

NFA's Initial Margin Ongoing Monitoring Program
September 15, 2020

Christie Hillsman: Hello, everyone. Welcome to NFA's webinar on the revised initial margin ongoing monitoring program.

My name is Christie Hillsman, and I'm a manager in NFA's Communications department. With me today are Rina Callisto, Senior Quantitative Risk Manager, and Antonina Harden, Senior Quantitative Specialist, both from our OTC Derivatives department.

With today's webinar we aim to educate members on why we are revising our existing initial margin ongoing monitoring program, what's changing, and where you can find additional and useful information about the program.

If you'd like to ask a question now or at any time during today's webinar, look for the box labeled "Ask a Question" on the left side of your webinar screen. Please type the question you would like to ask into the box and click "Send." We are able to see questions as they are submitted. And for questions that are firm-specific, just know that we will reach out to you individually following today's presentation.

Additionally, a recording of this webinar, along with a written transcript, will be on NFA's website in the coming weeks. So, no need to take detailed notes throughout this presentation.

And now, I'll turn it over to Antonina to provide background on NFA's Initial Margin Ongoing Monitoring Program and the "why" behind its overhaul.

Antonina Harden: Thanks, Christie. As you know, the CFTC's margin rules for uncleared swaps permit covered swap entities subject to the rules to choose between using a standardized calculation for initial margin or an internal risk-based IM model that has been approved by the CFTC or NFA. Any swap dealer using an approved IM model is also required to establish a process of ongoing monitoring of the IM model's performance.

In December 2016, NFA launched a program to oversee the ongoing IM model monitoring process implemented by each swap dealer using an approved IM model. When the program launched in 2016, NFA elected not to standardize the information collected, but rather, to allow firms to submit the information in whatever format they chose. Doing so helped staff to gain an understanding of the information submitted by the firms and to identify the information that could be most useful for oversight purposes.

The filings we have received every quarter are similar in content, but the data that we've been collecting is not standardized. This has resulted in staff spending a significant amount of time organizing data and engaging in data normalization, which negatively impacts the efficiency of the process.

Based on our experience, staff strongly believes that NFA's oversight program will be much more effective and efficient if we standardize the filings and limit the material provided to key pieces of information that will allow us to more quickly identify potential red flags with respect to swap dealers' IM model performance.

As a result, beginning September 30, NFA's oversight program will require swap dealers to use a standardized format for their filings. Specifically, standardized quarterly filings must include AcadiaSoft IM portfolio reconciliation reports for each of the three months-end in the quarter and the top five backtesting against realized P&L and benchmarking shortfalls, along with an analysis of any exceedances breaching internal thresholds and remedial actions on an IM amount.

The IM model performance should be assessed based on statistical frameworks such as Basel Traffic Light.

Generally, the quarterly reports must contain all counterparties of each CFTC-regulated entity and must be limited to CFTC-regulated products.

In addition, quarterly submissions must be filed by the last business day of the following month of the reporting quarter.

On an annual basis, firms must submit an NFA-designed IM model monitoring questionnaire that covers topics such as the swap dealer's IM model governance, IM model changes, and ongoing IM model performance monitoring. The questionnaire's purpose is to give NFA staff context when reviewing a swap dealer's ongoing monitoring activities and the IM model performance testing results.

The information requested in the questionnaire is information swap dealers currently submit on a quarterly basis under our existing program, alongside a large volume of additional information submitted quarterly. So, we expect this information to already be readily available to each swap dealer.

From a process standpoint, the questionnaire asks targeted questions, of which the vast majority of responses will be "yes," "no," or "not applicable," with some allowing for comments. Additionally, it is a smart questionnaire, in that certain questions are only asked based on swap dealers' answers to prior questions. Finally, the questionnaire must be completed once annually and is not intended to be amended throughout the year.

As the questionnaire is focused on the swap dealer's IM model frameworks, the expectation is that it will be completed by the swap dealer's CRO or equivalent function. The questionnaire is not intended to trigger internal certifications, sub-certifications, or require elevation to senior management as is involved in the annual CCO report and periodic risk exposure report processes.

It will become available on January 1, 2021.

Finally, firms are also required annually to submit the CFTC-required internal audit report. The internal audit report should assess on an annual basis the effectiveness of the controls supporting the IM calculation, including the activities of the business trading units and risk control units, compliance with policies and procedures, and calculation of the swap dealer's initial margin requirements. Annual filings must be filed by the last business day of January 2021 and annually thereafter.

This new approach builds on what we have learned over the last few years, and by limiting the information requested and the data collected to key indicators of model performance will result in a more efficient model monitoring program, as well as a reduced reporting burden on swap dealers. In particular, the more targeted quarterly collection of data will make it much easier to identify red flags and allow staff to follow up on areas that appear to pose a higher compliance risk. If that is the case, firms will receive a request to submit additional data and information.

Finally, the revised oversight program will also include a more in-depth review of each swap dealer's IM model on an 18-month cycle. During this review, staff will do a more extensive analysis of the firm's monitoring activities, focusing in more detail on aspects such as backtesting and benchmarking testing results. Staff will also review other areas covered by CFTC regulations or NFA requirements, such as model validation reports, the

appropriateness of data inputs, benchmarking against CCPs, and risks not in IM model analysis.

This review will also allow us to ensure that swap dealers' quarterly and annual submissions are accurate and complete. As noted before, however, staff may elect to conduct this review on an ad hoc basis based on information received from the quarterly or annual submissions.

Now I'll turn it over to Rina to walk through how to submit quarterly filings and an annual filing.

Rina Callisto:

Thanks, Antonina. To submit a quarterly filing, first, you will need to access NFA's EasyFile Margin Model Submission System. This is the same system used for margin model approval and monitoring under the prior program.

To access the system, click "Electronic Filing System" at the top of any page of NFA's website. Then, click the "+" sign on the swap dealer listing to see a list of applicable systems. From the list, click "EasyFile Margin Model Submission System." On the system landing page, click the "Access the System" button. Enter your username and password and click "Log In." If you need access to the system but don't yet have a login, contact your firm's ORS security manager for access.

Once you have logged in, you will see the NFA Filing Index page. On the Filing Index page, click the creation date for the filing you wish to complete and submit and select the quarterly filing that's coming due.

A template will appear for the filing you selected and will be populated with the first of three sections: Top 5 Backtesting Shortfalls, Top 5 Benchmarking Shortfalls, and Portfolio Reconciliation. Complete the fields in the table with the requested information about your top five backtesting shortfalls. If the information requested in a certain field is not available, click the "Not Applicable" check box. Once you have completed the fields, click "Next."

You will then see a similar table where you will input information about your top five benchmarking shortfalls. Follow the same steps you did for the top five benchmarking shortfalls table, then click "Next."

This is the Portfolio Reconciliation section. Upload the three required AcadiaSoft portfolio reconciliation files by clicking "Browse." In the event that your files do not upload successfully, you will receive an error message. For assistance, contact NFA's Swaps Filing Support Team.

Once you have uploaded the files, you can confirm that you have selected the correct file by checking the file names and upload date. If a file was uploaded in error, click "Delete" and upload the correct file. After successfully uploading your file, click "Next."

You will arrive at the Summary of Errors and/or Warnings for your filings. If any errors or warnings appear, on-screen actions will guide you to remediate them. Once any errors and warnings have been remediated, click "Submit Filing" to complete your submission.

Let's return to the Filing Index to submit another filing. To submit another filing, click the creation date to select the filing you wish to submit. A template will appear for the filing you selected and will be populated with the first of four sections: General Compliance and IM Model Governance, Model Changes, Ongoing Model Performance Monitoring, and Internal Audit.

For each of the first three sections, which constitute the required annual questionnaire Antonina discussed earlier, provide the information requested by completing the fields that appear, then click "Next."

When you reach the Internal Audit section, upload your firm's internal audit files by clicking "Browse" and selecting the appropriate files. Similar to the Portfolio Reconciliation step in the quarterly filing, in the event that your files do not upload successfully, you will receive an error message. For assistance, contact NFA's web filing support team.

Once you have uploaded the files, you can confirm that you have selected the correct files by checking the file names and the upload date. If a file was uploaded in error, click "Delete" and upload the correct file. After successfully uploading your file, click "Next."

You will arrive at the Summary or Errors and/or Warnings for your filing. If any error or warnings appear, on-screen actions will guide you to remediate them. Once any errors and warnings have been remediated, click "Submit Filing."

An Oath will appear on the screen. Please verify that the information for name and name of company are correct, then select "Submit Filing" to complete the firm submission. The filing is successfully submitted when the you see a message appearing on the screen.

To amend an annual or quarterly filing that you have previously submitted, on the Filing Index click the creation date for the filing you wish to amend. Then, in the top navigation, click "Amend Filing." In the text box that appears, provide a brief explanation of why you are amending the filing, then click "Amend Filing." You will then be redirected to the Filing Index. Note that the status of the filing that you elected to amend has changed from "Received" to "Amending." Click the creation date for the filing once more and amend the filing as needed, submitting it to NFA once complete.

In order to provide information and support, we will issue a User Guide prior to system go-live. You will be able to access the guide by clicking "Help" in the top navigation within the Margin Model Submission System.

Christie Hillsman:

Thanks, Rina, for all of that helpful information.

This concludes the prepared portion of today's webinar, but throughout today's discussion, we've received some great questions. The questions that have already been submitted appear to fall into a number of overarching topics. So, we'll begin by addressing those questions grouped by topic. But please feel free to continue submitting questions as we jump into the Q&A. We'll handle those questions following these first, grouped questions. And then, just a reminder, if for whatever reason we don't get to your question or if you submitted a firm-specific question, an NFA staff member will respond to you via email shortly.

So, the first series of questions that we have here are related to data collection. And Rina, I'm hoping you can answer the first of these for us. That question is, "Could you please provide a definition of backtesting and benchmarking shortfalls?"

Rina Callisto:

Yes, Christie. Sure. Backtesting shortfalls are the least amount of extra IM which will need to be added to give a Green result from the backtesting against clean realized P&L test for portfolios in Amber or Red zones. Similarly, benchmarking shortfalls are the difference between the internal risk measure values and the corresponding IM amounts, in cases that the call or post side of IM amounts are less than the corresponding internal risk measure values by absolute values.

Christie Hillsman: Great. Thanks, Rina.

And Antonina, I'm going to turn to you with our next data collection-related question. That question is, "Can we submit backtesting shortfalls based on historical (3+1) backtesting?"

Antonina Harden: Sure, Christie. While we encourage firms to conduct all types of monitoring testing which the firm deems necessary to adequately assess the IM model performance on an ongoing basis, firms are expected to provide shortfalls based on backtesting against clean realized P&L. Since SIMM is a projection, actual backtesting is an important test to assess model performance.

Christie Hillsman: Great. Thanks, Antonina.

And Rina, I'm going to turn to you with our next question here, again a data collection question. That is, "In addition to backtesting and benchmarking results, our firm has previously submitted to a DCO benchmarking results and risk-not-in-IM-model analysis. Are we expected to continue to perform these types of monitoring?"

Rina Callisto: Yes. A firm at the minimum should continue to perform all types of monitoring and testing specified in the NFA approval letter or included in the firm's policies and procedures.

Christie Hillsman: Perfect. Thanks, Rina.

And it looks like we have one more data collection-related question, and Rina, I'll ask you to answer that one, as well. This question is, "Do the quarterly reports have to contain all counterparties, or only CFTC counterparties?"

Rina Callisto: The quarterly report must contain all counterparties of each CFTC-regulated entity and also must be limited to CFTC-regulated products.

Christie Hillsman: Great. Thank you, Rina.

At this point I'd like to turn to the next grouping of questions that I have here, and these are all somewhat technical questions. So, we'll move on to these. Our first technical question, I'll pass over to you, Antonina, and that is, "You mentioned earlier that NFA doesn't expect firms to amend the annual questionnaire once it has been submitted. But can a firm modify answers to the questionnaire if needed?"

Antonina Harden: Sure. The questionnaire must be completed once annually and is not intended to be amended throughout the year. However, if incorrect information was submitted to NFA, the firm can modify the answers to the questionnaire, as appropriate.

Christie Hillsman: Great. Thank you, Antonina.

And I'm going to pass our next question over to you as well. That is, "In case of multiple entities, does NFA require multiple submissions?"

Antonina Harden: [AMENDED] The Firm can submit annual filings only for the primary entity. Quarterly filings must be submitted at the entity level.

Christie Hillsman: Perfect. Thanks, Antonina.

And Rina, I'll turn over to you with our next question, technical-related again. That is, "Is this a new system being used for the new program?"

Rina Callisto: No, this is not a new system. Actually, the system and the access are the same. Also, on a separate note, it appears that sometimes there are delays in our communication and it takes some time for margin- and capital-related communications to reach all appropriate stakeholders. Please note that we have established a "Margin Contact" tool in the Margin Model Submission System that allows you to indicate individuals that should be included in IM-related communications, in addition to those that are in the ORS system. Please make sure that the right people are included as margin contacts. Something similar exists for capital, too. If you need more information, please feel free to reach out after the webinar, and we will point you in the right direction.

Christie Hillsman: Excellent. Thanks for that, Rina.

Antonina, I'm going to pass our next question here over to you. "Are you requiring data to be submitted via an XML file similar to the risk data filing and swap valuation dispute submission?"

Antonina Harden: No. Only manual submissions will be accepted by the system. Given the extremely limited amount of data requested, we do not intend to publish an XML template at this stage. Of course, if you think a template would be helpful please let us know.

Christie Hillsman: Perfect. Thanks, Antonina.

Now we'll turn over to the third overarching topic that I've identified with the questions that were submitted while we were going through our presentation. These are all questions that appear to be specific to the new program. So, we'll start off with a question for you, Antonina. That is, "How will NFA prioritize firms for margin exams?"

Antonina Harden: Sure. Prioritization will be based on red flags identified in the quarterly and annual submissions. However, NFA staff will request additional information before conducting a review. Note that firms also have the opportunity to explain any anomalies during their submission process.

In any case, as we have mentioned previously, the revised oversight program will also include a more in-depth review of each swap dealer's IM model on an 18-month cycle on areas covered by the CFTC regulations and NFA requirements, regardless. I would say that each firm at the minimum will undergo a review process within an 18-month cycle. The 18-month cycle will start with the first data collection.

Christie Hillsman: Perfect. Thank you, Antonina.

Rina, I'll turn to you with our next question. That is, "If a firm has red flags, will an ad hoc review start immediately?"

Rina Callisto: Yes. So, a firm with red flags will be prioritized and most likely will be seen before other firms.

Christie Hillsman: Thanks, Rina.

And I'll pass our next question to you, as well. And that is, "Are we expected to start submitting under the new program starting this upcoming quarter?"

Rina Callisto: So, the go-live date is set for the 30th of September, 2020, with the first quarterly filing due on the last business day of October 2020. Please note that the old program has been retired and NFA does not accept submissions under the old program anymore. However, any outstanding item pertaining to an ad hoc request is still due by the established due date.

Christie Hillsman: Great. Thank you, Rina.

And our next question I will pass to you, Antonina. That is, "Can NFA require analysis of the shortfalls during the margin exam?"

Antonina Harden: Yes. We expect the firm to perform all types of monitoring testing specified in NFA's approval letter and to analyze all the exceedances breaching internal thresholds established by the swap dealer and included in the swap dealer's policies and procedures and ongoing monitoring reports. This information can be requested by NFA during the margin review or as needed.

Christie Hillsman: Excellent. Thank you, Antonina.

And that concludes the list of questions that I was able to categorize as we were going through our prepared presentation. So, at this point, I apologize—the next questions that I go through will not be grouped in any meaningful way, but we'll just address those in the order that they were submitted.

So, first, Antonina, I will turn to you with a question. That question is, "When you say CFTC internal audit report, do you mean the CCO report?"

Antonina Harden: No. CFTC Regulation 23.154 requires swap dealers to conduct an annual audit report of the initial margin model framework, and the regulation prescribes to check on an annual basis the effectiveness of the controls supporting the IM model calculation and describes certain components which must be checked.

Christie Hillsman: Great. Thanks for that, Antonina.

And Rina, I'll turn to you with our next question. That is, "Our firm has a submission due for the end of September. Will the User Guide be available by then and the system live? We usually submit a few days before the end of the month."

Rina Callisto: So, as we have specified before, the User Guide will be available prior the system will go live. So, the system will go live on the 30th of September, 2020. So, the User Guide will be available prior to that date.

Christie Hillsman: Great. Thank you, Rina.

And I will pass our next question to you, as well. That is, "Is the upcoming filing due by September 30th expected to be completed according to the new standardized requirements?" Rina?

Rina Callisto: So, the system will go live September 30th, with the first filing due the last business day of October 2020. So, the standardized filing will be due by the last business day of October 2020.

Christie Hillsman: Great. Thank you, Rina.

And our next question I will turn over to you, Antonina. That is, "Will NFA be conducting on-site model exams?"

Antonina Harden: While we anticipate that most of the work will be done by document request, if needed we may schedule an interview with main stakeholders.

Christie Hillsman: Perfect. Thank you, Antonina.

And this next question may be our last, depending on if anything additional comes through as we address this one. But Antonina, I will pass this over to you, as well. That is, "Are firms required to submit backtesting and benchmarking shortfalls only on the SIMM collect side? Or are we expected to take the biggest five from SIMM collect and post side?"

Antonina Harden: NFA will be interested in each side separately. So, five on each side.

Christie Hillsman: Great. Thank you, Antonina.

And actually, we did just get another question that is a great segue into wrapping up today. That question is, "When will the replay of today's webinar be available?" And shortly following the conclusion of today's webinar, a recording will be available at the same link that you used to access this morning's webinar. And then, as a reminder, we will also have a transcript of today's webinar available for you in the coming weeks, as well.

So, to close, first, I'd like to thank all of you for participating today. We hope you found the information we provided to be helpful. And I'd also like to thank Rina and Antonina for contributing to today's webinar. I think that was great.

Just one more quick reminder for everybody on today's webinar, if you do have questions at any point in time please do feel free to contact our Information Center, using the information that's available on your screen.

Again, thanks to everybody for participating in today's webinar, and enjoy the rest of your day.