

## SUPPORTING STATEMENT

### **for the Paperwork Reduction Act Information Collection Submission for Rule 18a-10 – Alternative compliance mechanism for security-based swap dealers that are registered as swap dealers and have limited security-based swap activities.**

**OMB Number (3235-0785)**

*This submission is being made pursuant to the Paperwork Reduction Act of 1995, 44 U.S.C. Section 3501 et seq.*

#### **A. Justification**

##### **1. Necessity of information Collection**

On June 21, 2019, in accordance with Section 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”),<sup>1</sup> which added section 15F to the Securities Exchange Act of 1934 (the “Exchange Act”),<sup>2</sup> the Securities and Exchange Commission (the “Commission”) adopted Rule 18a-10.<sup>3</sup> Rule 18a-10, as originally adopted, provides an alternative compliance mechanism pursuant to which stand-alone security-based swap dealers (“SBSDs”)<sup>4</sup> registered as a swap dealer that predominantly engages in a swaps business, and that meet certain conditions set forth in the rule, may elect to comply with the capital, margin, and segregation requirements of the Commodity Exchange Act (“CEA”) and the U.S. Commodity Futures Trading Commission’s (“CFTC”) rules in lieu of complying with Rules 18a-1, 18a-3, and 18a-4, as adopted.<sup>5</sup> Rule 18a-10 requires the firm to provide a written

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<sup>1</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

<sup>2</sup> See 15 U.S.C. 78o-10(e)(2)(B).

<sup>3</sup> The Commission did not propose Rule 18a-10, and Rule 18a-10 was not proposed in connection with the proposing release for Rules 18a-1, 18a-3, or 18a-4. Instead, the adoption of Rule 18a-10 followed from comments received in connection with the proposal of other rules, including Rules 18a-1, 18a-3, and 18a-4, suggesting that the Commission provide an alternative compliance mechanism for SBSDs that are registered as swap dealers that predominantly engage in a swaps business to permit such entities to comply with the rules of the CFTC applicable to swap dealers. Following the adoption of Rule 18a-10, the burdens associated with the Rule were included in the Collection of Information in Rule 18a-3 (OMB No. 3235-0702), and were approved on November 19, 2019. See *Supporting Statement for Paperwork Reduction Act Information Collection Submission for Rule 18a-3 – Non-cleared security-based swap margin requirements for security-based swap dealers and major security-based swap participants for which there is not a prudential regulator*, available at [https://www.reginfo.gov/public/do/PRAViewDocument?ref\\_nbr=201907-3235-017](https://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201907-3235-017). See also [OMB Control Number History \(reginfo.gov\)](#).

<sup>4</sup> The alternative compliance mechanism in Rule 18a-10, as adopted, is not available to nonbank SBSDs that are registered as either a broker-dealer or an OTC derivatives dealer. Consequently, term “stand-alone SBSD,” in the context of discussing the alternative compliance mechanism, refers to a stand-alone SBSD that is not also registered as a broker-dealer or an OTC derivatives dealer.

<sup>5</sup> See *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-*

disclosure to its counterparties after it begins operating pursuant to the rule. The disclosure requirement is designed to alert the counterparty that the firm is not complying with these Commission rules notwithstanding the fact that the firm is registered with the Commission as an SBSB. This will provide the counterparty with the opportunity to assess the implications of transacting with the SBSB under these circumstances.

Furthermore, Rule 18a-10 requires the firm to immediately notify the Commission and the CFTC in writing if it fails to meet a condition in the rule. This notice – by immediately alerting the Commission and the CFTC of the firm’s status – will provide the agencies with the opportunity to promptly evaluate the situation and coordinate any regulatory responses such as increased monitoring of the firm.

### **September 2019 Amendments to Rule 18a-10**

On September 19, 2019, the Commission adopted amendments to Rule 18a-10.<sup>6</sup> Specifically, the Commission amended the Rule 18a-10 to reference recordkeeping and reporting requirements of the CEA and the CFTC’s rules, as well as Commission Rules 18a-5, 18a-6, 18a-7, 18a-8, and 18a-9 in order to add these requirements to the full alternative compliance mechanism described above. Consequently, these amendments will permit firms that operate under Rule 18a-10 to elect to comply with the recordkeeping and reporting requirements of the CEA and the CFTC’s rules in lieu of complying with Rules 18a-5, 18a-6, 18a-7, 18a-8, and 18a-9, and will also require SBSBs to comply with the requirement to provide a written disclosure to its counterparties after it begins operating pursuant to the rule indicating that the SBSB is complying with the applicable recordkeeping and reporting requirements of the CEA and the CFTC’s rules in lieu of complying with Rules 18a-5, 18a-6, 18a-7, 18a-8, and 18a-9.

The Commission also added new paragraph (b)(4) to Rule 18a-10 which requires SBSBs operating under Rule 18a-10 to simultaneously notify the Commission whenever the SBSB is required to notify the CFTC concerning the SBSB’s capital, books and records, liquidity, margin operations, or segregation operations.

The Commission also amended Rule 18a-10 to add certain clarifying language to provide that a firm must treat a security-based swap or collateral related to a security-based swap *as a swap or collateral related to a security-based swap, as applicable*, if the CEA or the CFTC’s rules do not specifically address a security-based swap or collateral related to a security-based swap.

### **Revision to Information Collection and Request for New OMB Number**

The Commission revised the estimated burdens for the information collection in Rule

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*Based Swap Participants and Capital Requirements for Broker-Dealers*, Exchange Act Release No. 86175 (Jun. 21, 2019), 84 FR 43872 (Aug. 22, 2019).

<sup>6</sup> See *Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap participants, and Broker-Dealers; Final Rule*, Exchange Act Release No. 87005 (Sep. 19, 2019), 84 FR 68550 (Dec. 16, 2019).

18a-10 as a result of the amendments, described above, that were adopted in connection with the adopting or recordkeeping and reporting requirements for security-based swap dealers and major security-based swap participants.<sup>7</sup> The Commission also requested a separate OMB number for Rule 18a-10 in order to separate the burdens associated with Rule 18a-10 from Rule 18a-3 and to include the revised burden estimates associated with the amendments to Rule 18a-10 described above.

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

Information collection under Rule 18a-10, as adopted is integral to the Commission's financial responsibility program for certain stand-alone SBSBs. The disclosure requirement under Rule 18a-10, as adopted, is designed to alert the counterparty that the firm is not complying with these Commission rules notwithstanding the fact that the firm is registered with the Commission as an SBSB. This will provide the counterparty with the opportunity to assess the implications of transacting with the SBSB under these circumstances.

Rule 18a-10 requires notification to the Commission if the SBSB chooses the alternative compliance mechanism described in the rule. The Commission believes stand-alone SBSBs that meet the conditions of Rule 18a-10 should be permitted to adhere to capital, margin, and segregation requirements of the CEA and the CFTC's rules (which, potentially, could include a bank-like capital standard) because, among other reasons, they will be predominantly engaging in a swaps business and, therefore, the CFTC will have a heightened regulatory interest in these firms as compared to the Commission's regulatory interest.

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

The information collections will not require that respondents use any specific information technology system either to prepare or submit information collections under Rule 18a-10.

## **4. Duplication**

This information collection does not duplicate any existing information collection.

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

The information collections required under Rule 18a-10 would not place burdens on small entities. The stand-alone SBSBs subject to the information collections under the rule are not expected to be small entities.

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

If the required information collections are not conducted or are conducted less frequently,

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<sup>7</sup> See *Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap participants, and Broker-Dealers; Final Rule, Exchange Act Release No. 87005 (Sep. 19, 2019), 84 FR 68550 (Dec. 16, 2019)*.

the protection afforded to counterparties and the U.S. financial system 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 information collection 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 under Rule 18a-10 is kept confidential to the extent permitted by the Freedom of Information Act (5 U.S.C. § 552 *et seq.*).

**11. Sensitive Questions**

The Information Collection does not collect information about individuals, therefore, a PIA, SORN, and PAS are not required.

**12. Burden of Information Collection**

Rule 18a-10 contains an alternative compliance mechanism pursuant to which a stand-alone SBSB that is registered as a swap dealer and predominantly engages in a swaps business may elect to comply with the capital, margin, segregation, and recordkeeping and reporting requirements of the CEA and the CFTC's rules in lieu of complying with Commission Rules 18a-1 and 18a-3 through 18a-9. There are currently two stand-alone SBSBs operating pursuant to the alternative compliance mechanism. The Commission does not anticipate that additional stand-alone SBSBs will elect to operate pursuant to this Rule during the next three years and, as a result, the Commission estimates the following hour burdens for the information collection burdens associated with Rule 18a-10.

**Rule 18a-10(b)(2)**

Paragraph (b)(2) of Rule 18a-10 requires stand-alone SBSBs to provide a written disclosure to its counterparties after it begins operating pursuant to the rule. The Commission estimates that the majority of the paperwork burden associated with the disclosure requirements under paragraph (b)(2) of Rule 18a-10, as adopted, was experienced during the first year as the required disclosure language was developed and incorporated into transaction documentation. Since the new disclosure language has been developed and incorporated into transaction

documentation, the Commission believes that the information collection burden associated with Rule 18a-10(b)(2) will be an ongoing burden limited to periodically updating the disclosures. The burdens associated with the development, incorporation, and updating of the disclosure language are estimated below.

### **Develop Disclosure Language (Rule 18a-10(b)(2))**

The Commission previously estimated that the paperwork burden associated with developing new disclosure language under paragraph (b)(2) of Rule 18a-10 would require each stand-alone SBSB to spend 5 hours of in-house counsel time to develop the required disclosure. As stated above, there are currently two stand-alone SBSBs which the Commission estimates have already developed the required disclosure language. Consequently, the Commission estimates that no stand-alone SBSBs will be required to develop disclosure language, and as a result there is no hour burden for this collection of information.

### **Incorporate Disclosure Language (Rule 18a-10(b)(2))**

Based on previous experience, the Commission staff estimated that the average stand-alone SBSB would have approximately 1,000 counterparties at any given time and that the time of incorporating new disclosure language into the trading documentation of an average SBSB would require 10 hours of in-house counsel time, for a total of 10,000 hours per stand-alone SBSB. As stated above, there are currently two stand-alone SBSBs which the Commission estimates have already incorporated the required disclosure language into the relevant transaction documentation. Consequently, the Commission estimates that no stand-alone SBSBs will be required to incorporate disclosure language in connection with this requirement, and as a result there is no hour burden for this collection of information.

### **Update Disclosures (Rule 18a-10(b)(2))**

The Commission estimates that the paperwork burden associated with updating the disclosure language required under paragraph (b)(2) of Rule 18a-10 would result in each stand-alone SBSB taking 5 hours per year to make the necessary updates. **The Commission estimates that this ongoing paperwork burden will not exceed 5 hours per stand-alone SBSB, for a total of 10 hours annually for the 2 stand-alone SBSBs.**<sup>8</sup>

### **Notices (Rule 18a-10(b)(3))**

Based on the number of notices currently filed by broker-dealers, the Commission staff estimates that the notice requirement of paragraph (b)(3) of Rule 18a-10 will result in annual hour burdens to stand-alone SBSBs. The Commission staff estimates that 1 stand-alone SBSB will file notice annually with the Commission. In addition, based on the estimates for similar collections of information, **the Commission staff estimates that it will take a stand-alone SBSB approximately a half hour to file this notice, resulting in an industry-wide annual**

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<sup>8</sup> 2 stand-alone SBSBs x 5 hours = 10 hours.

**hour burden of a half hour.<sup>9</sup>**

**Simultaneous Notification (Rule 18a-10(b)(4))**

Based on the number of notices currently filed by broker-dealers, the Commission staff estimates that the notice requirement of paragraph (b)(3) of Rule 18a-10 will result in annual hour burdens to stand-alone SBSBs. The Commission staff estimates that annually 1 stand-alone SBSB will transmit a copy of a notice to the Commission that was submitted to the CFTC. **The Commission staff estimates that it will take a stand-alone SBSB approximately 5 minutes to provide the Commission with a copy of the notice, resulting in an industry-wide annual hour burden of a 0.083 hours.**<sup>10</sup>

**Alternative Compliance Mechanism (Rule 18a-10(d)(1) and (d)(2))**

Finally, under paragraphs (d)(1) and (d)(2) of Rule 18a-10, respectively, a stand-alone SBSB can make an election to operate under the alternative compliance mechanism, during the registration process or after the firm registers as an SBSB, by providing written notice to the Commission and the CFTC of its intent to operate pursuant to Rule 18a-10. The Commission previously estimated that in the first 3 years of the effective date of the rule that the 3 nonbank SBSBs that elect to operate under Rule 18a-10 would file the notice as part of their application process. As noted above, there are currently 2 stand-alone SBSBs operating pursuant to the Rule. While the Commission estimates that no additional stand-alone SBSBs will elect to operate pursuant to the Rule, the Commission believes that the time it would take an entity to file a notice as part of the application process would be *de minimis* and, therefore, would not result in an hour burden for this collection of information or any collection of information associated with registering with the Commission as an SBSB. Consequently, the Commission believes that there will be no respondents, and no paperwork hour or cost burden under the PRA associated with paragraph (d)(2) of Rule 18a-10, as adopted.

**Total Industry Hour Burden:** The Commission estimates the total annualized ongoing industry hour burden attributable to rule 18a-10 to be 11 hours.<sup>11</sup> The table below summarizes the estimated burdens.

Summary of Hourly Burdens										
Name of Information Collection	Type of Burden	Number of Entities Impacted	Annual Responses per Entity	Initial Burden per Entity per Response	Initial Burden Annualized per Entity per Response	Ongoing Burden per Entity per Response	Annual Burden Per Entity per Response	Total Annual Burden Per Entity	Total Industry Burden	Small Business Entities Affected
Rule 18a-10(b)(2) (Update Disclosures)	Third Party	2	1	0	0	5	5	5	10	0
Rule 18a-10(b)(3) (Notices)	Reporting	1	1	0	0	.5	.5	.5	0.5 (rounds to 1)	0

<sup>9</sup> 1 stand-alone SBSB x 1 notice x 30 minutes = 30 minutes.

<sup>10</sup> 1 notice per year x (5 minutes per notice ÷ 60 minutes per hour) = 0.0833 hours.

<sup>11</sup> 10 hours + 1 hour = 11 hours.

Rule 18a-10(b)(4) (Simultaneous Notification)	Reporting	1	1	0	0	0.083	0.083	0.083	0.083 (rounds to 0)	0
<b>TOTAL HOURLY BURDEN FOR ALL RESPONDENTS</b>									11	

### 13. Costs to Respondents

The Commission does not expect any cost burdens associated with Rule 18a-10, as adopted.

### 14. Cost to Federal Government

The Commission does not anticipate this information collection to impose additional costs to the Federal Government.

### 15. Changes in Burden

The estimated burdens have changed from those that were previously approved. The table below summarizes the changes in the estimated burdens.

<b>Summary of Change in Hourly Burden (Annual)</b>				
<b>Name of Information Collection</b>	<b>Previously Reviewed Burden</b>	<b>New Estimated Burden</b>	<b>Change in Burden</b>	<b>Reason for the Change</b>
Rule 18a-10(b)(2) (Develop Disclosure Language)	15 hours	0 hours	(15) hours	The burden was largely expected to be experienced during the first year after the adoption of the rule. Therefore, the burden has already been incurred and is no longer applicable.
Rule 18a-10(b)(2) (Incorporate Disclosure Language)	10,000 hours	0 hours	(10,000) hours	The burden was largely expected to be experienced during the first year after the adoption of the rule. Therefore, the burden has already been incurred and is no longer applicable.
Rule 18a-10(b)(2) (Update Disclosures)	15 hours	10 hours	(5) hours	Reduction in the number of respondents from 3 to 2.
Rule 18a-10(b)(3) (Notices)	0.5 hours	0.5	No change	No change.
Rule 18a-10(b)(4) (Simultaneous Notification)	0.083 hours	0.083 hours	No change	No change.

### 16. Information Collected Planned for Statistical Purposes

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

### 17. OMB Expiration Date

The Commission is not seeking approval to not display the OMB approval expiration date.

**18. Exceptions to Certification for Paperwork Reduction Act Submissions**

This information collection complies with the requirements of 5 CFR 1320.9.

**B. COLLECTIONS OF INFORMATION EMPLOYEING STATISTICAL METHODS**

This information collection does not involve statistical methods.