SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission for
"Appendix F to Rule 15c3-1"

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 F[2] 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 and Use of 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 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

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[1] 17 CFR 240.15c3-1.

[2] 17 CFR 240.15c3-1f.

the protection of investors and the public.

3. Consideration Given to Information Technology

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. Duplication

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

5. Effect 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 Not Conducting 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)

There are no special circumstances. This collection is consistent with the guidelines in 5 CFR 1320.5(d).

8. Consultations Outside the Agency

The required Federal Register notice with a 60-day comment period soliciting comments on this collection of information was published. No public comments were received.

9. Payment or Gift

No gifts or payments will be given to respondents.

10. 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 natural 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. Burden of Information Collection

At present, Appendix F applies to four OTC derivatives dealers registered with the Commission. These OTC derivatives dealers will spend an average of approximately 1,000 hours each per year maintaining the model, for an annual recurring burden of 4,000 hours.[3] The Commission anticipates that four additional entities will become OTC derivatives dealers during the next three years (including one entity that has submitted a pending application to become an OTC derivatives dealer). The Commission estimates that, on average, a firm initially will take approximately 1,000 hours to develop and establish a system model, for a one time burden of 4,000 hours. Additionally, these OTC derivatives dealers will spend an average of approximately 1,000 hours each maintaining the system model, for an annual burden of 4,000 hours.[4]

Consequently, the estimated total industry-wide recurring annual burden will be 8,000 hours.[5] There will also be an estimated one-time industry-wide startup burden of 4,000 hours.[6] Thus, the total industry-wide burden is estimated to be 12,000 hours for the first year and 8,000 hours for each subsequent year.[7] The estimates of the annual burden are based on experience from the registration of the four current OTC derivatives dealers.

The staff anticipates that four firms will register as OTC derivatives dealers within the next three years. The staff believes that compliance personnel will develop an OTC derivative dealer's VaR model, financial reporting specialists and compliance personnel will prepare the application describing the OTC derivative dealer's VaR model, and that financial reporting specialists will monitor the OTC derivative dealer's maintenance of the information on the VaR model. The staff estimates that the hourly salary of a financial reporting manager is $309 per hour,[8] and the hourly salary of a senior compliance staff is $230 per hour[9]. Based upon these numbers, the total one time

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3 Four (4) OTC derivatives dealers x 1,000 hours = 4,000 hours.

4 Four (4) OTC derivatives dealers x 1,000 hours = 4,000 hours.

5 (Four (4) OTC derivatives dealers + four (4) expected OTC derivatives dealer registrants) x 1,000 hours = 8,000 hours.

6 Four (4) OTC derivatives dealers x 1,000 hours = 4,000 hours.

7 8,000 hours + 4,000 hours = 12,000 hours.

8 $309 per hour figure for a financial reporting manager is from SIFMA's Management & Professional Earnings in the Securities Industry 2011, 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.

9 $230 per hour figure for a financial reporting manager is from SIFMA's Management & Professional Earnings in the Securities Industry 2011, 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.

internal start-up cost of compliance for four respondents is $277,400.00.[10]

13. Cost to Respondents

There is no cost to respondents apart from the monetization of the initial compliance cost stated in number 12.

14. Costs to Federal Government

The Division estimates that it will cost approximately $38,400 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. This includes $24,000 for the submissions of the four OTC derivatives dealers currently registered with the Commission, the one anticipated OTC derivatives dealer included in the previous collection, and an estimated $14,400 for the submissions three four firms that will register as OTC derivatives dealers within the next three years. These estimates have been computed pursuant to the GSA, Guide to Estimating Reporting Costs (1973).

15. Changes in Burden

The Commission estimates that a total of eight entities will be registered as OTC derivatives dealers at the end of the next three years, consisting of the four current OTC derivatives dealers and four anticipated registrants. This is in contrast with the prior estimate of five OTC derivatives dealers, consisting of four current OTC derivatives dealers and one anticipated registrant.

The increase in a one-time burden of establishing a system model from 0 hours to 4,000 hours is due to the fact that there are four entities expected to develop and establish system models. The increase in the annual recurring burden from 5,000 hours to 8,000 hours is due the fact that the number of OTC derivatives dealers is expected to increase from 5 OTC derivatives dealers to 8 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. Approval to Omit OMB Expiration Date

The Commission is not seeking approval to omit the OMB expiration date.

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[10] [(600 hours × $309) + (400 hours × $230)] × four (4) OTC derivatives dealers = $277,400.

18. Exceptions to Certification for Paperwork Reduction Act Submissions

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

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

This collection does not involve statistical methods.