

**SUPPORTING STATEMENT**  
**for the Paperwork Reduction Act Information Collection Submission for**  
**Rule 15c3-4 – Internal Risk Management Control Systems for OTC Derivatives Dealers**

**A. JUSTIFICATION**

**1. Necessity of Information Collection**

Rule 15c3-4 (17 CFR 240.15c3-4) under the Securities Exchange Act of 1934 (“Exchange Act”) requires broker-dealers that are registered with the U.S. Securities and Exchange Commission (the “Commission”) as over-the-counter (“OTC”) derivatives dealers, or that use Appendix E to Rule 15c3-1 (17 CFR 240.15c3-1e),<sup>1</sup> to establish, document, and maintain an internal risk management control system. Paragraph (b) of Rule 17a-4 (17 CFR 240.17a-4(b)) requires that a broker-dealer’s documentation of its risk management control systems and periodic reviews thereof must be preserved for a period of not less than three years, the first two years in an easily accessible place. In addition, an OTC derivatives dealer or ANC firm is expected to be able to provide the Commission staff with a copy of its documented risk management control procedures when it registers with the Commission as an OTC derivatives dealer or ANC firm and it is expected to be able to provide examiners with a copy of such procedures when it is subsequently examined.

Rule 15c3-4 further sets forth the basic elements governing the establishment, execution, and review of an OTC derivatives dealer’s or an ANC firm’s risk management control system. These elements are designed to ensure the integrity of an OTC derivatives dealer’s or an ANC firm’s risk measurement, monitoring, and management process, to clarify accountability at the appropriate organizational level, and to define the permitted scope of the dealer’s activity and level of risk.

Rule 15c3-4 is designed to ensure the integrity of the risk measurement, monitoring, and management process, and to clarify accountability, at the appropriate organizational level, for defining the permitted scope of activity and level of risk. All financial market participants are exposed to various types of risk, whether they conduct business in the standardized securities markets or the OTC derivatives market. Because of these and other risks, an OTC derivatives dealer or ANC firm must comply with, among other things, Rule 15c3-4, which makes it necessary for such broker-dealer to implement a risk management control system.

An OTC derivatives dealer or ANC firm also is required under Rule 15c3-4 to consider a number of issues impacting its business environment when creating its risk management control system. For example, an OTC derivatives dealer or ANC firm must consider, among other things, the sophistication and experience of relevant trading, risk management, and internal audit personnel and the firm’s management philosophy, when designing and implementing its internal

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<sup>1</sup> The requirements of Rule 15c3-4 to adopt an internal risk management system also apply to certain broker-dealers that compute specific net capital charges under Appendix E to Rule 15c3-1 (which are collectively referred to as “ANC firms”). See Securities Exchange Act Release No. 49380 (June 8, 2004), 69 FR 34472 (June 21, 2004) (S7-22-03).

control system's guidelines, policies, and procedures. This ensures that the implemented control system adequately addresses the risks posed by the business being conducted and the environment in which it is being conducted. In addition, this enables the firm to implement specific policies and procedures that are unique to its circumstances.

The Commission is statutorily authorized to promulgate Rule 15c3-4 under Section 15(c)(3) of the Exchange Act (15 U.S.C. §§78o). This section authorizes the Commission to adopt rules and regulations regarding the financial responsibility of broker-dealers that the Commission deems necessary or appropriate in the public interest or for the protection of investors. Further statutory authority is found in Section 23(a) of the Exchange Act (15 U.S.C. §78w).

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

Rule 15c3-4 is an integral part of the Commission's financial responsibility program for OTC derivatives dealers and ANC firms. The information collected under Rule 15c3-4 is essential to the regulation and oversight of OTC derivatives dealers and ANC firms and to their financial responsibility. More specifically, requiring these firms to document the planning, implementation, and periodic review of their risk management controls ensures that all pertinent issues are considered and that the risk management controls are implemented properly and that they continue to adequately address the risks faced by OTC derivatives dealers and ANC firms.

A strong risk management control system is necessary for firms to manage the complex risks arising from the business of an OTC derivatives dealer or an ANC firm. The implementation of risk management controls within financial intermediaries promotes their stability, and consequently, the stability of the entire financial system by reducing the risk of significant losses on the part of market participants. This, in turn, reduces the risk that massive defaults could undermine the market as a whole. Specifically, internal risk management controls provide two important functions: (1) to protect against firm-specific risks such as operational, market, credit, leverage, legal, and liquidity risks; and (2) to protect the financial industry from systemic risk.

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

There are three OTC derivatives dealers currently subject to Rule 15c3-4 and staff anticipates that six additional firms will register as OTC derivatives dealers over the next three years. Each of these firms utilizes or is anticipated to utilize automated systems for preparing and reporting information about their internal risk management control systems. Thus, improved technology would not reduce the burden.<sup>2</sup>

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<sup>2</sup> This information collection does not cover the hour burden associated with ANC firms, because the hour burden for ANC firms is included in the Paperwork Reduction Act collection for Rule 15c3-1, which requires ANC firms to comply with specific provisions of Rule 15c3-4 in Appendix E to Rule 15c3-1. See 17 CFR 240.15c3-1(a)(7)(iii), 17 CFR 240.15c3-1e(a)(1)(ii), and 17 CFR 240.15c3-1e(a)(1)(viii)(C).

#### **4. Duplication**

We are not aware of duplication of this information, because OTC derivatives dealers are not otherwise required to obtain and maintain the information required by Rule 15c3-4.

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

Rule 15c3-4 does not and will not affect small entities because the definition of an OTC derivatives dealer excludes small entities.

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

If the required activities were not conducted or were conducted less frequently (*i.e.*, due to a reduction in risk management procedures), the protection afforded to the public 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 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 information collected by the Commission from OTC derivatives dealers in accordance with Rule 15c3-4 is kept confidential to the extent permitted by the Freedom of Information Act (5 U.S.C. § 552 *et seq.*). To the extent that the information in this collection is provided to the Commission in connection with an application by an OTC derivatives dealer, the assurance of confidentiality is provided in accordance with the applicable rules.<sup>3</sup>

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

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

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<sup>3</sup> Securities Exchange Act Release No. 40594 (Oct. 23, 1998), 63 FR 593362 (November 3, 1998).

## 12. Burden of Information Collection

At present, three OTC derivatives dealers are registered with the Commission. The Commission anticipates that approximately six additional entities may become OTC derivatives dealers during the next three years.

Based upon discussions with affected and potentially affected industry participants, the Commission estimates that, on average, a firm initially will take approximately 2,000 hours to establish and document its risk management control system. Further, we estimate that, on average, an OTC derivatives dealer will take approximately 200 hours each year to maintain its risk management control system.

Thus, under Rule 15c3-4, the estimated annualized burden would be 600 hours for the three OTC derivatives dealers currently registered with the Commission to maintain their risk management control systems,<sup>4</sup> 4,000 hours for the six new OTC derivatives dealers to establish and document their risk management control systems,<sup>5</sup> and 1,200 hours for the six new OTC derivatives dealers to maintain their risk management control systems.<sup>6</sup>

<b>Rule</b>	<b>Burden Type</b>	<b>Number of Respondents</b>	<b>Number of Annual Responses per Respondent</b>	<b>Time Per Response (Hours)</b>	<b>Total Burden Per Burden Type (Hours)</b>
<b>15c3-4 (existing respondents)</b>	Ongoing Recordkeeping	3	1	200	600
<b>15c3-4 (new respondents)</b>	Initial Recordkeeping	6	1	666.67	4,000
<b>15c3-4 (new respondents)</b>	Ongoing Recordkeeping	6	1	200	1,200
<b>Total Aggregate Burden</b>					<b>5,800</b>

## 13. Cost to Respondents

<sup>4</sup> (200 hours x 3 firms) = 600.

<sup>5</sup> ((2,000 hours/3 years) x 6 firms) = 4,000.

<sup>6</sup> (200 hours x 6 firms) = 1,200.

The Commission believes that there would be no additional reporting costs associated with the proposed rule, other than the costs described in Item 12 above.

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

It is estimated that reviews of existing and anticipated OTC derivatives dealers' risk management control systems, which will be performed by Commission staff, will take approximately 864 hours,<sup>7</sup> costing the Commission approximately \$49,896<sup>8</sup> based on the number of reviews that are likely to be performed and our computation of the value of staff time devoted to these reviews and the related overhead, valued at 75% of the value of staff time.<sup>9</sup>

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

The increase in burden hours is due to an increase in the estimated number of registrants subject to the rule. The Commission now estimates that a total of nine entities will be registered as OTC derivatives dealers at the end of the next three years, consisting of the three current OTC derivatives dealers, and six anticipated registrants (in contrast with the prior estimate of six OTC derivatives dealers, consisting of four current OTC derivatives dealers and two anticipated registrants).

#### **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.

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<sup>7</sup> ((3 firms x 96 hours) + (6 firms x 96 hours)) = 864 hours.

<sup>8</sup> (.75 x (864 hours x \$77 per hour)) = \$49,896.

<sup>9</sup> This estimate was computed according to the guidelines set forth in U.S. General Services Administration, Guide to Estimating Reporting Costs (1973).