

SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission for
“Rule 15c3-1”

A. Justification

1. Necessity of Information Collection

Rule 15c3-1¹ (the “net capital rule”) under the Securities Exchange Act of 1934 (the “Exchange Act”)² is intended to ensure that broker-dealers registered with the Securities and Exchange Commission (the “Commission”) at all times have sufficient liquid capital to protect the assets of customers and to meet their responsibilities to other broker-dealers.³ The rule generally defines the term “net capital” as a broker-dealer’s net worth (assets minus liabilities), plus certain subordinated liabilities, less certain assets that are not readily convertible into cash (e.g., fixed assets), and less a percentage (haircut) of certain other liquid assets (e.g., securities).⁴

Rule 15c3-1 is an integral part of the Commission’s financial responsibility program for broker-dealers. In particular, it facilitates the monitoring of the financial condition of brokers-dealers by the Commission and the broker-dealer’s designated examining authority (“DEA”). If the information were not required to be collected, the Commission and the DEAs would not be able to monitor the financial condition of broker-dealers, exposing their customers and others to increased risk.

2. Purpose and Use of the Information Collection

As discussed above, Rule 15c3-1 is intended to help ensure that broker-dealers maintain at all times sufficient liquid resources to meet all liabilities, particularly the claims of customers, by requiring that broker-dealers maintain a minimum amount of net capital. A broker-dealer’s minimum net capital requirement is the greater of: (1) a fixed minimum amount set forth in Rule 15c3-1 based on the types of business that the broker-dealer conducts;⁵ or (2) a financial ratio.⁶ Exchange Act Section 15(c)(3) and Rule 15c3-1 promulgated thereunder prohibit a broker-dealer from effecting transactions in securities while not in compliance with its minimum net capital requirement.

Various provisions of Rule 15c3-1 require that broker-dealers provide written notification to the Commission and/or their DEA under certain circumstances. For example, a broker-dealer carrying the account of an options market maker must file a notice with the Commission and the

¹ 17 CFR 240.15c3-1.

² 15 U.S.C. § 78 *et seq.*

³ *See Net Capital Rule*, Exchange Act Release No. 39455 (Dec. 17, 1997), 62 FR 67996 (Dec. 30, 1997).

⁴ *See* 17 CFR 240.15c3-1(c)(2).

⁵ *See, e.g.*, 17 CFR 240.15c3-1(a)(2)-(9).

⁶ *See* 17 CFR 240.15c3-1(a)(1)(i)-(iii).

DEA of both the carrying firm and the market maker prior to effecting transactions in the account.⁷ In addition, the carrying firm must notify the Commission and the appropriate DEA if a market maker fails to deposit the required equity with the carrying broker-dealer relating to the market maker's account within the prescribed time period or if certain deductions and other amounts relating to the carrying firm's market maker accounts computed in accordance with Rule 15c3-1 exceeds 1,000% of the carrying broker-dealer's net capital.⁸ In addition, a broker-dealer electing to compute its net capital using the alternative method under paragraph (a)(1)(ii) of Rule 15c3-1 must notify its DEA of the election in writing,⁹ and thereafter must continue to compute its net capital in this manner unless a change is approved upon application to the Commission.¹⁰

Moreover, Appendix C to Rule 15c3-1 requires broker-dealers that consolidate their financial statements with a subsidiary or affiliate, under certain circumstances, to submit to their DEA an opinion of counsel.¹¹ The opinion of counsel must state, among other things, that the broker-dealer may cause that portion of the net assets of a subsidiary or affiliate related to its ownership interest in the entity to be distributed to the broker-dealer within 30 calendar days.¹²

Appendix E to Rule 15c3-1 provides an alternative method for determining certain net capital charges for certain broker-dealers.¹³ Such broker-dealers are referred to as alternative net capital firms, or ANC firms. Appendix G to Rule 15c3-1 requires the holding company of an ANC firm that has a principal regulator to file certain periodic reports with the Commission, preserve certain records, and notify the Commission of certain events.

Rule 15c3-1 was promulgated under Section 15(c)(3) of the Exchange Act,¹⁴ which directed the Commission to adopt minimum financial responsibility requirements for broker-dealers. The statutory authority for Rule 15c3-1 is embodied in Sections 15(c)(3) and 23(a)¹⁵ of the Exchange Act.

3. Consideration Given to Information Technology

The method of computing net capital varies by size and complexity of a broker-dealer. Most larger broker-dealers subject to the net capital rule utilize automated systems for computing their net capital and minimum requirements. Smaller broker-dealers with simple balance sheets

⁷ See 17 CFR 240.15c3-1(a)(6)(vi).

⁸ See 17 CFR 240.15c3-1(a)(6)(iv)(B) and 17 CFR 240.15c3-1(a)(6)(v).

⁹ See 17 CFR 240.15c3-1(a)(1)(ii).

¹⁰ Id.

¹¹ See 17 CFR 240.15c3-1c(b)(1).

¹² See 17 CFR 240.15c3-1c(b)(2).

¹³ See 17 CFR 240.15c3-1e.

¹⁴ 15 USC 78o(c)(3).

¹⁵ 15 USC 78w.

may compute their net capital on a manual basis.

4. Duplication

We are not aware of duplication of this information.

5. Effects on Small Entities

Small entities may be affected to the extent they are required to maintain a minimum amount of net capital under Rule 15c3-1. However, there are different requirements for small entities subject to Rule 15c3-1. Most of these entities are not affected by the information collection provisions of Rule 15c3-1.

6. Consequences of Not Conducting Collection

If the required activities were not required to be collected, or were required to be conducted less frequently, the Commission and the DEAs would not be able to monitor the financial condition of broker-dealers, exposing their customers and others to increased risk and lessening 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)(2).

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 payment or gift is provided to respondents.

10. Confidentiality

The Commission regards information obtained pursuant to the filings and notices required by Rule 15c3-1 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

Not applicable; no information of a sensitive nature is required.

12. Burden of Information Collection

a. Summary of Reporting Burden Under Rule 15c3-1

Commission staff estimates that broker-dealers annually file approximately 815 notices under Rule 15c3-1. Based on the staff's experience with the industry, a broker-dealer expends approximately 30 minutes to prepare and file these notices. Therefore, Commission staff estimates that under Rule 15c3-1, broker-dealers expend approximately 408 hours annually to comply with the reporting burden in this rule.

Commission staff estimates that the total internal labor cost of compliance to broker-dealers in connection with this requirement is approximately \$119,952 per year (\$294 per hour x 408 burden hours).¹⁶

b. Summary of Reporting Burden Under Appendixes E and G to Rule 15c3-1

The Paperwork Reduction Act ("PRA") estimates below are based on the assumption that ten broker-dealers will ultimately apply to compute deductions for market risk under Appendix E to Rule 15c3-1. There are currently six ANC firms; therefore, the Commission expects that four additional firms will apply to compute deductions for market risk under Appendix E to the net capital rule. Commission staff estimates that each broker-dealer that applies would incur a one-time burden of approximately 1,000 hours to create and compile the various documents to be included with the application and to work with Commission staff through the application process. The estimated total internal labor cost of complying with these application requirements is approximately \$1,206,400. Specifically, Commission staff estimates that a financial reporting manager will spend approximately 900 hours preparing the application and working with Commission staff, and an in-house counsel will spend approximately 100 hours completing a review of the application. Assuming an hourly cost of \$294¹⁷ for a financial reporting manager and \$370 for an in-house attorney,¹⁸ the resultant total one-time internal labor cost for the four respondents is \$1,206,400 (4 applications x ((900 hours x \$294/hour) + (100 hours x \$370/hour))).

¹⁶ This hourly rate is based on the average annual salary for a Financial Reporting Manager, as reflected in SIFMA's Management and Professional Earnings in the Securities Industry 2012, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

¹⁷ Id.

¹⁸ This hourly rate is based on the average annual salary for an Attorney, as reflected in SIFMA's Management and Professional Earnings in the Securities Industry 2012, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

Commission staff estimates that an ANC firm using Appendixes E and G to Rule 15c3-1 spends approximately 5,600 hours per year to review and update the models it uses to assess market and credit risk and approximately 160 hours each quarter, or approximately 640 hours per year, to backtest the models. Consequently, Commission staff estimates that the total aggregate burden associated with reviewing and backtesting mathematical models for the six ANC firms will be approximately 37,440 hours per year $((5,600 \text{ hours} + 640 \text{ hours}) \times 6 \text{ broker-dealers})$ and 12,480 for the four broker-dealers expected to become ANC firms $((5,600 \text{ hours} + 640 \text{ hours})/2 \times 4 \text{ broker-dealers})$. The estimated total internal labor cost of compliance with these requirements is approximately \$9,634,560 per year $(\$193/\text{hour}^{19} \times 49,920 = \$9,634,560)$.

Commission staff estimates that the average amount of time necessary to prepare and file the monthly reports required by Appendix G would be approximately eight hours per month, or approximately 96 hours per year, that the average amount of time necessary to prepare and file the quarterly reports would be about 16 hours per quarter, or approximately 64 hours per year, and that the average amount of time necessary to prepare and file the annual audit reports would be approximately 200 hours per year. Consequently, Commission staff estimates that the total annual reporting burden of Appendix G for the six ANC firms would be approximately 2,160 hours $((96 \text{ hours} + 64 \text{ hours} + 200 \text{ hours}) \times 6 \text{ broker-dealers})$, and the total for the four broker-dealers expected to become ANC firms would be approximately 720 hours $((96 \text{ hours} + 64 \text{ hours} + 200 \text{ hours})/2 \times 4 \text{ broker-dealers})$. The estimated total internal labor cost of compliance with these requirements is approximately \$555,840 per year $(\$193/\text{hour}^{20} \times 2,880 \text{ hours} = \$555,840)$.

Commission staff expects that any additional burden associated with the requirements of Appendix G relating to preserving records would be minimal because a prudent firm that manages risk on a group-wide basis would make and preserve these records in the ordinary course of its business. Commission staff estimates that the average one-time burden of making and preserving these records would be approximately 40 hours and that the average annual burden would be approximately 290 hours. Consequently, Commission staff estimates that the total burden for the six ANC firms would be approximately 1,740 hours on an annual basis $(290 \text{ hours} \times 6 \text{ broker-dealers})$, and the total annual burden for the four broker-dealers expected to become ANC firms would be approximately 634 hours $((40 \text{ hours}/3 \text{ years} + 290 \text{ hours}/2 \text{ years}) \times 4 \text{ broker-dealers})$. The estimated total internal labor cost of compliance with these requirements is approximately \$458,182 $(\$193/\text{hour}^{21} \times 2,374 \text{ hours} = \$458,182)$.

The notification provisions of Appendix G are designed to give the Commission advance warning of situations that may pose material financial and operational risks to the broker-dealer and its holding company. These provisions are integral to Commission supervision of broker-dealers that use Appendix E. Commission staff estimates that it would require a total of

¹⁹ This hourly rate is based on the average annual salary for a Senior Accountant, as reflected in SIFMA's Management and Professional Earnings in the Securities Industry 2012, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead

²⁰ Id.

²¹ Id.

approximately one hour per year to comply with the notification provisions of Appendix G, resulting in a total annual burden of 6 hours for the six ANC firms and 2 hours (1 hour/2 x 4 broker-dealers) for the four broker-dealers expected to become ANC firms. The estimated total internal labor cost of compliance with this requirement is approximately \$2,152 ($\$269/\text{hour}^{22} \times 8 \text{ hours} = \$2,152$).

Lastly, Commission staff estimates that each broker-dealer would spend approximately 250 hours per year reviewing and updating its risk management control system, resulting in an aggregate annual burden of 2,000 hours ($(250 \times 6 \text{ broker-dealers}) + (250/2 \times 4 \text{ broker-dealers})$). The estimated total internal labor cost of compliance with this requirement is approximately \$538,000 ($\$269/\text{hour}^{23} \times 2,000 \text{ hours} = \$538,000$).

In summary, the total annual hour burden for Appendix E and G to Rule 15c3-1 is 58,518 hours ($1,336 + 49,920 + 2,880 + 2,374 + 8 + 2,000 = 58,518 \text{ hours}$). In addition, Commission staff estimates that the total internal cost of the annual hour burden would be approximately \$11,590,967 under Appendix E and G to Rule 15c3-1 ($\$402,133 + \$9,634,560 + \$555,840 + \$458,182 + \$2,152 + \$538,100 = \$11,590,967$).

c. Total Annual Recordkeeping and Reporting Burden

In summary, Commission staff estimates that the total annual hour burden for Rule 15c3-1 is 58,926 ($408 + 58,518 = 71,818$). Finally, the estimated internal cost for the annual hour burden for Rule 15c3-1 is approximately \$11,710,919 ($\$119,952 + \$11,590,967 = \$11,710,919$).

13. Costs to Respondents

Approximately 80 broker-dealers file consolidated financial reports, of which approximately 20 obtain an opinion of counsel under Appendix C of Rule 15c3-1. Commission staff estimates that the approximate cost to broker-dealers to obtain an opinion of counsel to file the consolidated financial reports as required under Appendix C of Rule 15c3-1 would be \$8,000. This figure is based on an estimate of 20 hours per opinion for an outside counsel at \$400 per hour²⁴ ($\$400/\text{hour} \times 20 \text{ hours} = \$8,000$). The total costs for all respondents would be \$160,000 ($20 \text{ opinions} \times \$8,000 = \$160,000$).

²² This hourly rate is based on the average annual salary for a Compliance Manager, as reflected in SIFMA's Management and Professional Earnings in the Securities Industry 2012, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead

²³ Id.

²⁴ This is based on an estimated \$400 per hour cost for outside consulting and/or legal services. This is the same estimate used by the Commission when it adopted its consolidated audit trail rule. See Securities Exchange Act Release No. 67457 (Jul. 18, 2012), 77 FR 45722 (Aug. 1, 2012).

14. Costs to Federal Government

Not applicable. Rule 15c3-1 would not result in any costs to the federal government beyond normal full-time employee labor costs, nor does the rule require the Commission to hire any new employees or reallocate existing employees to ensure compliance with the rule.

15. Changes in Burden

Since the last submission, there has been a decrease in the number of notices filed by broker-dealers, the number of broker-dealers that file consolidated financial reports, and the number of broker-dealers that Commission staff estimates will calculate net capital deductions for market and credit risk under Appendix E, resulting in an overall decrease in the burden estimates. The decrease in the aggregate dollar cost burden per year also is due to the fact that the prior PRA extensions erroneously treated the monetization of internal labor costs of compliance as a separate cost burden.

16. Information Collection Planned for Statistical Purposes

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

17. Approval to Omit OMB Expiration Date

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

18. Exceptions to Certification for Paperwork Reduction Act Submissions

This collection complies with the requirements in 5 CFR 1320.9.

B. Collection of Information Employing Statistical Methods

This collection does not involve statistical methods.