

Rule 17i-8: Notification Requirements for Supervised Investment Bank Holding Companies

SUPPORTING STATEMENT

A. Justification

1. Necessity For Information Collection

Section 231 of the Gramm-Leach-Bliley Act of 1999¹ (the “GLBA”) amended Section 17 of the Securities Exchange Act of 1934 (the “Exchange Act” or the “Act”) to create a regulatory framework under which a holding company of a broker-dealer may voluntarily be supervised by the Commission as a supervised investment bank holding company (or “SIBHC”).² In 2004, the Commission promulgated rules, including Rule 17i-6, to create a framework for the Commission to supervise SIBHCs.³ This framework includes qualification criteria for investment bank holding companies (“IBHCs”) that file notices of intention to be supervised by the Commission, as well as recordkeeping and reporting requirements for SIBHCs. Taken as a whole, the SIBHC framework permits the Commission to better monitor the financial condition, risk management, and activities of a broker-dealer’s parent and affiliates on a group-wide basis. In particular, it creates a formal process through which the Commission can access important information regarding activities of a broker-dealer’s affiliates that could impair the financial and operational stability of the broker-dealer or the SIBHC.

In addition, securities firms that do business in the European Union (“EU”) have indicated that they may need to demonstrate that they have consolidated supervision at the holding company level that is “equivalent” to EU consolidated supervision.⁴ The enactment of Section 17(i) of the Exchange Act was also intended to address this concern.⁵ This regulatory framework for SIBHCs is intended to provide a basis for non-U.S. financial regulators to treat the Commission as the principal U.S. consolidated, home-country supervisor for SIBHCs and their affiliated broker-dealers.⁶ This would minimize duplicative regulatory burdens on broker-dealers that are active in the EU and in other jurisdictions that may have similar laws.

Rule 17i-8 requires that an SIBHC to notify the Commission upon the occurrence of certain events. These events include (i) the occurrence of certain backtesting exceptions; (ii) the SIBHC’s computation reflects that consolidated allowable capital is less than 110% of the sum of consolidated allowances for market, credit and operational risk; (iii) an affiliate declares bankruptcy or otherwise becomes insolvent; (iv) the SIBHC becomes aware that a credit rating agency intends to decrease its evaluation of the creditworthiness of an affiliate or the credit rating assigned to one or more outstanding short or long-term obligations of an affiliate; (v) the

1 Pub. L. No. 106-102, 113 Stat. 1338 (1999).

2 See 15 U.S.C. 78q(i).

3 See Exchange Act Release No. 49831 (Jun. 8, 2004), 69 FR 34472 (Jun. 21, 2004).

4 See “Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002.”

5 See H.R. Conf. Rep. No. 106-434, 165 (1999).

6 See Exchange Act Release No. 49831, at 6 (Jun. 8, 2004), 69 FR 34472, at 34473 (Jun. 21, 2004).

SIBHC becomes aware that a financial regulatory agency or self-regulatory organization has taken certain regulatory actions against an affiliate; (vi) the SIBHC becomes ineligible to be supervised by the Commission as a SIBHC (e.g., the SIBHC purchases an insured bank, or the SIBHC's affiliated broker-dealer's tentative net capital falls below \$100 million);⁷ or (vii) if there were a material change (along with a description of that change) in the ownership or organization of the affiliate group, the status of any affiliate that is material, or the major business functions of any material affiliate. Certain of these events likely would indicate a decline in the financial and operational well-being of the firm.

The collections of information included in Rule 17i-8 are necessary to allow the Commission to effectively determine whether supervision of an IBHC as an SIBHC is necessary or appropriate in furtherance of the purposes of § 17 of the Act and allow the Commission to supervise the activities of these SIBHCs. Rule 17i-8 also enhances the Commission's supervision of the SIBHCs' subsidiary broker-dealers through collection of additional information and inspections of affiliates of those broker-dealers.

2. Purpose of, and Consequences of Not Requiring, the Information Collection

The early warning system provided for in Rule 17i-8 is designed to provide the Commission with information so that it can identify potential risks to broker-dealers affiliated with SIBHCs and, if necessary, seek additional information from the SIBHC or otherwise begin monitoring the SIBHC's activities more closely.

Without these notices, the Commission will be unable to adequately supervise an SIBHC, nor would it be able to determine whether continued supervision of an IBHC as an SIBHC were necessary and appropriate in furtherance of the purposes of § 17 of the Act.

3. Role of Improved Information Technology and Obstacles to Reducing Burden

Rule 17i-8 does not require that an SIBHC file information or documents via electronic submission. Further, as Rule 17i-8 only requires an SIBHC to notify the Commission upon the occurrence of certain events, it is unlikely that the SIBHC will be required to file these notices often. Thus, it would not be cost-effective to require that an information technology ("IT") system be created for this purpose and improved technology would not reduce the burden.

4. Efforts To Identify Duplication

No duplication is apparent.

5. Effects On Small Entities

An IBHC can apply to become an SIBHC only if it is not affiliated with an insured bank or a savings association,⁸ (ii) a foreign bank, foreign company, or a company that is described in section 8(a) of the International Banking Act of 1978, or (iii) a foreign bank that controls a

⁷ See paragraph 17i-8(a).

⁸ Exchange Act § 17(i)(1)(A)(i) [15 U.S.C. 78q(i)(1)(A)(i)].

corporation chartered under section 25A of the Federal Reserve Act.⁹ In addition, pursuant to paragraph (d)(2)(i)(B) of Rule 17i-2, the Commission would not consider such supervision necessary or appropriate unless the investment bank holding company demonstrates that it owns or controls a broker or dealer that has a substantial presence in the securities business, which may be demonstrated by a showing that the broker or dealer maintains tentative net capital of \$100 million or more. Accordingly, neither an IBHC nor an SIBHC could be a small entity.¹⁰

6. Consequences of Less Frequent Collection

These notices alert the Commission to any deterioration in an SIBHC's financial or operational position and risk profile. To the extent they are filed less frequently, the financial condition of an SIBHC could seriously decline before the Commission became aware of it, which could jeopardize the financial and operational condition of the SIBHC's affiliated broker-dealers and could possibly pose a risk to the securities marketplace.

7. Inconsistencies With Guidelines In 5 CFR 1320.5(d)(2)

The collection of information is not inconsistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

All Commission rule proposals are published in the Federal Register for public comment. This comment period is generally thirty days (but for Rule 17i-8 it was 90 days), which affords the public an opportunity to respond to the proposed rule changes.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Pursuant to Exchange Act § 17(j)¹¹ and Section 552(b)(3)(B) of the Freedom of Information Act,¹² notwithstanding any other provision of law, the Commission cannot be compelled to disclose any information required to be reported under §17(i). Section 17(j) states, [f]or purposes of section 522 of title 5 United States Code [commonly referred to as the Freedom of Information Act], this subsection shall be considered a statute described in subsection (b)(3) (B) of section 552," and "the Commission shall designate information described in or obtained pursuant to this section as confidential information for purposes of Exchange Act § 24(b)(2) [15 U.S.C. 78x(b)(2)]." In addition, paragraph 17i-8(c) specifies that the notices and reports filed in accordance with Rule 17i-8 will be accorded confidential treatment to the extent permitted by law.

9 Federal Reserve Act § 25A [12 U.S.C. 611].

10 See 17 CFR 240.0-10(c).

11 15 U.S.C. 78o(j).

12 5 U.S.C. 552(b)(3)(B).

11. Sensitive Questions

Not applicable; questions of a sensitive nature are not asked.

12. Estimate of Respondent Reporting Burden

As of March 31, 2006, approximately 140 registered broker-dealers reported their tentative net capital as being over \$100 million.¹³ Many of these broker-dealers are affiliated with another broker-dealer that reported its tentative net capital as being more than \$100 million. Approximately 35 could not be supervised by the Commission as an SIBHC due to the fact that each is either: (i) affiliated with an insured bank or a savings association,¹⁴ (ii) a foreign bank, foreign company, or a company that is described in section 8(a) of the International Banking Act of 1978, or (iii) a foreign bank that controls a corporation chartered under section 25A of the Federal Reserve Act.¹⁵ In addition, some broker-dealers may not be active in jurisdictions that require securities firms to demonstrate that they have consolidated supervision at the holding company level that is equivalent to EU consolidated supervision, or may not find it to be cost-effective to register as an SIBHC for other reasons.¹⁶ Thus, the Commission estimates that three IBHCs will file notices of intent to be supervised by the Commission as SIBHCs.

An SIBHC will require about one hour to create a notice required to be submitted to the Commission pursuant to Rule 17i-8. However, as these notices only need be filed in certain situations indicative of financial or operational difficulty, only one SIBHC may be required to file notice pursuant to the Rule every other year. Thus, we estimate that the annual burden of Rule 17i-8 for all SIBHCs would be about 30 minutes.

We estimate that it would cost an SIBHC approximately \$324 to create a notice required to be submitted to the Commission pursuant to Rule 17i-8.¹⁷ However, as stated above we

13 Per March 31, 2006, FOCUS Report filings. Broker-dealers are required to file monthly and/or quarterly reports on Form X-17A-5 pursuant to Rule 17a-5(a) (17 CFR 240.17a-5(a)), commonly referred to as FOCUS Reports.

14 See note 8.

15 See note 9.

16 Broker-dealers that have more than \$1 billion in tentative net capital can elect to calculate market and credit risk capital charges using mathematical modeling techniques if their holding company volunteers to be subject to consolidated supervision by the Commission under an alternative supervisory framework. Consequently, broker-dealers that are able to do so generally will elect that supervisory framework over the SIBHC framework. As of March 31, 2006 (*See note Error: Reference source not found*), 33 broker-dealers reported having tentative net capital over \$1 billion.

17 According to the Securities Industry Association (or "SIA"), the hourly cost of an Attorney based in New York City is \$324, as reflected in the SIA's *Report on Management and Professional Earnings for 2005*, and modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. (The SIA recently spoke with the Commission's Office of Economic Analysis to inform the Commission that the multiplier of 1.35 that the Commission has historically used was too low. The SIA informed the Commission that,

estimate that only one SIBHC may be required to send a notice as required by Rule 17i-8 every other year. Thus, we estimate that the total dollar cost of the ongoing paperwork burden associated with Rule 17i-8 for all SIBHCs would be about \$162.¹⁸

13. Estimate of Total Annualized Cost Burden

The estimated total annualized cost burden for Rule 17i-8 is \$0. Other than provided for in item number 12, it is not anticipated that any of the respondents will incur additional operational or maintenance costs.

14. Estimate of Cost to Federal Government

There will be no additional costs to the Federal Government.

15. Explanation of Changes in Burden

The changes in burden estimates are a result of changes to two factors included in the calculation. First, there was a change to the multiplier used to calculate the salary costs for broker-dealer employees.¹⁹ Second, the salary figures for the broker-dealer employees were updated.

16. Information Collection Planned for Statistical Purposes

Not applicable. There is no intention to publish the information for any purpose.

17. Explanation as to Why Expiration Date Will Not Be Displayed

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collection of Information Employing Statistical Methods

The collection of information does not employ statistical methods, nor would the implementation of such methods reduce the burden or improve the accuracy of results.

with increasing health care costs, the fact that the largest firms that pay higher salaries generally fail to respond to the SIA's salary survey, and other factors, the Commission should increase its multipliers. Consequently, the Commission and the SIA worked together to determine the level at which the multipliers should be set.) (\$324 x 1 hour) = \$324.

18 (\$324 x (30 minutes / one hour)) = \$162.

19 See note Error: Reference source not found.