

**SUPPORTING STATEMENT**  
**for the Paperwork Reduction Act Information Collection Submission for**  
**Rule 17a-12/Form X-17A-5 Part IIB**

**A. JUSTIFICATION**

**1. Necessity of Information Collection**

Section 17(a)(1) of the Securities Exchange Act of 1934 ("Exchange Act") requires registered broker-dealers to make, keep, furnish, and disseminate records and reports prescribed by the Commission as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. Section 17(e) of the Exchange Act requires every registered broker-dealer to file annually with the Commission a balance sheet and income statement certified by an independent public accountant or by an accounting firm registered with the Public Company Accounting Oversight Board, if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, and such other information concerning its financial condition as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Pursuant to this authority, in October 1998 the Commission enacted Rule 17a-12 ("Reports to be made by certain OTC derivatives dealers")<sup>1</sup> and amended Form X-17A-5 to add Part IIB<sup>2</sup> to establish the basic periodic reporting structure for OTC (over-the-counter) derivatives dealers. Rule 17a-12 requires OTC derivatives dealers registered with the Commission to file quarterly Financial and Operational Combined Uniform Single Reports ("FOCUS" reports) on Part IIB of Form X-17A-5 and annual audit reports with the Commission. The provisions of Rule 17a-12 are similar to those contained in Exchange Act Rule 17a-5 ("Reports to be made by certain brokers and dealers")<sup>3</sup> but take into consideration the more limited and unique business conducted by OTC derivatives dealers.

The quarterly filings must include certain information specified in the Framework for Voluntary Oversight of the Derivatives Policy Group ("DPG").<sup>4</sup> This credit and market risk information, which must be reported on Schedules I - V and VII of Part IIB of Form X-17A-5, enables the Commission to ascertain the nature and scope of a firm's OTC derivatives activity and to monitor the firm's risk exposure.

Rule 17a-12 also requires that OTC derivatives dealers file an annual audit report. Among other things, the audit report must include a statement of financial condition, a statement of income, a statement of cash flows, a statement of changes in owners' equity, a statement of changes in subordinated liabilities, and supporting schedules, including a computation of net capital. The report must be audited. Concurrently with the annual audit report, OTC derivatives

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<sup>1</sup> 17 CFR 240.17a-12.

<sup>2</sup> 17 CFR 249.617.

<sup>3</sup> 17 CFR 240.17a-5.

<sup>4</sup> See Framework for Voluntary Oversight, Derivatives Policy Group (Mar. 1995).

dealers must file supplemental reports by the auditor, including an accountant's report on material inadequacies and reportable conditions, an accountant's report on management controls, and an accountant's report on inventory pricing and modeling.

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

The information collected under Rule 17a-12 is essential to the regulation and oversight of OTC derivatives dealers and the primary means the Commission uses to monitor and enforce compliance with the Commission's financial responsibility rules as prescribed by the Exchange Act. These quarterly FOCUS and annual audit reports are used to evaluate the securities-related and other activities each OTC derivatives dealer is engaged in, the extent to which it is engaged in those activities, and how economic events and government policies might affect various segments of the securities industry. In addition, the Commission staff reviews FOCUS report information as part of its preparation for examinations and inspections. A firm's failure to comply with this rule would severely impair the Commission's ability to protect customers, industry counter-parties, and others.

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

Most OTC derivatives dealers and other firms engaged in swaps and related activities use automated systems to prepare information provided on Part IIB of Form X-17A-5. As so few OTC derivatives dealers have registered with the Commission, it is not economically feasible for the Commission to develop a system which would allow for electronic filing of this form.

## **4. Duplication**

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

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

The rule does not affect small entities.

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

If the collection were not made, or were made less frequently, the protection afforded to the public would be lessened.

## **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 to Respondents**

Not applicable. No payment or gift was provided to respondents.

#### **10. Confidentiality**

Information provided by OTC derivatives dealers in FOCUS reports, supporting schedules, and annual audited reports is confidential pursuant to Rule 17a-12(a)(2) and (c)(3). The statutory basis for this confidential treatment is the exemption contained in Section (b)(4) of the Freedom of Information Act, 5 U.S.C. 552, which provides that the requirement for public dissemination does not apply to commercial or financial information which is privileged or confidential.

#### **11. Sensitive Questions**

Not applicable. No inquiries of a sensitive nature are made. The information collection does not collect any Personally Identifiable Information (PII).

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

There are currently four OTC derivatives dealers registered with the Commission. The staff anticipates that one more OTC derivatives dealer will register with the Commission in the next three years. The staff estimates that the average amount of time necessary to prepare and file the information required by the rule is 80 hours per OTC derivatives dealer per year to prepare the quarterly reports on Part IIB of Form X-17A-5 (based upon 4 quarterly responses per year and an average of 20 hours spent preparing each response) and 100 hours per OTC derivatives dealer per year to prepare the annual audit report and supporting schedules. Thus the total reporting burden for each OTC derivatives dealer is approximately 180 hours per year. The total annual reporting burden for the five current and anticipated OTC derivatives dealers is estimated to be 900 hours per year ( $5 \times 180 = 900$ ). The estimates of the annual burden are based upon discussions with industry participants. Further, the Commission estimates that the total internal compliance cost associated with this requirement is approximately \$255,000 per year.<sup>5</sup>

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Based on staff experience, an OTC derivatives dealer likely would have a Compliance Manager gather the necessary information and prepare and file the quarterly reports and annual audit report and supporting schedules. According to the Securities Industry and Financial Markets Association Report on Management and Professional Earnings in the Securities Industry dated October 2013, which provides base salary and bonus information for middle-management and professional positions within the securities industry, the hourly cost of a compliance manager, which the Commission staff has modified to account for an 1800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, is approximately \$283/hour.  $\$283/\text{hour} \times 900 \text{ hours} = \$254,700$ , rounded to \$255,000.

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

The Commission estimates that the average annual reporting cost per broker-dealer for the independent public accountant to examine the financial statements is approximately \$46,300 per broker-dealer. Based on this estimate, the total industry-wide annual reporting cost is approximately \$231,500 (\$46,300 x 5).

### **14. Costs to Federal Government**

It is estimated that the Commission review of the filings takes approximately 275 hours per year (based upon an average of four quarterly filings at 10 hours each, plus one annual filing at 15 hours for each of 5 OTC derivatives dealers). The staff estimates that the hourly cost of these reviews is \$47.25.<sup>6</sup> Thus the total annual cost to the Commission of the reviews is approximately \$12,994.

### **15. Explanation of Changes in Burden**

Not Applicable. The number of firms registered with the Commission as OTC derivatives dealers has not changed from four firms. The staff continues to expect that one more firm will register with the Commission as an OTC derivatives dealer within the next three years. As a result, the total annual hour burden has not changed. The annual industry-wide reporting cost also remains the same at \$231,500.

### **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.

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<sup>6</sup> GSA, Guide to Estimating Reporting Costs (1973) (which sets the value of one hour of staff time at \$35.00) + 35% overhead.