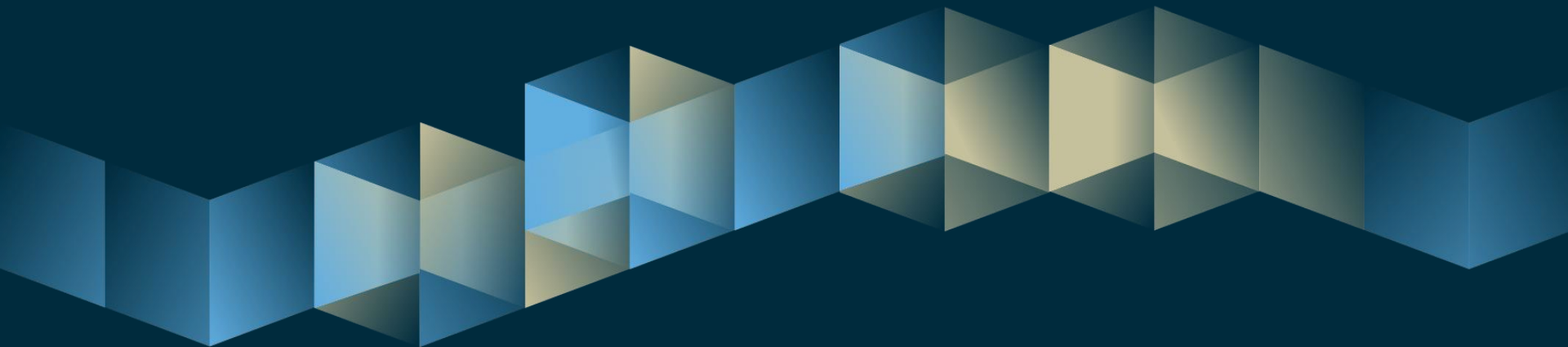




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NFA Swap Dealer Regulatory Workshop

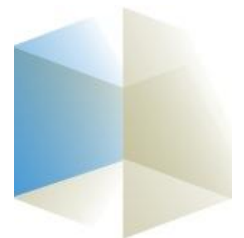
May 10, 2017 | New York



Today's Agenda

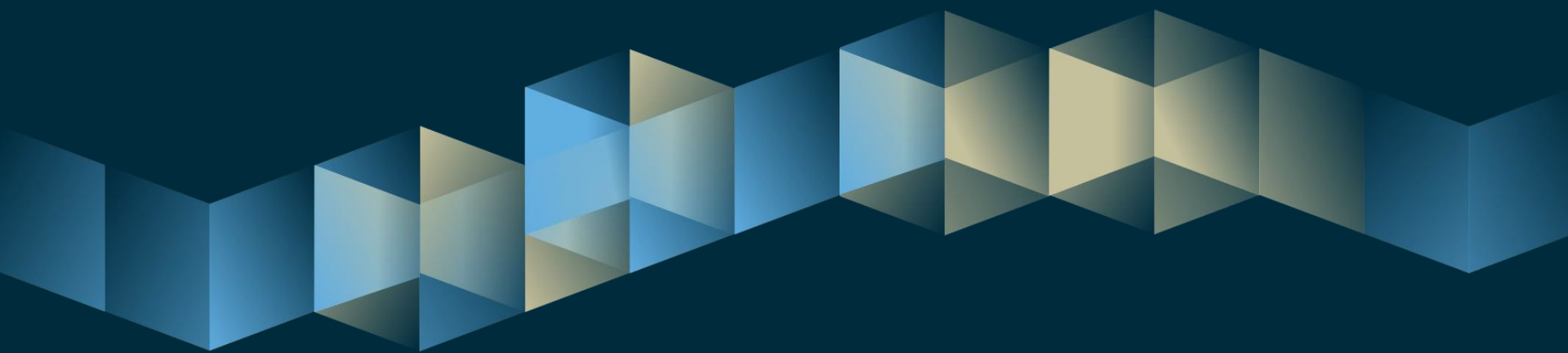
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- SD regulatory program background
- Themes from SD risk and market practice examinations
- NFA disciplinary process
- Upcoming SD examinations
- Questions





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SD REGULATORY PROGRAM BACKGROUND



SD Regulatory Program Background

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- NFA stays informed of significant developments at Member firms and in the industry (e.g. changes in business activities, key personnel)
- NFA uses a risk-based approach to examinations and determining examination scope
- NFA's SD regulatory program covers both U.S. and non-U.S. SDs



SD Regulatory Program Background

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- To stay informed of firm activities, NFA may:
 - Hold periodic meetings with Chief Compliance Officers (CCO) and other firm personnel to ascertain their continuing compliance with NFA rules and CFTC regulations
 - Review CCO Annual Report and perform due diligence of any material non-compliance issues





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A decorative graphic consisting of a series of interlocking, three-dimensional geometric shapes (cubes or prisms) arranged in a wave-like pattern. The shapes are rendered in shades of blue and gold, creating a sense of depth and movement.

THEMES FROM RISK MANAGEMENT AND MARKET PRACTICE EXAMINATIONS

Overview

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- Examinations focused on CFTC Regulations 23.600 and 23.410:
 - Risk governance
 - Risk management structure
 - Risk monitoring
 - Annual testing of the Risk Management Program (RMP)
 - Market practice



Risk Governance

8

- Governing body (GB) and senior management (SM) duties:
 - Approve risk tolerance limits (annually for GB & quarterly for SM)
 - Review quarterly risk exposure reports
 - Review results of annual test of risk management program
 - Approve risk management program (GB only)
 - Be informed of breaches to risk tolerance limits, as appropriate (SM only)
 - Other



Risk Governance Observations

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- Governing body (GB) and senior management (SM) composition:
 - Varies from 1 to 20 members
 - Members may include:
 - President, CEO, CCO, CRO, CFO and heads of business units
 - Risk Committee, Management Committee, other committees
 - Board of Directors (GB only)



Senior Management

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NFA's expectation:

- Representation from both the business and control functions
- Sufficient seniority and authority



Findings—Risk Governance

11

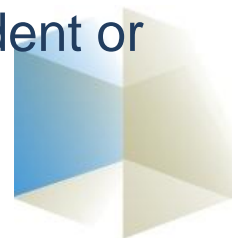
- Duties of governing body (GB) or senior management (SM) not performed
 - Risk Tolerance Limits not approved annually (GB) or quarterly (SM)
 - Not receiving results of the annual testing of risk management program
- Approvals not evidenced
- No representation of control function in senior management



Risk Management Structure

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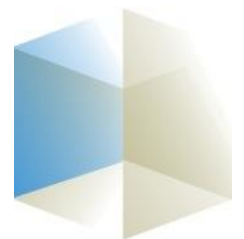
- Large global swap dealers
 - Matrix structure—CROs or risk officers:
 - Firm-wide;
 - Across line of business;
 - Within lines of business;
 - By region; and
 - By legal entity
 - Established legal entity risk limits
- Regional and smaller swap dealers (swap activities focus on one or two asset classes)
 - Designated CRO or other senior individuals such as President or CFO also performing CRO duties



Findings—Risk Monitoring

13

- Models not reviewed in accordance with policies
- Limits used in risk monitoring reports not consistent with approved limits
- Limit breaches not documented to show proper escalation and resolution
- Certain swap activities excluded from Dodd-Frank monitoring



Findings—Risk Monitoring

14

- Rules require SDs to provide a Risk Exposure Report to senior management and the governing body (GB) upon detection of a material change in risk exposure
 - Firms did not define what constitutes a material change in risk exposure
 - NFA is therefore unable to determine whether the SDs are meeting this rule requirement



Annual Testing of the RMP Observations

15

- Most SDs
 - Reliance on a combination of routine audits and a Dodd-Frank risk management program audit
 - Mapped rule areas to audit reports
- Some SDs
 - Single audit focused on Dodd-Frank risk management program



Findings—Annual Testing of the Risk Management Program (RMP)

16

- Insufficient testing performed
- Rules require SDs to review and test the RMP upon any material change in the business
 - Firms did not define what constitutes a material change in the business
 - NFA is therefore unable to determine if SDs are complying with the rules
- Results of testing not reported to the CCO, governing body (GB) and senior management (SM)



Market Practice

Prohibition On Fraud, Manipulation & Other Abusive Practices

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Examinations focused on:

- Communication of policy on prohibition
- E-communications and voice surveillance
- Trade surveillance
- Mandatory vacation



Communications Surveillance Observations

18

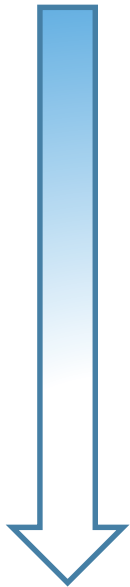
- Who is performing surveillance of e-communications and voice calls?
 - Primarily compliance
 - Business in some instances
- Common Practices
 - Sampling of voice records
 - Using surveillance technology



Observations—Trade Surveillance

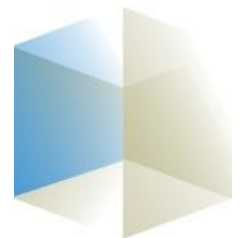
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Most Common



- Cancel and Corrects
- Usage of Allocation, Wash & Dormant Accounts
- Unusual Volume, Pricing, Commissions or Spreads
- Off Market Transactions
- Large Trades
- Front Running
- Trades Booked by Non-APs

Least Common



Mandatory Consecutive Days Vacation Observations

20

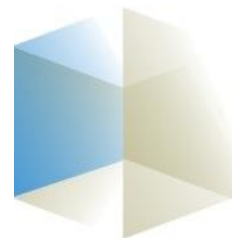
- Required by most firms
- Required of APs and sensitive persons in operations, finance, back-office
- Consecutive leave varied from five days to two weeks
- Varied from limited access to no access to systems or office
- Monitored using automated system or manual spreadsheet



Findings—Market Practice

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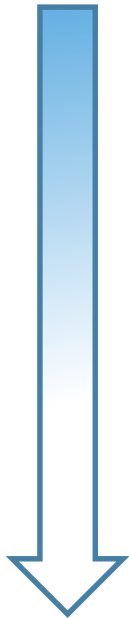
- E-communication surveillance:
 - Not performed
 - If performed by the business, no compliance oversight
- Not all associated persons included in e-communication surveillance
- Chat room not included in surveillance
- Limited trade surveillance with respect to the type of surveillance or asset classes covered



Findings Summary

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Most Common



- Risk Governance
- Testing of Risk Management Program
- Market Risk
- Market Practice
- Business Unit Responsibilities
- Recordkeeping
- Credit Risk
- Risk Exposure Report
- Operational Risk

Least Common

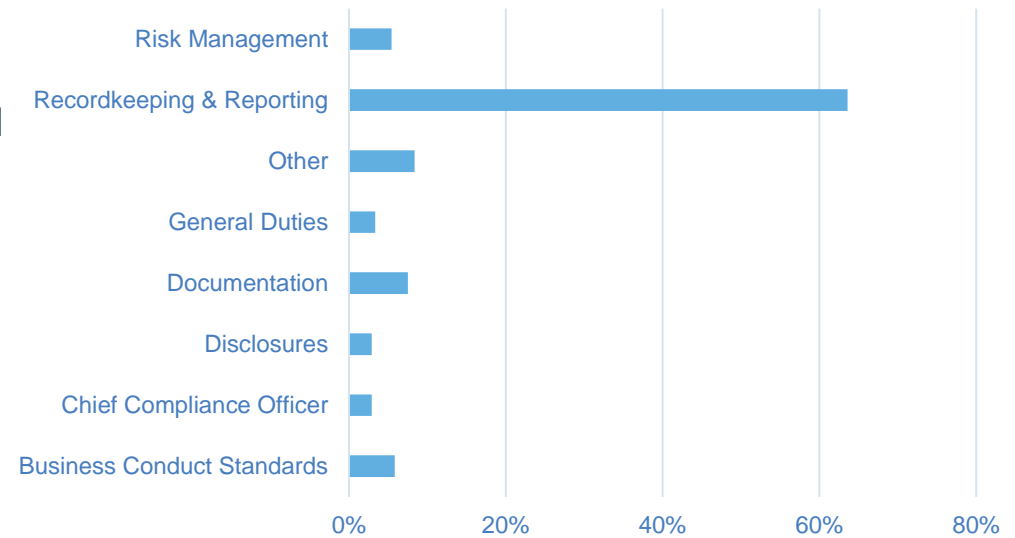


Self-Reported Issues Metrics

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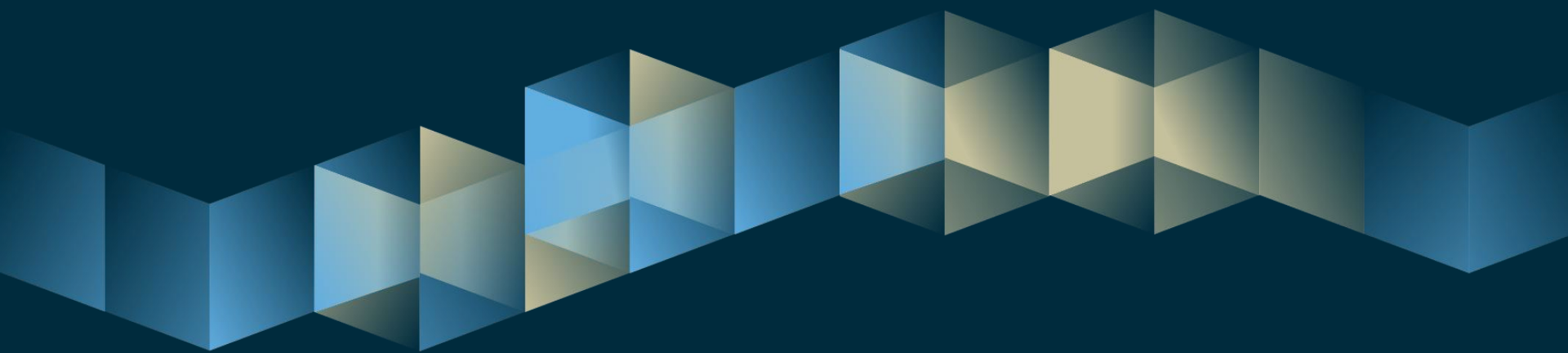
- Issues from January 2016 – March 2017
- Reported throughout the year and in CCO Annual Report as material non-compliance issues

- Recordkeeping and Reporting
 - SDR, LTR, Storage of data in proper format, retrievability of trade data and reconstruction of trades
- Documentation
 - Improper classification of counterparties, onboarding errors, confirmations
- Other category includes:
 - BCDR, Counterparty, Market Practice, Processing, Segregation, and Diligent Supervision





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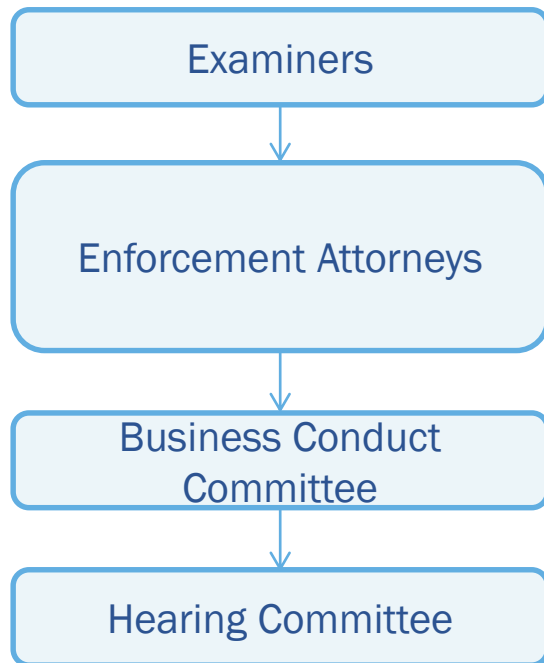


NFA DISCIPLINARY PROCESS



NFA Disciplinary Process Overview

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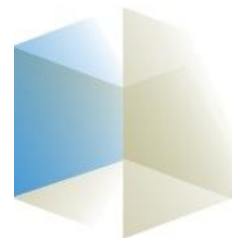


Identify apparent violations of NFA rules from regular examinations or investigations

Work with examiners to review apparent rule violations and determine whether the matter should be presented to NFA's Business Conduct Committee (BCC) for formal action

Reviews information presented by NFA staff and determines whether to issue a Complaint

Makes final determination of whether rule violations occurred and appropriate penalty



NFA Disciplinary Process

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Identifying apparent rule violations:

- NFA's disciplinary cases are limited to violations of NFA's rules
- Potential violations are identified in examinations or investigations
- Examiners work with NFA enforcement attorneys to reach initial conclusion on whether violation has occurred
- Senior staff determine whether to bring matter to the Business Conduct Committee (BCC)



NFA Disciplinary Process

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Business Conduct Committee (BCC) overview:

- Background on BCC
- BCC reviews a report prepared by staff on the apparent rule violation(s)
- BCC authorizes a formal Complaint if it believes the evidence provided supports a probable cause determination that an NFA rule(s) has been violated
- Complaint identifies the alleged rule violations and the activity that constitutes the violations

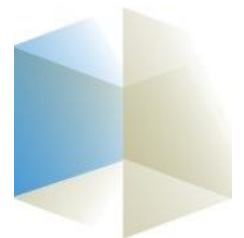


NFA Disciplinary Process

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Post Complaint:

- Background on NFA's Hearing Committee
- Prehearing Conference
- Settlements
- Hearings
- Decision
- Penalties
- Appeals Process



NFA Disciplinary Process

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Emergency Disciplinary Action:

- NFA also has authority to take an emergency action known as a Member Responsibility Action (MRA)
- NFA's Executive Committee will issue an MRA at the recommendation of staff when it believes the action is necessary to protect the markets, customers or other Members
- MRA may summarily suspend a Member, impose restrictions on the Member's operations or impose other remedial sanctions without a hearing



NFA Disciplinary Process

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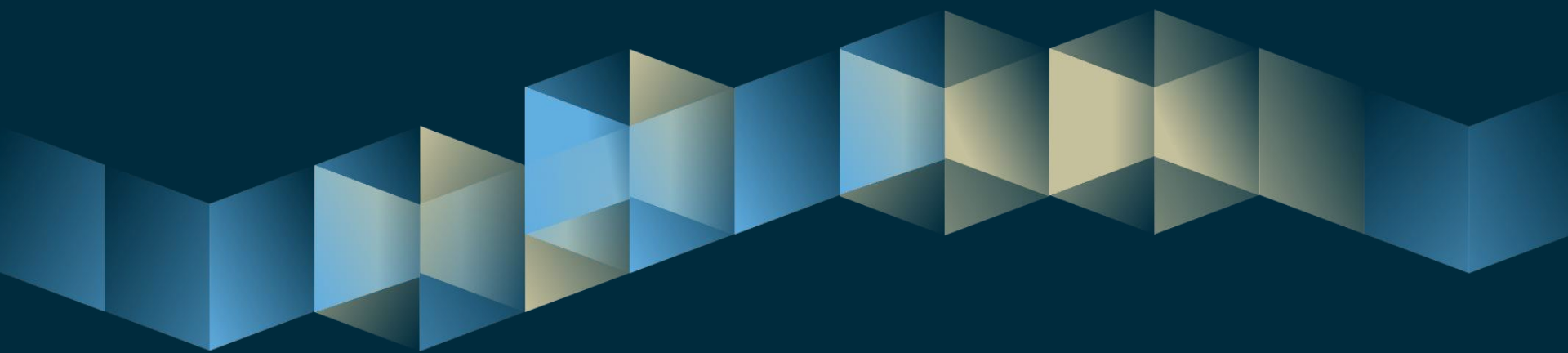
Emergency Disciplinary Action:

- Member respondent is entitled to a prompt hearing on the MRA
- Three-person Hearing Panel presides over the hearing
- Issues a Decision that may affirm, modify or lift the MRA
- Member respondent may appeal an adverse Decision to the CFTC





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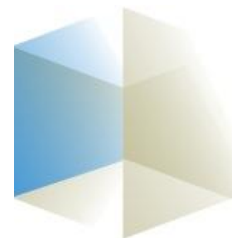
UPCOMING SD EXAMINATIONS



Upcoming SD Examinations

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- Next round begins May/June 2017
- Cycle lasts 18 to 24 months
- Covers U.S. SDs and several non-U.S. SDs



Examination Process

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NFA's Examination Process

Planning

Advise firm of upcoming examination
Send First Day Letter requesting documents required to start the review

Fieldwork

On-site
Interview key personnel and perform tests

Reporting

Provide preliminary findings at exit meeting
Issue written examination report



Examination Scope

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Topics	CFTC Regulation(s)
Margin	23.150-23.161
Segregation	23.701-23.704
Recordkeeping	23.202(a)(1), 23.204, 23.205
Swap Documentation	23.501-23.506
Special Entities	23.440, 23.450, 23.451
Disclosures	23.431, 23.432
Know Your Counterparty	23.402, 23.430, 23.434
Risk Management (including Cybersecurity)	23.600 (c)(4)(vi)

Note: If necessary, NFA may expand the examination scope to include additional rule areas / matters pursuant to the Commodity Exchange Act, CFTC Regulations or NFA requirements.

Contact Us

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If you have questions or would like more information, please contact NFA.

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