

Appendix F of Rule 15c3-1

SUPPORTING STATEMENT

A. Justification

1. Necessity of Information Collection

Appendix F to Rule 15c3-1 is one of several rules that tailor capital, margin and other broker-dealer regulatory requirements to OTC derivative dealers. Registration as an OTC derivatives dealer is optional. Under Rule 15c3-1,¹ a broker-dealer that elects to register as an OTC derivatives dealer is required to maintain tentative net capital of not less than \$100 million and net capital of not less than \$20 million. The purpose of Appendix F² to the net capital rule is to ensure that OTC derivative dealers maintain sufficient liquid resources to meet their liabilities.

Under Appendix F's alternative net capital requirements, the Commission may authorize an OTC derivatives dealer to use value-at-risk ("VaR") models to calculate capital charges for market risk and to take alternative charges for credit risk than those currently prescribed for broker-dealers. In order to use VaR models under Appendix F, an OTC derivatives dealer must file an application with, and obtain authorization from, the Commission. The application, among other things, must describe the VaR model, including whether the firm has developed its own model and how the qualitative and quantitative aspects of Appendix F are incorporated into the model. In addition to obtaining Commission approval of its application, an OTC derivatives dealer must maintain its model according to certain prescribed standards. Maintenance of the model requires an OTC derivatives dealer to create and maintain certain information. For example, the OTC derivatives dealer must conduct backtesting by comparing each of its most recent 250 business days' actual net trading profit or loss with the corresponding daily VAR measures. Finally, the OTC derivatives dealer must submit a description of its risk management control system implemented pursuant to Rule 15c3-4.

The statutory authority for Appendix F is embodied in Sections 15(c)(3) and 23(a) of the Securities Exchange Act, 15 USC 78o(c)(3), 78w. Appendix F was promulgated under Section 15(c)(3) of the Securities Exchange Act of 1934, as amended, which directed the Commission to adopt minimum financial responsibility requirements for all brokers and dealers.

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

Appendix F of Rule 15c3-1 is an integral part of the Commission's financial responsibility program for OTC derivatives dealers. The purpose of Appendix F is to ensure that OTC derivatives dealers have on hand at all times sufficient liquid resources to meet their obligations and liabilities. Appendix F enables the Commission monitor the financial condition

¹ 17 CFR 240.15c3-1.

² 17 CFR 240.15c3-1f.

of OTC derivatives dealers. If the information is not required to be collected, the Commission would not be able to monitor the financial condition of OTC derivatives dealers, thus weakening the protection of investors and the public.

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

Firms subject to Appendix F utilize automated systems for computing their capital requirements. Because the staff expects relatively few OTC derivatives dealers to register, it is not economically feasible for the Commission to develop a system which would allow for electronic filing.

4. Efforts to Identify Duplication

OTC derivatives dealers are not otherwise required to obtain and maintain the information required by the Rule.

5. Effects on Small Entities

Registered broker-dealers must maintain a minimum amount of net capital. However, the Rule subjects small entities to different requirements. Appendix F to the Rule does not affect small entities because the required minimum net capital, by definition, excludes small entities.

6. Consequences of Less Frequent Collection

Conducting the required activities less frequently would lessen the protection afforded to the public.

7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)

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

8. Consultations Outside Agency

Appendix F was published in the Federal Register for public comment on December 17, 1997 as part of the Commission's OTC derivatives dealers proposed rules.³ The comment period lasted sixty days, and the Commission received approximately twenty-one comment letters. The Commission considered these comments when drafting the final rule. The Rule was adopted in

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Exchange Act Release No. 34-39454 (Dec. 17, 1997), 62 FR 67940.

1998 and has since remained unchanged.⁴ Therefore, there has been no recent need for consultation with persons outside the agency.

9. Payment or Gift to Respondents

No gifts or payments will be given to respondents.

10. Assurance of Confidentiality

The Commission regards the information obtained pursuant to the filings and notices required by the Rule to be confidential. Such information is of a financial nature and generally is not disclosed to the public. The statutory basis for the Commission's refusal to disclose such information to the public is the exemption contained in Section (b)(4) of the Freedom of Information Act, 5 U.S.C. 552, which essentially provides that the requirement of public dissemination does not apply to commercial or financial information which is privileged or confidential.

11. Sensitive Questions

No inquiries of a sensitive nature are made.

12. Estimates of Respondent Reporting Burden

Appendix F currently applies to five firms, which applied to and received permission from the Commission to register as OTC derivatives dealers. No additional firms are anticipated to apply. These OTC derivatives dealers will spend an average of approximately 1,000 hours each maintaining the model. Consequently, the total annual burden is estimated to be 5,000 hours (5 x 1,000). The estimates of the annual burden are based on experience from the registration of the five current OTC derivatives dealers.

13. Estimates of Total Annualized Cost Burden

The staff does not anticipate that any additional firms will register as OTC derivatives. Therefore, the estimated total annualized cost burden would be \$0.

14. Estimated Cost to the Federal Government

The Division estimates that it will cost approximately \$24,000 to review the submissions required by the Rule based on our computation of the value of staff time devoted to this activity and the related overhead, valued at 35 percent of staff time. These estimates have been computed pursuant to the GSA, Guide to Estimating Reporting Costs (1973).

⁴

Exchange Act Release No. 34-40594 (Nov. 3, 1998), 63 FR 59398.

15. Explanation of Changes in Burden

There is no change in the annual reporting and record-keeping hours burden of 1,000 hours listed on Item 12 of the Appendix F OMB Form 83-I. Although the staff estimated that six firms would apply to become OTC derivatives dealers when the OTC derivatives dealers rules were adopted, five firms have done so. Based upon recent inquiries, however, the staff does not expect that any additional firms will register as OTC derivatives dealers.

The change in the total annualized capital/startup costs listed on Item 13 of the Appendix F OMB Form 83-I from \$106,000 to zero reflects the fact that the staff does not anticipate that any additional firms will register as OTC derivatives dealers.

16. Information Collection Planned for Statistical Purposes

This provision is not applicable because compliance with Rule 15c3-1 will not require the employment of statistical methods. There is no intention to publish the information for any purpose.

17. Explanation of Why Expiration Date Will Not Be Displayed

Not applicable.

18. Exceptions to the Certification

The Commission is not seeking an exception to the certification statement.

B. Collections of Information Employing Statistical Methods

Not applicable.