



Capital Requirements for Major Swap Participants and Swap Dealers

Section 4s(e) sets out the rulemaking requirements for swap dealers (SDs) and major swap participants (MSPs) that are banks and for SDs and MSPs that are not banks. The Commission's team working on developing capital requirements for SDs and MSPs requested NFA's input on the appropriate components of these requirements. NFA's goal is to provide the Commission with a conceptual model, rather than actual dollar or percentage requirements. Keeping in mind the overall goal of these capital requirements – ensuring the safety and soundness of SDs and MSPs – NFA has developed the following recommendations for the Commission's consideration.

Swap Dealers and Major Swap Participants that are Banks

SDs and MSPs that are banks will be subject to the capital requirements developed by their prudential regulator in consultation with the Commission and the SEC. For all practical purposes, the bank regulators will be setting these requirements, and although the regulatory agencies are supposed to harmonize them as much as possible, the banking requirements will have no real impact on SDs and MSPs that are not banks and subject to the Commission's requirements.

Swap Dealers and Major Swap Participants that are not Banks

There are fundamental differences between SDs and MSPs that call for different capital requirements that recognize those differences.

A. Major Swap Participants

This area may pose the greatest challenge for the Commission. Unlike a SD, many of the entities that will qualify as MSPs are companies that have never been restricted by a regulatory net capital requirement, and their ability to engage in swap transactions was dependent largely on the SD's view of their credit-worthiness. For example, many MSPs will be investment vehicles that are using swaps for speculation. These entities must be able to meet redemption requests from participants therefore there has to be more flexibility in what qualifies as "good capital" for purposes of the capital requirement. Given these factors, NFA concluded that the most appropriate capital requirement would, as discussed more fully below, include an eligibility requirement and a liquidity requirement.

In order for an entity to be able to engage in swaps to the level that would make it an MSP, that entity should have to meet a financial eligibility requirement – a minimum net worth that is commensurate with what the Commission determines is a “substantial position” in swaps. The eligibility amount may change based on the type and number of categories of swaps to which the entity is considered an MSP. This net worth number, however, will not be calculated in the same way that an FCM calculates its adjusted net capital. The MSP will not have to adjust its assets to reflect the ideas of “current” or “liquid.” Rather, the MSP will use a simple calculation of assets minus liabilities. NFA anticipates, however, that this minimum net worth requirement would be significantly higher than the current FCM capital requirement.

Although the net worth requirement will not take into account the idea of current or liquid assets, NFA does believe that it is important that these entities have a minimum amount of liquid assets to ensure they can meet margin calls on their swap positions. After considering numerous methods on how to calculate the appropriate amount of liquidity, NFA concluded that the method could not be so complicated that it would be difficult to calculate or to ensure compliance. NFA believes that the best method is to require an MSP to have access to liquid assets equal to a certain percentage of either current margin requirements for its swap positions or its required net worth. If the liquidity measure is based on margin requirements, there should not be any need to have an increased percentage for non-cleared compared to cleared swaps because the margin requirements for non-cleared should be set to offset the greater risk to the MSP arising from the use of swaps that are not cleared. As a result, the liquidity requirement would capture this additional risk.

NFA does not believe that MSPs should have to calculate capital and liquidity on a daily basis. Though a monthly calculation should be adequate, an MSP should be able to demonstrate compliance whenever requested by a regulator to do so.

B. Swap Dealers

The capital requirement model for a SD should be similar to the model used for calculating an FCM’s capital requirement. The minimum amount however would be significantly greater than an FCM’s requirement. Moreover, haircuts and other charges, especially those related to non-cleared swaps, would be greater than those attributable to exchange traded futures.

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