Extension of Rule 15c3-4

SUPPORTING STATEMENT

A. Justification

1. Necessity for Information Collection

Rule 15c3-4 requires that an OTC derivatives dealer establish, document, and maintain an internal risk management control system. While the rule does not specify the length of time the record created pursuant to this rule must be maintained, an OTC derivatives dealer is expected to be able to provide the staff with a copy of its documented risk management control procedures when it registers to become an OTC derivatives dealer and it is expected to be able to provide examiners with a copy of such procedures when it is subsequently examined.

Rule 15c3-4 further sets forth the basic elements governing the establishment, execution, and review of an OTC derivatives dealer's risk management control system. These elements are designed to ensure the integrity of OTC derivatives dealer's risk measurement, monitoring, and management process, to clarify accountability, at the appropriate organizational level, and to define the permitted scope of the dealer's activity and level of risk. The requirements of Rule 15c3-4 to adopt an internal risk management system also apply to certain broker-dealers that compute specific net capital charges under Appendix E to the Rule 15c3-1 and their ultimate holding companies that submit to group-wide Commission supervision under Appendix G to Rule 15c3-1 (which are collectively referred to as consolidated supervised entities or Cases).[1]

Rule 15c3-4 is designed to ensure the integrity of the risk measurement, monitoring, and management process, and to clarify accountability, at the appropriate organizational level, for defining the permitted scope of activity and level of risk. All financial market participants are exposed to various types of risk, whether they conduct business in the standardized securities markets or the over-the-counter derivatives market. Because of these and other risks, a broker-dealer registered with the Securities and Exchange Commission (the "Commission") as an OTC derivatives dealer must comply with, among other

[1] *See* Securities Exchange Act Release No. 49380 (June 8, 2004). This information collection, however, covers the hour burden associated with OTC derivatives dealers only. The hour burden for CSE firms is included in the Paperwork Reduction Act collection for Rule 15c3-1 which requires CSE firms to comply with specific provisions of Rule 15c3-4 in Appendix E to Rule 15c3-1. See 17 CFR 240.15c3-1e(a)(1)(ii) and (a)(viii)(C).

things, Rule 15c3-4 under the Securities Exchange Act of 1934 (the "Exchange Act"), which makes it necessary for such dealer to implement a risk management control system.

An OTC derivatives dealer also is required under Rule 15c3-4 to consider a number of issues impacting its business environment when creating its risk management control system. For example, an OTC derivatives dealer must consider, among other things, the sophistication and experience of relevant trading, risk management, and internal audit personnel, as well as the separation of duties among these personnel when designing and implementing its internal control system's guidelines, policies, and procedures. This ensures that the control system that is implemented adequately addresses the risks posed by the business being conducted and the environment in which it is being conducted. In addition, this enables an OTC derivatives dealer to implement specific policies and procedures that are unique to its circumstances.

The Commission is statutorily authorized to promulgate Rule 15c3-4 under Section 15(c)(3) of the Exchange Act (15 U.S.C. §§78o and 78q). This section authorizes the Commission to adopt rules and regulations regarding the financial responsibility of broker-dealers that the Commission deems necessary or appropriate in the public interest or for the protection of investors. Further statutory authority is found in Section 23(a) of the Exchange Act, 15 U.S.C. §78w.

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

Rule 15c3-4 is an integral part of the Commission's financial responsibility program for OTC derivatives dealers. The information collected under Rule 15c3-4 is essential to the regulation and oversight of OTC derivatives dealers and their financial responsibility. More specifically, requiring the OTC derivatives dealer to document the planning, implementation, and periodic review of their risk management controls ensures that all pertinent issues are considered and that the risk management controls are implemented properly and that they continue to adequately address the risks faced by OTC derivatives dealers.

A strong risk management control system is necessary for firms to manage the complex risks arising from the dealer's OTC derivatives business. Otherwise, the firm is vulnerable to enormous losses or financial failure. The implementation of risk management controls within financial intermediaries promotes their stability, and consequently, the stability of the entire financial system by reducing the risk of significant losses on the part of market participants. This, in turn, reduces the risk that massive defaults could undermine the market as a whole. Specifically, internal risk management controls provide two important functions: (1) to protect against firm specific risks such as operational, market, credit, legal, and liquidity risks; and (2) to protect the financial industry from systemic risk.

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

The four OTC derivatives dealers currently subject to Rule 15c3-4 and the one firm anticipated to be subject to Rule 15c3-4, utilize automated systems for preparing and reporting information. Thus, improved technology would not reduce the burden.

4. Efforts To Identify Duplication

OTC derivatives dealers are not otherwise required to obtain and maintain the information required by Rule 15c3-4.

5. Effects On Small Entities

Rule 15c3-4 does not and will not affect small entities because the required minimum net capital for an OTC derivatives dealer excludes small entities.

6. Consequences of Less Frequent Collection

If the required activities were to be conducted less frequently, the protection afforded to the public would be diminished.

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 the Agency

All Commission rule proposals are published in the Federal Register for public comment. The comment period for Rule 15c3-4 was ninety days, which afforded the public an opportunity to respond to or comment on the rule when it was proposed.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

The Commission treats information obtained pursuant to Rule 15c3-4 as 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 questions of a sensitive nature are asked under Rule 15c3-4.

12. Estimate of Respondent Reporting Burden

At present, four OTC derivatives dealers are registered with the Commission. The Commission anticipates that one additional entity will apply to become an OTC derivatives dealer within the next three years.

Based upon discussions with affected and potentially affected industry participants, the Commission estimates that, on average, a firm initially will take approximately 2,000 hours to establish and document its risk management control system. Further, we estimate that, on average, an OTC derivatives dealer will take approximately 200 hours each year to maintain its risk management control system.

Thus, under the present Rule 15c3-4, the total annualized burden would be 1,567 hours.[2]

13. Estimate of Total Annualized Cost Burden

The staff believes that the cost of complying with the current Rule 15c3-4 will be approximately $258 per hour.[3] Consequently, the annual cost for the one new OTC derivatives dealer will be approximately $516,000[4] to establish and document an internal risk management control system. Further, the new OTC derivatives dealer will also have be maintain this system for some period during the three years, which will cost, on average, $77,400.[5] Finally, the other four OTC

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2 ((2,000 hours x one firm {*for the new firm to establish and document its risk management control system*}) + (200 hours x one firm x (3 years / 2) {*to account for the new firm to maintain the internal risk management control system it has already established and documented after it has become registered at some point in the next 3 years*}) + (200 hours x 4 firms x 3 years {*to account for the existing registered OTC derivatives dealers maintenance of their existing risk management control systems*})) = 4,700 hours for three years. Consequently, the annualized burden equals approximately 1,567 hours.

3 This per hour cost is based upon an annual average hourly salary for a compliance manager who would be responsible for ensuring compliance with the requirements of Rule 15c3-4. The $258 per hour salary figure for a Compliance Manager is from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

4 (2,000 hours x 1 firm x $258 per hour) = $516,000.

5 (200 hours x 1 firm x (3 years / 2) x $258 per hour) = $77,400.

derivatives dealers will need to maintain their internal risk management control systems, which will cost, on average, $619,200 over the three year period.[6] Consequently, the total cost for all OTC derivatives dealers is estimated to be $1,212,600,[7] or $404,200 on an annualized basis.[8]

14. Estimate of Cost to Federal Government

It is estimated that reviews of existing and anticipated OTC derivatives dealers' risk management control systems, which will be performed by Commission staff, will take approximately 480 hours, costing the Commission approximately $24,000 based on the number of reviews that are likely to be performed and our computation of the value of staff time devoted to these reviews and the related overhead, valued at 35% of the value of staff time. This estimate was computed according to the guidelines set forth in GSA, Guide to Estimating Reporting Costs (1973). Guide to Estimating Reporting Costs (1973).

15. Explanation of Changes in Burden

The number of respondents decreased by one, from six OTC derivatives dealers to five.

The Commission also has adjusted the cost, based on updated salary information, from $205 per hour to $285 per hour.[9]

Finally, this PRA includes in the Total Annualized Cost Burden the costs associated with the burden to maintain the system incurred by registered OTC derivatives dealers. While the last PRA did estimate the burden hours associated with the annual maintenance of an OTC derivatives dealer's risk management control system, it did not include that estimate when calculating the Total Annualized Cost Burden (instead only the burden relative to the establishing and documenting the risk management control system were included in the cost estimate.

16. Information Collection Planned for Statistical Purposes

Not applicable.

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

Not applicable.

18. Exceptions to Certification

Not applicable.

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6 (200 hours x 4 firms x $258 x 3 years) = $619,200.

7 ($516,000 + $77,400 + $619,200) = $1,212,600.

8 ($1,212,600 / 3 years) = $404,200.

9 *See* footnote 2.

B. Collection of Information Employing Statistical Methods

Not applicable.