May 15, 2017

Mr. Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: RIN 3038—AD54: Capital Requirements of Swap Dealers and Major Swap Participants

Dear Mr. Kirkpatrick:

National Futures Association (NFA) appreciates the opportunity to comment on the Commodity Futures Trading Commission's (CFTC or Commission) proposed rulemaking regarding capital requirements of Swap Dealers (SDs) and Major Swap Participants. Under the proposal, SDs that are subject to the bank-based, net liquid assets, or tangible net worth capital approaches are subject to market and credit risk capital charges on their swaps, security-based swaps and other proprietary positions in computing their regulatory capital. Proposed Commission Regulation 23.102 permits an SD to compute market and credit risk capital charges using internal models in lieu of the standardized rules-based capital charges provided the Commission or a registered futures association of which the SD is a member (*i.e.*, NFA) has approved the SD's use of internal models to calculate credit and market risk exposures.

If the Commission adopts Commission Regulation 23.102, NFA is certainly willing to undertake a review of SDs' internal models for calculating market and credit risk exposures to determine the models' compliance with proposed Appendix A to Regulation 23.102. As discussed below, NFA assembled a team with significant model expertise in order to review SD initial margin models, and NFA will utilize similar resources to ensure an appropriate review of capital models. NFA encourages the Commission to consider NFA's comments on the process for reviewing these internal models.

NFA recognizes the importance of conducting a thorough and rigorous review of any capital models submitted to NFA for review and is committed to doing just that. We also share the Commission's goal of ensuring that the review process for capital models is efficient and that regulatory resources are not squandered through

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duplication of effort. Based on those goals and on our experience in reviewing initial margin models, NFA proposes certain changes to the proposed approval process as explained below. In our view, these proposed changes will significantly enhance the efficiency of the process without in any way reducing its effectiveness.

Last year, NFA reviewed and approved 32 SDs' (from nine corporate families) use of an internal margin model for uncleared swaps. These SDs were required to meet the September 1, 2016 compliance date for the initial margin rules and the vast majority of these SDs were non-bank subsidiaries of bank holding companies. In order to review and approve the SDs' internal margin models, NFA developed an extensive model review process, hired three senior quantitative analysts, and engaged thirteen other quantitative analysts for a total cost of over $1.5 million. As the Commission notes in its release, the proposed review and approval framework for internal market and credit risk models is consistent with the Commission's requirements related to initial margin models.

Importantly, however, as the Commission also notes in its release, the review and approval of capital models will pose different challenges than those faced in reviewing and approving initial margin models. As the Commission recognized in the proposed rulemaking, there are several reasons why approvals of internal capital models will be significantly more complex than approvals of initial margin models. Those reasons include:

- There is no industry-wide, internal capital model that could be submitted for approval (in contrast to the industry's adoption of the ISDA SIMM™ for initial margin model purposes); and
- Capital model reviews could involve the analysis of several models per firm that cover different capital-related market and credit risks (e.g., VaR, stressed VaR, incremental default risk, comprehensive risk), all of which are significantly more complex than an initial margin model.

Additionally, unlike the Commission's initial margin requirements that have a five year phase-in period, the timing of the effective date for the capital requirements is undetermined. As a result, all SDs may be required to comply by the same date, which would include firms with little or no experience with models or, in some cases, no experience with regulatory capital standards.

There are currently 102 registered SDs and based on our estimates, 51 of those SDs are not subject to the Commission's capital requirements (15 US banks and

36 non-US banks) since they will be recognized as regulated by a US prudential regulator for capital purposes. Nine are broker dealers that will be permitted to rely on the SEC's approval of models under the SEC's alternative net capital rules. Therefore, if the Commission establishes a single compliance date for its final capital requirements, it appears that as many as 42 SDs (from 24 corporate families) will be subject to the full scope of the CFTC's capital rules, including required model approvals.

Given the number of SDs that may seek model approval to meet a capital rule's effective date and the complexity of these individually developed models, NFA strongly believes that a review and approval framework different from the one implemented for internal margin model reviews is necessary. The new framework will have its greatest impact on the review of capital models for SDs that are non-bank subsidiaries of prudentially regulated bank holding companies and foreign bank-regulated SDs. Specifically, for these SDs, NFA proposes an alternative framework that will still determine whether an SD's internal market and credit risk models comply with proposed Appendix A to Regulation 23.102 but at the same time will appropriately leverage prior reviews and/or approvals of existing models by prudential regulators, thus minimizing the duplication of efforts across regulators.

Of the 42 SDs subject to the Commission's capital rules, 25 (from 9 corporate families) are non-bank subsidiaries of prudentially regulated bank holding companies or foreign bank-regulated SDs. Those 25 SDs will likely adopt the bank-based capital approach set forth in proposed Commission Regulation 23.101(a)(1)(i), and seek to use the market and credit risk capital models previously reviewed for use by a prudential regulator for the SD's affiliated bank holding company. NFA believes the fact that these SDs will likely use previously reviewed capital models permits a review process different than that applicable to the SDs' use of the ISDA SIMM™ for internal margin, which no SD had in use prior to September 1, 2016.

Therefore, for an SD electing to adopt the bank-based capital approach, NFA recommends that if the SD will use internal credit and market risk capital models previously reviewed by a prudential regulator, the Commission or NFA will not have to formally approve the SD's use of these models prior to the capital rule's effective date. Rather, NFA will develop a framework as part of NFA's examination process and ongoing capital compliance monitoring program to review these SDs' models for compliance with the CFTC's SD capital requirements after the effective date. NFA's monitoring framework for capital models will be conceptually similar to the current program NFA uses to monitor initial margin models, and NFA will monitor, at a minimum, each SD's overall governance around its market and credit risk models and their use, analyzing performance test results for the models, and monitoring for compliance with the CFTC's SD capital rules.

If the Commission adopts this alternative framework for SDs adopting the bank-based capital approach set forth in proposed Commission Regulation 23.101(a)(1)(i), then the CFTC or NFA will be able to focus model review and approval resources on those SDs that plan to use credit and market risk models that have not been subject to any prior reviews. For example, NFA estimates that if its review and formal approval of credit and market risk capital models is limited to approximately 17 SDs[1] (from 15 corporate families), then the resources devoted to this process would be similar to those utilized for NFA's review of initial margin models (over a one year time frame as noted below).

Given the complexity of the market and credit risk models, and the fact that firms will likely be submitting multiple models, NFA recommends that the Commission's final capital rule establish a review and approval process timeline requiring that those SDs seeking model approval submit their applications to the Commission or NFA within 90 days of the rule's effective date with a compliance date one year after the effective date. Based on NFA's experience reviewing internal margin models, this type of timeline will allow NFA to adequately review and approve credit and market risk capital models that have not been subject to any prior reviews and approvals.

NFA would also like to briefly comment on the additional reporting requirements set forth in proposed Regulation 23.105(k). In particular, NFA is in the process of adopting new reporting requirements for SDs, which will require SDs to report certain market and credit risk metrics to NFA on a monthly basis. NFA encourages the Commission to coordinate with NFA on any reporting requirements in order to avoid unnecessary duplication. NFA staff remains available to discuss with Commission staff the specific metrics that NFA intends to collect.

As previously noted, if the Commission adopts Commission Regulation 23.102, then NFA is certainly willing to assist the Commission to undertake a review of SDs' internal models for calculating market and credit risk exposures to determine the

[1] Three of these firms may be eligible for substituted compliance, which would reduce the number of firms to 14 (from 13 corporate families).

models' compliance with proposed Appendix A to Regulation 23.102. We appreciate the opportunity to comment on the model review and approval framework and are available to discuss this topic further with Commission staff. If you have any questions concerning this letter, please do not hesitate to contact Jamila Piracci, Vice President, OTC Derivatives (jpiracci@nfa.futures.org or 212-513-6014) or me (cwooding@nfa.futures.org or 312-781-1409).

Very truly yours,

Carol A. Wooding
Vice President and
General Counsel

(caw:Comment Letters_Swap Dealer Capital v2)