

SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission for
Appendix F to Rule 15c3-1

A. JUSTIFICATION

1. Information Collection Necessity

Appendix F to Rule 15c3-1¹ under the Securities Exchange Act of 1934 (“Exchange Act”) is one of several Commission rules that apply to a class of broker-dealers known as over-the-counter (“OTC”) derivatives dealers.

Under appendix F, an OTC derivatives dealer may apply to the Commission for authorization to compute net capital charges for market and credit risk in accordance with appendix F in lieu of computing securities haircuts under paragraph (c)(2)(vi) of Exchange Act Rule 15c3-1.² Rule 15c3-1 is the Commission’s net capital rule for broker-dealers. The application must contain, among other things, a description of the methods used for computing market and credit risk, including a description of all statistical models used for pricing OTC derivative instruments and for computing value-at-risk (“VAR”), a description of controls over those models, and a statement regarding whether the firm has developed its own internal VAR models. The application must also contain a description of the firm’s internal risk management systems and how those systems meet certain requirements in Exchange Act Rule 15c3-4.³

In addition, if the OTC derivatives dealer materially amends its VAR model or internal risk management control system, the firm must file an application describing the changes, which must be approved by the Commission before the changes may be implemented.

In addition to obtaining Commission approval of its application, the VAR models of OTC derivatives dealers must meet certain enumerated qualitative and quantitative requirements. For example: the OTC derivatives dealer must conduct backtesting by comparing each of its most recent 250 business days’ actual net trading profit or loss with the corresponding daily VAR measures generated for determining market risk, and once each quarter the firm must identify the number of business days for which the actual daily net trading loss exceeded the corresponding daily VAR measure; the firm must conduct stress tests of VAR model and develop appropriate procedures to follow in response to the results of those tests; and the firm must provide the Commission with evidence that its VAR model takes account of specific risk if the firm intends to use the model to compute capital charges for equity price risk.

Under paragraph (a)(5) of Rule 15c3-1, a broker-dealer for which the Commission has granted its application to compute capital charges in accordance with appendix F is required to maintain tentative net capital of not less than \$100 million and net capital of not less than \$20 million.

¹ 17 CFR 240.15c3-1f.

² 17 CFR 240.15c3-1.

³ 17 CFR 240.15c3-4.

2. Information Collection Purpose and Use

Appendix F to Rule 15c3-1 is an integral part of the Commission's financial responsibility program for OTC derivatives dealers. The purpose of appendix F is to provide OTC derivatives dealers an alternative method for computing net capital charges for market and credit risk, while ensuring that OTC derivatives dealers have, on hand at all times, sufficient liquid resources to meet their obligations and liabilities.

3. Consideration Given to Information Technology

Firms subject to appendix F use automated systems for computing their capital requirements. Because there are relatively few OTC derivatives dealers, it is not economically feasible for the Commission to develop a system which would allow for electronic filing of OTC derivatives dealers' applications under appendix F.

4. Duplication

OTC derivatives dealers are not otherwise required to obtain, maintain, and report the information required by appendix F, so no duplication exists.

5. Effect on Small Entities

Appendix F does not affect small entities because OTC derivatives dealers must maintain tentative net capital of not less than \$100 million and net capital of not less than \$20 million.

6. Consequences of Not Conducting Collection

Collecting the required information less frequently would lessen 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 gifts or payments will be given to respondents.

10. Confidentiality

Under paragraph (a)(4) of appendix F, applications for authorization to use appendix F and applications to amend VAR models or the broker-dealer's internal risk management system shall be deemed to be confidential.

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

At present, three OTC derivatives dealers have been approved to use appendix F. Two OTC derivatives dealers have applied to use appendix F, and the staff expects that one additional OTC derivatives dealer will apply to use appendix F during the next three years.

The Commission estimates that the three approved OTC derivatives dealers and two OTC derivatives dealers with pending applications (if approved) will spend an average of approximately 1,000 hours each per year reporting information concerning their VAR models and internal risk management systems, for an annual burden of 5,000 hours.⁴

The Commission estimates that the one additional entity expected to apply to use appendix F will take approximately 1,000 hours to prepare the application, for an annual burden of 333 hours per year amortized over three years. In the years after it registers, the new registrant will spend an average of approximately 1,000 hours each year reporting information concerning its VAR model and internal risk management system, for an annual burden of 667 hours per year.⁵

13. Costs to Respondents

The Commission believes that there are no reporting costs associated with the rule.

14. Costs to Federal Government

There are no additional costs to the Federal Government.

⁴ Five (5) OTC derivatives dealers x 1,000 hours = 5,000 hours.

⁵ Assuming the registrant registers in the first year, it will have the monitoring burden of 1,000 hours per year in each of the next two years. $((1,000 \text{ hours} \times 2 \text{ year}) / 3 \text{ years} = 667 \text{ hours})$.

15. Changes in Burden

The Commission now estimates that a total of six OTC derivatives dealers will be approved to use appendix F within the next three years, consisting of the three broker-dealers currently approved, the two broker-dealers with pending applications, and one additional broker-dealer expected to apply.

The Commission previously estimated that a total of five entities would be approved to use appendix F at the end of three years, consisting of four current OTC derivatives dealers and one anticipated applicant.

IC	IC Title	Annual No. of Responses			Annual Time Burden (Hrs.)		
		<i>Previously approved</i>	<i>Requested</i>	<i>Change</i>	<i>Previously approved</i>	<i>Requested</i>	<i>Change</i>
IC1	Existing Dealer Maintenance	4	5	1	4,000	5,000	1,000
IC2	New Registrant Start-up	1	1	0	333	333	0
IC3	New Registrant Maintenance	1	1	0	667	667	0
	Total for all ICs	6	7	1	5,000	6,000	1,000

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 OMB expiration date.

18. Exceptions to Certification for Paperwork Reduction Act Submissions

The Commission is not seeking an exception to the certification statement.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

This collection does not involve statistical methods.