

SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission for Rule 18a-3 under
the Exchange Act –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
OMB Control Number 3235-0702

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”),¹ which added Section 15F to the Securities Exchange Act of 1934 (the “Exchange Act”),² the Securities and Exchange Commission (the “Commission”) adopted Rule 18a-3 to establish minimum margin requirements for nonbank security-based swap dealers (“SBSDs”) and nonbank major security-based swap participants (“MSBSPs”) for non-cleared security-based swaps.³ The rule established a new collection of information requirement with respect to nonbank SBSDs.

Specifically, under Rule 18a-3(e) nonbank SBSDs are required to monitor the risk of each account that holds non-cleared security-based swaps for a counterparty and to establish, maintain, and document procedures and guidelines for monitoring the risk of accounts as part of its risk management control system required under Exchange Act Rule 15c3-4. In addition, the rule requires nonbank SBSDs to review, in accordance with written procedures and at reasonable periodic intervals, its non-cleared security-based swap activities for consistency with such risk monitoring procedures and guidelines. Nonbank SBSDs are also required to determine whether information and data necessary to apply the risk monitoring procedures and guidelines are accessible on a timely basis and whether information systems are available to adequately capture, monitor, analyze, and report relevant data and information. Finally, the rule requires that the monitoring procedures and guidelines must include, at a minimum, procedures and guidelines for:

- Obtaining and reviewing account documentation and financial information necessary for assessing the amount of current and potential future exposure to a given counterparty permitted by the SBSD;
- Determining, approving, and periodically reviewing credit limits for each counterparty, and across all counterparties;

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

² See 15 U.S.C. 78o-10(e)(2)(B).

³ See *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers*, Exchange Act Release No. 86175.

- Monitoring credit risk exposure to the SBSB from non-cleared security-based swaps, including the type, scope, and frequency of reporting to senior management;
- Using stress tests to monitor potential future exposure to a single counterparty and across all counterparties over a specified range of possible market movements over a specified time period;
- Managing the impact of credit exposure related to non-cleared security-based swaps on the SBSB's overall risk exposure;
- Determining the need to collect collateral from a particular counterparty, including whether that determination was based upon the creditworthiness of the counterparty and/or the risk of the specific non-cleared security-based swap contracts with the counterparty;
- Monitoring the credit exposure resulting from concentrated positions with a single counterparty and across all counterparties, and during periods of extreme volatility; and
- Maintaining sufficient equity in the account of each counterparty to protect against the largest individual potential future exposure of a non-cleared security-based swap carried in the account of the counterparty as measured by computing the largest maximum possible loss that could result from the exposure.

In addition, Rule 18a-3(d)(2) provides that a nonbank SBSB seeking approval to use a model to calculate initial margin will be subject to an application process consistent with Exchange Act Rule 15c3-1e and Exchange Act Rule 18a-1(d), as applicable, governing the use of internal models to compute net capital. The nonbank SBSB will need to submit sufficient information to allow the Commission to make a determination regarding the performance of the nonbank SBSB's initial margin methodology.⁴

2. Purpose and Use of the Information Collection

Information collections under Rule 18a-3 are integral to the Commission's financial responsibility program for nonbank SBSBs. The program is designed to ensure that nonbank SBSBs effectively manage counterparty risk by monitoring their financial exposures to non-cleared security-based swap counterparties. These information collections will facilitate the collection of adequate levels of margin assets by nonbank SBSBs to protect them against counterparty default on both current and potential future exposures.

Under Rule 18a-3, a nonbank SBSB is required to establish and implement risk monitoring procedures with respect to counterparty accounts. The purpose of the rule is to limit risks to individual firms and systemic risk arising from non-cleared security-based swaps. Firms' records relating to the collection of collateral required by Rule 18a-3 assist examiners in evaluating whether SBSBs are in compliance with requirements in the rule.⁵

⁴ While Rule 18a-3 contains requirements that apply to both nonbank SBSBs and MSBSPs, the particular requirements that constitute a collection of information relate only to nonbank SBSBs.

⁵ The records required to be made and maintained, and the retention requirements for nonbank SBSBs are set forth in Rules 18a-5 (17 CFR 240.18a-5) and 18a-6 (17 CFR 240.18a-6).

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-3.

4. Duplication

This information collection does not duplicate any existing information collection.

5. Effect on Small Entities

The information collections required under Rule 18a-3 would not place burdens on small entities. The nonbank SBSDs 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, 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 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 under Rule 18a-3 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. Information Collection Burden

The total annual hour burden associated with Rule 18a-3 is approximately 1,030 hours

calculated as follows:

Counterparty Risk Monitoring Procedures (Rule 18a-3(e))

The Commission staff estimates that there are 13 nonbank SBSBs that are subject to Rule 18a-3. The staff previously estimated that each of the nonbank SBSBs would spend an average of approximately 210 hours establishing and documenting their Rule 18a-3 counterparty risk monitoring procedures. As this initial burden has already been incurred by the nonbank SBSBs, it is no longer applicable with respect to the determination of the hourly burden for Rule 18a-3(e).

With respect to ongoing burdens, the staff estimates that each nonbank SBSB would spend an average of approximately 60 hours per year reviewing risks associated with its counterparties, for an annual industry-wide burden of approximately 780 recordkeeping hours.⁶

Consequently, the annual hour burden for the total industry is approximately 780 hours per year.

Initial Margin Model (Rule 18a-3(d))

A nonbank SBSB may use a model to calculate initial margin, if the use of the model has been approved by the Commission. A nonbank SBSB seeking approval to use a margin model will be subject to an application process and ongoing conditions in Rule 15c3-1e and Rule 18a-1(d) governing the use of internal models to compute net capital. A nonbank SBSB seeking approval to use a margin model will need to submit sufficient information to allow the Commission to make a determination regarding the performance of the nonbank SBSB's margin methodology. With respect to one-time burdens, based on staff experience, the Commission previously estimated that it will take a nonbank SBSB approximately 50 hours to prepare and submit an application to the Commission to seek authorization to use an internal model to calculate initial margin. This initial burden has already been incurred by the nonbank SBSBs, and as a result is no longer applicable with respect to the determination of the hourly burden for Rule 18a-3(e).

With respect to ongoing burdens, the Commission estimates that each nonbank SBSB will spend approximately 250 hours per year reviewing, updating, and back testing their initial margin model. Based on current data, the Commission estimates that one nonbank SBSB has elected to use a model to calculate initial margin, resulting in a total industry-wide annual hour burden of approximately 250 recordkeeping hours.⁷ **In total, the Commission estimates an annual hour burden of approximately 250 hours per year.**

⁶ 13 nonbank SBSBs x 60 hours = 780 hours.

⁷ 1 nonbank SBSBs x 250 hours = 250 hours.

Summary of Hour 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-3(e) (Counterparty Risk Monitoring Procedures)	Recordkeeping	13	1	0.00	0.00	60.00	60.00	60.00	780	0
Rule 18a-3(d) (Initial Margin Model)	Recordkeeping	1	1	0.00	0.00	250.00	250.00	250.00	250	0
TOTAL HOURLY BURDEN FOR ALL RESPONDENTS									1,030	

13. Costs to Respondents

The Commission estimates that there are no costs associated with Rule 18a-3. The Commission previously estimated that the total one-time cost burden associated with Rule 18a-3 was approximately \$3,333. The Commission based this estimate on the 7 respondents previously estimated to be subject to the collection of information incurring start-up costs in order to comply with the collection of information. As those one-time start-up costs have already been incurred, they are no longer applicable to determining the costs to respondents related to Rule 18a-3.

14. Cost to Federal Government

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

15. Changes in Burden

The changes in burden result from an increase in the estimated number of respondents from 7 to 13, as well as from a reduction in the estimated initial one-time burdens. A chart summarizing the changes in burdens and costs is below.

Name of Information Collection	Current Annual Industry Burden	Revised Annual Industry Burden	Change in Burden	Reason for Change
Rule 18a-3(e) (Counterparty Risk Monitoring Procedures)	910	780	(130)	Change in staff estimate of entities impacted and reduction in one-time initial costs
Rule 18a-3(d) (Initial Margin Model)	1,333	250	(1,083)	Change in staff estimate of entities impacted and reduction in one-time initial costs
Rule 18a-3 (Cost Burden)	\$3,333	\$0	(\$3,333)	Change in staff estimate of entities impacted.

16. Information Collected Planned for Statistical Purposes

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

17. OMB Expiration Date Display Approval

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