

SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission for
Rule 204

A. JUSTIFICATION

1. Information Collection Necessity

i. Allocation Notification Requirement

Rule 204(d) of Regulation SHO imposes a notification requirement on a broker-dealer that has been allocated responsibility for complying with the rule's requirements that is designed to help ensure that participants will be on notice if a broker-dealer for which they clear and settle trades has become subject to Rule 204(b)'s pre-borrowing requirements.

ii. Demonstration Requirement for Fails to Deliver on Long Sales

Rule 204(a)(1) of Regulation SHO allows a participant additional settlement days, specifically, until no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date, in which to close out the fail to deliver position that resulted from a long sale, provided that the participant can demonstrate on its books and records that the fail to deliver position resulted from a long sale.

iii. Pre-Borrow Notification Requirement

Rule 204(c) of Regulation SHO requires that a participant notify any broker or dealer from which it receives trades for clearance and settlement if the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with Rule 204(a), and when the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency. This notification requirement is designed to help ensure that any broker or dealer that submits trades for clearance and settlement to a participant that has a fail to deliver position in an equity security that has not been closed out in accordance with Rule 204(a) will be on notice that short sales in that equity security to be cleared or settled through that participant will be subject to the pre-borrow requirements of Rule 204(b) until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency, unless the broker-dealer can demonstrate to the participant, as specified in Rule 204(b), that it is not responsible for the fail to deliver position.

iv. Certification Requirement

Rule 204(b) of Regulation SHO includes an exception from the rule's pre-borrowing requirements for any broker or dealer that timely certifies to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security

for which the participant has a fail to deliver position at a registered clearing agency or that the broker or dealer is in compliance with Rule 204(e). The certification provided by the broker or dealer to the participant will help ensure that a broker or dealer will not be improperly subject to the pre-borrowing requirements of the rule.

v. Pre-Fail Credit Demonstration Requirement

Rule 204(e)'s pre-fail credit provision requires, among other things, that the broker or dealer demonstrate that it has a net long position or net flat position on its books and records on the day of the purchase or borrow of securities supporting its claim to pre-fail credit. The information collected will enable the Commission and self-regulatory organizations ("SROs") to monitor more effectively whether or not a broker or dealer has complied with the requirements of Rule 204(e).

2. Information Collection Purpose and Use

The information collected will help further the Commission's goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by, among other actions, the adoption of Interim Final Temporary Rule 204T ("temporary Rule 204T"), which had been implemented via emergency order on September 17, 2008 and adopted as an interim final temporary rule on October 14, 2008.¹ Rule 204 made permanent the amendments contained in temporary Rule 204T, with some limited modifications to address commenters' concerns.

The information collected under Rule 204 will continue to be retained and/or provided to other entities pursuant to the specific rule provisions and will be available to the Commission and SRO examiners upon request. The information collected will continue to aid the Commission and SROs in monitoring compliance with these requirements. In addition, the information collected will aid those subject to Rule 204 in complying with its requirements.

In addition, Rule 204 is intended to help further the Commission's goal of addressing potentially abusive "naked" short selling in all equity securities. By strengthening the close-out requirements of Regulation SHO and promoting the prompt and accurate clearance and settlement of transactions involving equity securities, Rule 204 is intended to help restrict the practice of "naked" short selling. Rule 204 is intended to provide a disincentive to market participants who, but for the rule, may have failed to deliver securities by settlement date.

¹ Exchange Act Release No. 58733 (Oct. 14, 2008), 73 FR 61706 (Oct. 17, 2008) ("Rule 204T Adopting Release").

3. Consideration Given to Information Technology

The compilation of this information must be done on an individual basis by each respondent subject to any of the requirements discussed in item 1, above. Thus, improved information technology would not reduce the burden.

4. Duplication

We are not aware of duplication of this information.

5. Effects on Small Entities

The collection of information necessary to ensure compliance with Rule 204's requirements is not unduly burdensome on smaller entities.

6. Consequences of Not Conducting Collection

In order to ensure compliance with Rule 204, a participant or broker-dealer subject to any of the requirements discussed in item 1, above, must collect the required information on a daily basis. Less frequent or less individualized collection would impede the ability to verify compliance with Rule 204.

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

No assurance of confidentiality is provided.

11. Sensitive Questions

No questions of a sensitive nature are asked. The information collection does not collect any Personally Identifiable Information ("PII").

12. Information Collection Burden

i. Allocation Notification Requirement

Consistent with the prior Paperwork Reduction Act (“PRA”) Supporting Statement, we estimate that it will take a broker or dealer no more than approximately 0.16 hours (10 minutes) to notify a participant that the broker or dealer has become subject to the requirements of Rule 204(b) of Regulation SHO. Rule 204 was adopted in 2009, and brokers or dealers have developed the necessary communication mechanisms in order to comply with the notification requirement of Rule 204(d). These Rule 204(d) communication mechanisms were likely developed based on the broker’s or dealer’s legacy Rule 203(b) Threshold Securities communication mechanisms and legacy Rule 204T communication mechanisms, and we believe that the estimated time frame for notification by the broker or dealer would remain consistent with the prior PRA Supporting Statement.

As of December 31, 2017, there were 3,893 registered broker-dealers. Each of these broker-dealers could clear trades through a participant of a registered clearing agency and, therefore, become subject to the notification requirements of Rule 204(d). If a participant allocates a fail to deliver position to a broker or dealer pursuant to Rule 204(d), the broker or dealer that has been allocated the fail to deliver position in an equity security must determine whether or not such fail to deliver position was closed out in accordance with Rule 204(a). If such broker or dealer does not comply with the provisions of Rule 204(a), such broker or dealer must immediately notify the participant that it has become subject to the requirements of Rule 204(b). We estimate that a broker or dealer could have to make such determination and notification with respect to approximately 1.76 equity securities per day.²

We estimate a total of 1,719,772 potential notifications in accordance with Rule 204(d) across all registered broker-dealers (that could be allocated responsibility to close out a fail to deliver position) per year (3,893 registered broker-dealers notifying participants once per day³ on 1.76 equity securities, multiplied by 251 trading days in 2017). The total estimated annual burden hours per year will be approximately 275,164 burden hours (1,719,772 multiplied by 0.16 hours/notification). We estimate that the paperwork compliance for the allocation notification requirement for each broker-dealer will be approximately 71 burden hours per year (275,164 ÷ 3,893).

² The Commission’s Division of Economic and Risk Analysis (“DERA”) estimates that there were approximately 6,868 average daily fail to deliver positions during 2017. Across 3,893 registered broker-dealers, the number of securities per registered broker-dealer per trading day is approximately 1.76 equity securities.

³ Because failure to comply with the close-out requirements of Rule 204(a) is a violation of the rule, we believe that a broker or dealer would make the notification to a participant that it is subject to the borrowing requirements of Rule 204(b) at most once per day.

ii. Demonstration Requirement for Fails to Deliver on Long Sales

Consistent with the prior PRA Supporting Statement, we estimate that it will take a participant of a registered clearing agency no more than approximately 0.16 hours (10 minutes) to demonstrate on its books and records that it has a fail to deliver position at a registered clearing agency in an equity security that resulted from a long sale. Rule 204 was adopted in 2009, and participants have developed the necessary mechanisms in order to comply with the demonstration requirement of Rule 204(a). These Rule 204(a) processes were likely developed based on the participant's legacy Rule 204T processes, and we believe that the estimated time frame for demonstration by the participant would remain consistent with the prior PRA Supporting Statement.

As of December 5, 2017, there were 132 participants of NSCC that were registered as broker-dealers. If a participant of a registered clearing agency has a fail to deliver position in an equity security at a registered clearing agency and determined that such fail to deliver position resulted from a long sale, we estimate that a participant of a registered clearing agency will have to make such determination with respect to approximately 33 securities per day.⁴

We estimate a total of 1,093,356 potential demonstrations in accordance with Rule 204(a)(1) across all broker-dealer participants per year (132 participants checking for compliance once per day on 33 securities, multiplied by 251 trading days in 2017). The total approximate estimated annual burden hour per year will be approximately 174,937 burden hours (1,093,356 multiplied by 0.16 hours/documentation). We estimate that the paperwork burden for the temporary demonstration provision for each broker-dealer participant will be approximately 1,325 burden hours per year ($174,937 \div 132$).

iii. Pre-Borrow Notification Requirement

Consistent with the prior PRA Supporting Statement, we estimate that it will take a participant of a registered clearing agency no more than approximately 0.16 hours (10 minutes) to notify all broker-dealers from which the participant receives trades for clearance and settlement (1) that the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of Rule 204(a), and (2) when the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency. Rule 204 was adopted in 2009, and participants have developed the necessary communication mechanisms in order to comply with the notification requirement of Rule 204(c). These Rule 204(c) communication mechanisms

⁴ DERA estimates that during 2017 approximately 62.93% of trade volume was long. DERA estimates that there were approximately 6,868 average daily fail to deliver positions during 2017. Across 132 broker-dealer participants of the NSCC, the number of securities per participant per day is approximately 52 equity securities. 62.93% of 52 equity securities per trading day equals approximately 33 securities per day.

were likely developed based on the participant's legacy Rule 203(b) Threshold Securities communication mechanisms and legacy Rule 204T communication mechanisms, and we believe that the estimated time frame for notification by the participant would remain consistent with the prior PRA Supporting Statement.

As of December 5, 2017, there were 132 participants of NSCC that were registered as broker-dealers. If a participant of a registered clearing agency has a fail to deliver position in an equity security, the participant must determine whether or not the fail to deliver position was closed out in accordance with Rule 204(a). We estimate that a participant of a registered clearing agency will have to make such determination with respect to approximately 52 equity securities per day.⁵

We estimate a total of 1,722,864 potential notifications in accordance with Rule 204(c) across all participants per year (132 broker-dealer participants notifying broker-dealers once per day on 52 securities, multiplied by 251 trading days in 2017). The total estimated annual burden hours per year will be approximately 275,658 burden hours (1,722,864 multiplied by 0.16 hours/documentation). We estimate that the paperwork burden for the notification requirement for each broker-dealer participant will be approximately 2,088 burden hours per year (275,658 ÷ 132).

iv. Certification Requirement

Consistent with the prior PRA Supporting Statement, we estimate that it will take a broker or dealer no more than approximately 0.16 hours (10 minutes) to certify to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or that the broker or dealer is in compliance with the requirements set forth in the pre-fail credit provision of Rule 204(e). Rule 204 was adopted in 2009, and brokers or dealers have developed the necessary communication mechanisms in order to comply with the certification requirement of Rule 204(b). These Rule 204(b) communication mechanisms were likely developed based on the broker's or dealer's legacy Rule 203(b) Threshold Securities communication mechanisms and legacy Rule 204T communication mechanisms, and we believe that the estimated time frame for certification by the broker or dealer would remain consistent with the prior PRA Supporting Statement.

As of December 31, 2017, there were 3,893 registered broker-dealers. Each of these broker-dealers may clear trades through a participant of a registered clearing agency. If the broker-dealer determines that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or has purchased or borrowed securities in accordance with the pre-fail credit provision of Rule 204(e), we estimate that a broker-dealer could have to make such

⁵ See supra note 4.

determination with respect to approximately 1.76 securities per day.⁶ We estimate that registered broker-dealers could have to certify to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or, alternatively, that it is in compliance with the requirements set forth in the pre-fail credit provision of Rule 204(e), 1,719,772 times per year (3,893 registered broker-dealers certifying once per day on 1.76 securities, multiplied by 251 trading days in 2017). The total approximate estimated annual burden hour per year will be approximately 275,164 burden hours (1,719,772 multiplied by 0.16 hours/certification). We estimate that the paperwork burden for the certification provision for each registered broker-dealer will be approximately 71 burden hours per year (275,164 ÷ 3,893).

v. Pre-Fail Credit Demonstration Requirement

Consistent with the prior PRA Supporting Statement, we estimate that it will take a broker-dealer no more than approximately 0.16 hours (10 minutes) to demonstrate that it has a net long position or net flat position on its books and records on the day of the purchase or borrow of securities supporting its claim to pre-fail credit. Rule 204 was adopted in 2009, and brokers or dealers have developed the necessary mechanisms in order to comply with the demonstration requirement of Rule 204(e). These Rule 204(e) mechanisms were likely developed based on the broker's or dealer's legacy Rule 203(b) Threshold Securities communication mechanisms and legacy Rule 204T communication mechanisms, and we believe that the estimated time frame for demonstration by the broker or dealer would remain consistent with the prior PRA Supporting Statement.

As of December 31, 2014, there were 3,893 registered broker-dealers. If a broker-dealer purchased or borrowed securities in accordance with the conditions specified in Rule 204(e) and determined that it had a net long position or net flat position on the settlement day for which the broker-dealer is claiming pre-fail credit, we estimate that a broker-dealer could have to make such determination with respect to approximately 1.76 securities per day.⁷

We estimate that registered broker-dealers could have to demonstrate on its books and records that it has a net long position or net flat position on the settlement day for which the broker-dealer is claiming pre-fail credit, 1,719,772 times per year (3,893 registered broker-dealers checking for compliance once per day on 1.76 equity securities, multiplied by 251 trading days in 2017). The total approximate estimated annual burden hours per year will be 275,164 burden hours (1,719,772 multiplied by 0.16 hours/demonstration). We estimate that the paperwork burden for compliance with the demonstration requirement of Rule 204(e)(4) for each registered broker-dealer will be approximately 71 burden hours per year (275,164 ÷ 3,893).

⁶ See supra note 2.

⁷ See supra note 2.

The total aggregate annual record keeping and third-party disclosure burden for the collection of information undertaken pursuant to all five provisions is thus 1,276,087 hours per year (275,164 + 174,937 + 275,658 + 275,164 + 275,164). This is an aggregate reduction of 636,138 hours from the previous burden of 1,912,225.

13. Costs to Respondents

Rule 204 was adopted in 2009. Thus, it is not anticipated that respondents will have to incur any additional one-time capital or startup costs or ongoing operations and maintenance costs to comply with Rule 204 as participants should already have in place the mechanisms that are necessary to comply with Rule 204.

14. Costs to Federal Government

Not applicable.

15. Changes in Burden

The decrease in total aggregate burden hours from 1,912,225 to 1,276,087 is largely due to a decrease in the number of average daily fail to deliver positions during 2017 relative to the prior time period identified in the prior PRA Supporting Statement.

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. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

This collection does not involve statistical methods.