Capital Exam

Agenda



- Overview of Capital Exams
- Capital Model Approval Program
- What can you do to prepare?
- Q&A



Overview of Capital Exams



- Testing of in-scope firm's capital computation is in addition to our traditional examination scope
- NFA's capital related testing will focus heavily on a specific month end financial statement submitted to NFA

Overview of Capital Exams (cont.)



- Testing of a firm's capital falls broadly into 3 categories:
 - Walkthroughs of the firm's internal controls surrounding financial reporting and capital computations
 - Testing of the completeness and accuracy of significant balances on the firm's financial statements submitted to NFA
 - Testing of the firm's calculation of capital requirements including uncleared swaps margin, market risk charges, credit risk charges, and risk weighted assets as applicable to the firm

Types of information we are requesting



As this is the first time we are testing this area, we occasionally run into vocabulary issues. We encourage members to discuss our requests if the requests seem confusing

- Financial schedules and reconciliations
- Net capital computations
- Walkthroughs of specific internal control activities
- Trial balances and general ledgers used for financial reporting purposes
- Confirmation of certain balances held at third parties such as banks, brokers, and custodians
- One thing we have noted is discussions with firm personnel directly involved in firm's financial reporting functions have been very helpful

Walkthrough Expectations



- We are conducting walkthroughs of 8 specific internal control activities
- Walkthroughs have been conducted virtually to date, but exam teams are increasingly conducting testing onsite
- Internal control walkthroughs are a targeted area for in person testing, so that NFA staff can witness evidence of the controls or the controls being executed
- If the walkthrough cannot be conducted in person, NFA's expectation is that screensharing will take place

8 Internal Control Walk Throughs



1. Reconcile transactions between the general ledger, the trading system or system of record, and third party depositories
2. Segregation of duties for manual recording of transactions in the general ledger and trading system or system of record
3. Review and approval of general ledger and trading system or system of record entries
4. Review and approval of system mappings and changes related to automated recording of transactions in the general ledger and trading system or system of record
5. Review and approval of the firm's capital computation
6. Review and approval of the firm's computation of the capital requirement
7. Review and approval of implementation of, or changes to, internal models utilized for computation of market value of swaps or computation of capital charges
8. Review and approval of any adjustments to internal swap valuation model inputs and outputs

Corrective Action Expectations



- For any finding, NFA's expectation is that our members will begin correcting the issue as soon as the member is notified.
- For capital related findings, the firm has several opportunities to evidence corrective action through routine financial filing



What can you do to prepare for your capital exam?



At the beginning of the exam, you will be provided with an Internal Control Questionnaire. This represents an opportunity for the firm to provide information about the firm's internal controls and financial reporting process to enable NFA to scope the exam appropriately.

This was distributed to swap dealers in November of last year. The expectation is that firm's have completed this and it will be available shortly after NFA engages a swap dealer in an examination. If your firm has not completed this questionnaire, please do so. If you need any additional copy of the Internal Control Questionnaire, please reach out to a member of the Swaps Department.

Capital Risk Management



CFTC Risk Management requirements of swap dealers are reflected within 23.600

For capital firms, capital risk is a relevant risk to the firm's operations. This means the Risk Management Program should take into account capital risk, include a description of tolerance limits and escalation policies

If you have not revisited the firm's Risk Management policies since capital rules became effective, now is a good time to do so

Documentation of the Capital Computation Process



Through testing of the capital computation itself and the review of the firm's internal controls, NFA is spending a lot of time looking at how capital is computed. Some questions for firms to consider at this point include:

- How often is the firm's net capital computed? What systems are used?
- Who is responsible for preparing this computation? Who reviews this computation? How are the computation and the review evidenced?
- What type of event would prompt an escalation? What would this escalation entail?
- Where are the answers to these questions documented?



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SWAP DEALER CAPITAL MODEL UPDATES

Capital Model Approval Program



- CFTC Capital Rules:
 - Standardized method or internal model. Internal model must be pre-approved.
- The approval program includes:
 - Model election
 - Capital model questionnaires
 - Document requests pertaining to model testing results
 - A self-assessment by the firm on compliance with the CFTC Capital Rules.
- NFA's Capital Model Approval program received a comparability determination by the CFTC.

Capital Model Approval Program



- CFTC adopted NFA's Capital Model Questionnaires as its application to satisfy requirements in 23.102(f):
 - Under (f)(1), SDs are allowed to use its capital models approved by a qualified regulator pending the subsequent approval by the CFTC or NFA.
- During use of models, SDs must submit
 - 23.105(k) monthly & quarterly filings
 - Ongoing monitoring plans and quarterly internal risk reports
- NFA has started reviewing firms' applications

Capital Model Approval Program



- The First Day Letter starts an interaction with the firm that ends once NFA can make an approval determination.
- NFA's Capital Model Approval program focuses on the following:
 - Firm's assessments of models' conceptual soundness (including limitations), models implementation and use.
 - To compensate for material limitations, SDs are expected to establish controls and take other steps to ensure the adequacy of calculated capital charges.
 - On ongoing basis, in addition to model performance testing and analysis, firms must have
 - established thresholds for acceptable model behavior and
 - escalation and remediation policies and procedures.

Capital Model Approval Program

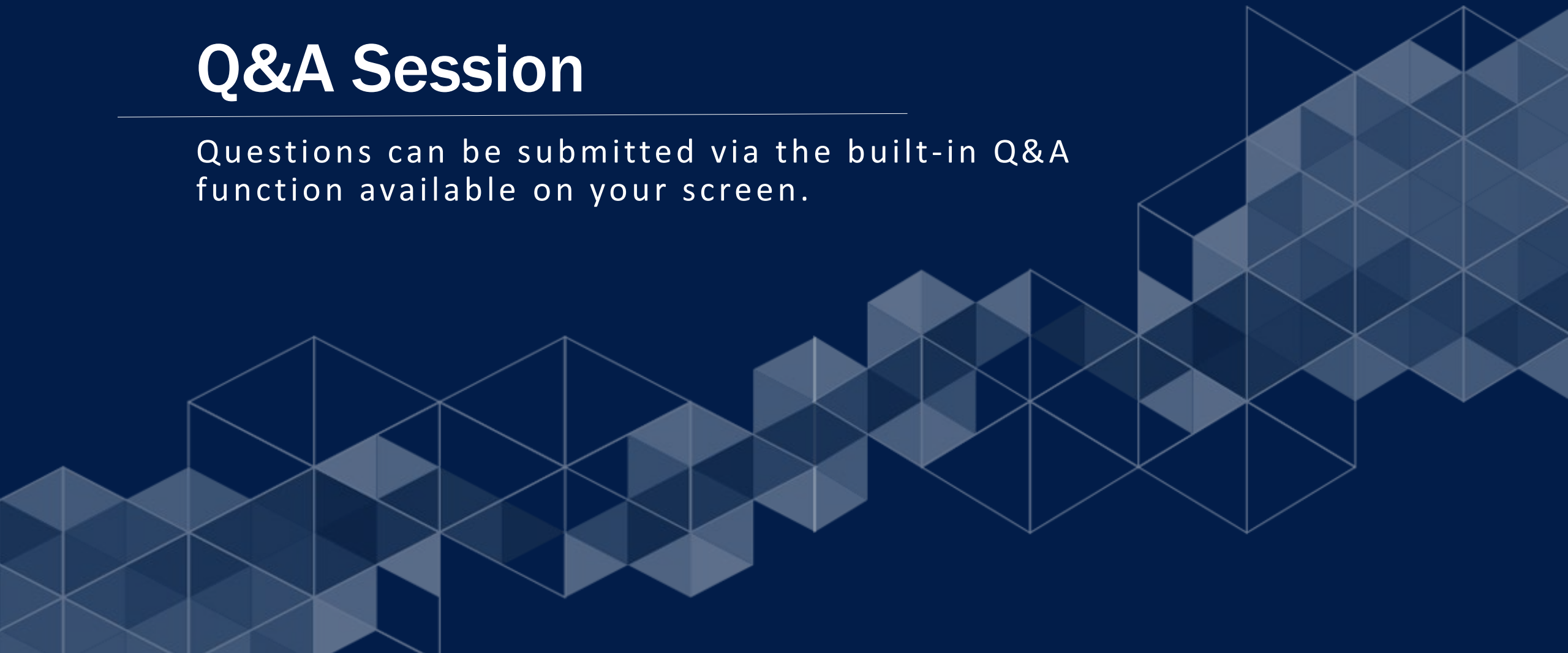


- Importance of a robust Model Risk Management framework in place:
 - on an ongoing basis allows firms to timely identify and monitor model risk, to assess its materiality and build controls to help manage such risks, and
 - to detect and deal with limitations and potential deterioration in model performance to ensure the ongoing adequacy of capital charges and the overall ongoing compliance with CFTC Capital Rules.



Q&A Session

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Member Regulatory Workshop – Next Session

Supervision of Remote Offices will begin at 12:00 p.m. CT/1:00 p.m. ET.

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