

**SUPPORTING STATEMENT**  
**for the Paperwork Reduction Act Information Collection Submission**

**Rule 18a-4 – Segregation requirements for security-based swap dealers and major security-based swap participants.**

**A. JUSTIFICATION**

**1. Necessity of Information Collection**

In accordance with Section 763 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), the Securities and Exchange Commission (the “Commission”) has proposed new Rule 18a-4 to set forth segregation requirements for security-based swap dealers (“SBSDs”) and major security-based swap participants (“MSBSPs”).<sup>1</sup> The rule would establish a number of new collection of information requirements. The Commission staff estimates that there will be a total of 55 respondents subject at least in part to these new requirements.

Proposed Rule 18a-4 would establish segregation requirements for cleared and non-cleared security-based swap transactions, which would apply to all SBSDs (i.e., they would apply to bank SBSDs, nonbank stand-alone SBSDs, and broker-dealer SBSDs), as well as notification requirements for SBSDs and MSBSPs. The rule would require SBSDs to open and maintain special accounts with banks and obtain written acknowledgements from, and enter into written contracts with, the banks. SBSDs would also be required to at all times maintain in a special account, through deposits into the account, cash and/or qualified securities in amounts computed in accordance with the formula set forth in Exhibit A to proposed Rule 18a-4. The rule would also require that the computations necessary to determine the amount required to be maintained in the special bank account must be made on a daily basis. In addition, the rule would require that both SBSDs and MSBSPs provide notice to a counterparty pursuant to Section 3E(f) of the Securities Exchange Act of 1934 (“Exchange Act”) prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the effective date of the proposed rule. Finally, the rule would require SBSDs to obtain agreements from counterparties that do not choose to require segregation of funds or other property pursuant to Section 3E(f) of the Exchange Act or paragraph (c)(3) of proposed Rule 18a-4 in which the counterparty agrees to subordinate all of its claims against the SBSD to the claims of security-based swap customers of the SBSD.

**2. Purpose and Use of the Information Collection**

Information collections under Rule 18a-4 would be integral parts of the Commission’s financial responsibility program for SBSDs and MSBSPs. The program is designed in part to ensure that SBSDs safely custody the assets of their customers such that those assets are readily available for distribution in the event the SBSD becomes insolvent. The program also would

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<sup>1</sup> See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213 (Nov. 23, 2012).

ensure that counterparties are made aware of the nature of their exposure to SBSs and MSBSs prior to executing security-based swap trades.

### **3. Consideration Given to Information Technology**

The information collections would not require that respondents use any specific information technology system either to prepare or submit information collections under Rule 18a-4.

### **4. Duplication**

We are not aware of that this information collection duplicates any existing information collection.

### **5. Effect on Small Entities**

The information collections required under Rule 18a-4 would not place burdens on small entities. The information collections are relevant only to market participants whose security-based swap market activity exceeds certain thresholds of notional amounts so as to trigger registration requirements with the Commission, such that small market participants are exempted.

### **6. Consequences of Not Conducting Collection**

If the required information collections were not conducted or were conducted less frequently, the protection afforded to counterparties and the U.S. financial and banking system would be diminished.

### **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)(2).

### **8. Consultations Outside the Agency**

The Commission has issued a release soliciting comment on the new “collection of information” requirements and associated paperwork burdens.<sup>2</sup> A copy of the release is attached. Comments on Commission releases are generally received from registrants, investors, and other market participants. In addition, the Commission and staff participate in ongoing dialogue with representatives of various market participants through public conferences, meetings, and informal exchanges. Any comments received on this proposed rulemaking will be posted on the Commission’s public website, and made available through <http://www.sec.gov/comments/s7-08-12/s70812.shtml>. The Commission will consider all comments received prior to publishing the final rule, and will explain in any adopting release how the final rule responds to such comments, in accordance with 5 C.F.R. 1320.11(f).

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<sup>2</sup> Id.

## **9. Payment or Gift**

No payment or gift would be provided to respondents.

## **10. Confidentiality**

The information collected by the Commission under Rule 18a-4 would be kept confidential to the extent permitted by the Freedom of Information Act (5 U.S.C. § 552 *et seq.*).

## **11. Sensitive Questions**

No information of a sensitive nature would be required.

## **12. Burden of Information Collection**

The staff estimates that Rule 18a-4 will require in total, on an industry wide basis, (1) a one-time burden of 50,250 recordkeeping hours and 509,167 disclosure hours, and (2) an annual burden of 101,170 recordkeeping hours and 1,833 disclosure hours.

### Special Accounts

Rule 18a-4 would require SBSBs to establish certain special accounts with banks and obtain written acknowledgements from, and enter written agreements with, those banks. These special accounts include qualified clearing agency accounts, qualified SBSB accounts, and special accounts for the exclusive benefit of security-based swap customers (collectively, the “special accounts”). The staff estimates that there will be 50 registered SBSBs that would have to open on average 6 special accounts. Based on the Commission staff’s experience with similar requirements under Rule 15c3-3, the staff estimates that each SBSB would spend approximately 30 hours drafting and obtaining the written acknowledgement and agreement for each account. This would result in a one-time industry-wide hours burden of 9,000 recordkeeping hours.<sup>3</sup>

The staff also estimates that 25% of all SBSBs (or 13 SBSBs) would, in any given year, establish a new account for each type of special account totaling 3 special accounts a year (and it takes 30 hours to draft and obtain the written acknowledgment and agreement for each account) because, for example, they changed their banking relationships. This would result in an annual industry-wide hours burden of 1,170 recordkeeping hours.<sup>4</sup>

### Customer Reserve Computation

Rule 18a-4 requires SBSBs to perform daily computations of the customer reserve amount, and ensure that the relevant special accounts hold sufficient cash and/or qualified securities to meet that amount. Based on the staff’s experience with similar computations performed by broker-dealers under Rule 15c3-3, the staff estimates that SBSBs would spend on average 2.5 hours per business day for each computation. This would result in a burden of 625

<sup>3</sup> 50 SBSBs x 6 special accounts x 30 hrs = 9,000 hrs. This amount annualized is 3000 recordkeeping hours per year and 60 hours per SBSB per year (6 special accounts x 30 hours/3 years).

<sup>4</sup> 13 SBSBs x 3 special accounts x 30 hrs = 1,170 hrs. Annualized each SBSB would spend 90 hours (3 special accounts x 30 hours). This on average results in .78 accounts per SBSB and 23.4 hours per SBSB annually.

recordkeeping hours per SBSB and an annual industry-wide hours burden of 31,250 recordkeeping hours.<sup>5</sup>

### Counterparty Notice

Both SBSBs and MSBSBs are required under Rule 18a-4 to give counterparties notice that they may elect segregation of their collateral, as required by the Dodd-Frank Act. This notice is to be given once, prior to the counterparty's first trade with the SBSB or MSBSB. All SBSBs and MSBSBs are subject to this requirement, and the staff estimates that there will be 55 such firms. The staff estimates that these firms would have an average of 1,000 counterparties to which they would have to send notices, spending an average of ten minutes per counterparty. This would result in a one-time industry-wide internal hours burden of 9,167 third party disclosure hours.<sup>6</sup>

The staff estimates that, on average, SBSBs and MSBSBs would initiate security-based swap trading with 200 new counterparties per year. This would result in an annual industry-wide hours burden of 1,833 third party disclosure hours.<sup>7</sup>

### Subordination Agreements

Rule 18a-4 would require that SBSBs obtain subordination agreements from counterparties that elect to either require individual segregation with a third-party or waive segregation. The staff estimates that an SBSB would spend on average 200 hours internally to draft and prepare standard subordination agreements, resulting in a one-time industry-wide internal hours burden of 10,000 recordkeeping hours.<sup>8</sup>

As discussed above, the staff estimates that SBSBs would on average have approximately 1,000 counterparties at any given time. The staff further estimates that half of these counterparties would either elect individual segregation or waive segregation altogether. The staff estimates that SBSBs would spend an average of 20 hours per counterparty to enter into a written subordination agreement,<sup>9</sup> resulting in a one-time industry-wide hours burden of 500,000 third-party disclosure hours.<sup>10</sup>

The staff also estimates that half of the estimated 200 new counterparties SBSBs are expected to add per year will either elect individual segregation or waive segregation altogether.

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<sup>5</sup> 50 SBSBx x 250 business days/year x 2.5 hrs/day = 31,250 hrs/year.

<sup>6</sup> 55 firms x 1,000 counterparties x 1/6 hr = 9,167 hrs. Each firm has a one-time internal hours burden of 166.66 hours. This amount annualized is 55.55 hours and an annualized total industry-wide recordkeeping burden of 3056 hours. For purposes of calculating the annual burden, each respondent would have to give notice to 533.33 counterparties (1000 counterparties averaged over three years (333.33) + 200 new counterparties each year).

<sup>7</sup> 55 firms x 200 counterparties x 1/6 hr = 1,833 hrs.

<sup>8</sup> 50 SBSBs x 200 hrs = 1,000 hrs. This one-time burden annualized is 66.66 hours per firm and 3333.33 hours industry-wide.

<sup>9</sup> For purposes of calculating the annual burden, this would average out to 10 hours per counterparty.

<sup>10</sup> 50 SBSBs x 20 hrs x 500 counterparties = 500,000 hrs. This amount annualized is 166,666.67 hours per year.

This would result in an annual industry-wide hours burden of 100,000 third-party disclosure hours and 2000 hours per SBSD.<sup>11</sup>

### **13. Costs to Respondents**

The staff estimates that SBSDs and MSBSPs will engage outside counsel for 10 hours to draft and review the template counterparty notice regarding segregation, resulting in a one-time industry-wide external hours burden of 550 hours.<sup>12</sup> The staff predicts that firms will hire an outside counsel to draft the notice, at a cost \$400 per hour resulting in an industry-wide one-time third party disclose cost of \$220,000. This results in a one-time industry-wide external third party disclosure cost of \$73,333, annualized over 3 years.<sup>13</sup>

The staff also estimates that SBSDs are likely to hire an outside counsel to review the template subordination agreement, requiring on average a total of 20 hours, or a one-time industry-wide external hours burden of 1,000 hours.<sup>14</sup> This results in a one-time industry-wide external recordkeeping cost of \$133,333, annualized over 3 years.<sup>15</sup>

### **14. Cost to Federal Government**

The staff does not anticipate this information collection to impose additional costs to the Federal Government.

### **15. Changes in Burden**

Not applicable. The information collection is related to a new rule.

### **16. Information Collected Planned for Statistical Purposes**

Not applicable. The information collection is not used for statistical purposes.

### **17. Display of OMB Approval Date**

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

### **18. Exceptions to Certification**

Not applicable. This collection complies with the requirements in 5 CFR 1320.9.

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<sup>11</sup> 50 SBSDx x 20 hrs x 100 counterparties = 100,000 hrs. The annual industry-wide burden is 166,666.66 hours and the annual burden per respondent is 3333.33.

<sup>12</sup> 55 firms x 10 hrs = 550 hrs.

<sup>13</sup> 550 hrs x \$400/hr / 3 years = \$73,333. The cost per SBSD annualized is \$1333.33.

<sup>14</sup> 50 SBSDs x 20 hrs = 1,000 hrs

<sup>15</sup> 1,000 hrs x \$400/hr / 3 years = \$133,333. This also results in a one-time cost of \$8000 per SBSD, which results in an annual cost of \$2666.66.

**B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS**

Not applicable. This collection does not employ statistical methods.