



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
www.cftc.gov

Market Participants
Division

Joshua B. Sterling
Director

Thomas W. Sexton, III
President and Chief Executive Officer
National Futures Association
300 S. Riverside Plaza, #1800
Chicago, IL 60606-6615

Re: Swap Dealer Capital Model Determination Letter

Dear Mr. Sexton:

The Market Participants Division (the “MPD”) of the Commodity Futures Trading Commission (the “Commission”) has received on December 3, 2020 a complete package of materials from the National Futures Association (the “NFA”) documenting the program for review and issuing a determination of swap dealer capital model approval as permitted under Commission regulation 23.102.¹ Commission regulation 23.102(a) generally permits a swap dealer to apply to the Commission or to the registered futures association of which it is a member to obtain approval to use internal models for purposes of making model computations for capital under the Commission’s rules. In the latter case, the Commission must first determine that the NFA’s model requirements and review process are comparable to those of the Commission in order for the NFA’s review and approval to be sufficient as an alternative means of compliance.² This letter is to inform you that MPD staff has reviewed, and has no further comments or questions with regard to, the NFA’s initial documentation of the proposed swap dealer capital model requirements and review process.

The MPD has reviewed the NFA’s materials submitted to date which document the model requirements and review process, including the “First Day Letters” and “Initial Questionnaires.” In addition, the MPD has met with the NFA’s model review staff on several occasions to discuss the NFA’s proposed capital model review program and the proposed implementation of this program. The MPD has reviewed the submitted materials and evaluated the NFA’s proposed

¹ Commission regulations are found at 17 CFR Ch. 1.

² See 17 CFR 23.102(a).

Swap Dealer Capital Model Determination

program against the Commission's own requirements and processes required under Commission regulation 23.102, noting no material differences.³

Accordingly, pursuant to authority delegated to the MPD by the Commission,⁴ the MPD has determined at this time that the NFA's swap dealer capital model requirements and model review process are comparable to those of the Commission and, as such, model approval by the NFA is hereby permitted to be accepted as an alternative means of compliance under Commission regulation 23.102.

The MPD expects routine discussions regarding implementation of the capital model program to continue as a matter of normal oversight. Any anticipated material changes to the processes or requirements related to the NFA swap dealer capital model approval program must be communicated to MPD staff prior to their implementation. MPD staff will review the anticipated changes for purposes of ensuring that the NFA model approval program remains comparable to the Commission's program.

If you have questions regarding this letter, please contact Thomas Smith, Deputy Director, at 202-418-5495, Rafael Martinez, Senior Financial Risk Analyst, at 202-418-5462, or Josh Beale, Associate Director, 202-418-5446.

Sincerely,

Joshua B. Sterling
Director
Market Participants Division

³ For more detail, please refer to the attached SD Capital Model Determination summary document.

⁴ See 17 CFR 140.91(a)(11).

Swap Dealer Capital Model Determination

Summary: *Commodity Futures Trading Commission (the “Commission”) Regulation 23.102 requires that a Swap Dealer (“SD”) applying for capital model approval provide to the Commission or a registered futures association⁵ a description of critical model components, and directs the SD to different requirements depending on its elected capital approach.⁶ SDs electing to comply with capital requirements using the “bank-based approach” are directed to submit information required under subpart E or F of 12 CFR 217, while SDs electing the “net liquid assets approach” are directed to file information required under Appendix A to subpart E of 17 CFR Part 23.⁷*

Each of these requirements include, but are not limited to, generally (i) a list of categories of positions that the SD holds in its proprietary accounts and a brief description of the methods the SD would use to calculate market risk and credit risk charges; (ii) a description of the mathematical models to be used to price positions and to compute market risk and credit risk; (iii) a description of how the SD would calculate current exposure and potential future exposure for its credit risk charges, and (iv) a description of how the SD would determine internal credit risk-weights of counterparties, if applicable.⁸ In addition, an application is further required to be supplemented by other information relating to the internal risk management control system, mathematical models and financial position of the SD that the Commission or a registered futures association may request to complete its review.⁹

The Commission has approved the NFA Compliance Rule 2-49, which automatically incorporates into the NFA’s rules all of the model requirements discussed above.¹⁰ In addition, the NFA submitted to the Commission additional model process documents which further outline the design and operation of the NFA’s SD capital model program, including a high-level model process overview, initial first-day request letter to be sent to firms, and several model-specific and operational questionnaires. The following table outlines the major model application components required by the rules and where such requirements have been identified in the NFA’s provided program.

⁵ The National Futures Association (NFA) is the only registered futures association under the Commodity Exchange Act.

⁶ See 17 CFR 23.102.

⁷ See 17 CFR 23.102(c).

⁸ See Paragraph (a) of Appendix A to Subpart E of 17 CFR Part 23.

⁹ See Paragraph (b) of Appendix A to Subpart E of 17 CFR Part 23.

¹⁰ See NFA Compliance Rule 2-49 available at:

<https://www.nfa.futures.org/rulebook/rules.aspx?Section=4&RuleID=RULE%202-49>.

SD Capital Model Determination

| Model Component | CFTC Ref. | NFA Ref. (Doc. or Questionnaire Title ¹¹) |
|---|--|---|
| Model Development and Implementation | | |
| Development | Appendix A (a)(3) | VaR, SVaR, Credit, Specific, Comprehensive, Incremental, Market, Model Dev. |
| Model Testing | Appendix A (i)(2)(iv)(A), Appendix A (k)(2)(iii) | VaR, SVaR, Credit, Specific, Incremental, Comprehensive, Model Dev. |
| P&L Methodology | 23.100 (definitions) | FDL, VaR, Credit |
| Model Changes | Appendix A (f) | FDL |
| Data Assessment | Appendix A (m)(2)(iii), Appendix A (m)(2)(ii), Appendix A (k)(3), Appendix A (i)(1)(ii)(B) | VaR, SVaR, Specific, Comprehensive, Incremental, Model Dev., Model Risk |
| Systems Integration | Appendix A (i)(1)(i) | VaR |
| Ongoing Monitoring | Appendix A (i)(1)(ii)(B) | Model Risk, Model Dev. |
| Validation | | |
| Benchmarking | Appendix A (m)(1)(ii)(B) | FDL, Comprehensive, SVaR, Credit |
| Outcomes/Backtesting | Appendix A (i)(1)(ii)(C) | FDL, Specific |
| Stress Period for SVaR | Appendix A (j)(1)(iii) | FDL, SVaR |
| Stress Test for Comprehensive Risk | Appendix A (m)(3)(ii) | FDL, Comprehensive |
| Risk Management | | |
| Governance | 23.600 (e)(2) | Model Risk |
| Audit | 23.600 (e)(2) | Model Risk |
| Documentation | 23.600 (e)(3) | Model Risk |

¹¹ NFA reference documents: First Day Request Letter (“FDL”); Model Development Questionnaire (“Model Dev.”); Model Risk Management Questionnaire (“Model Risk”); VaR Risk Questionnaire (“VaR”); Stressed VaR Risk Questionnaire (“SVaR”); Market Risk Questionnaire (“Market”); Credit Risk Questionnaire (“Credit”); Incremental Risk Questionnaire (“Incremental”); Comprehensive Risk Questionnaire (“Comprehensive”); Specific Risk Questionnaire (“Specific”).