

Should we consider any other conditions? Are any of the proposed conditions problematic?

c. Documents and Information To Be Submitted by the Holding Company

Under paragraph (a)(2) of proposed Appendix E, as a condition of the broker-dealer's use of the alternative capital treatment, the holding company of the broker-dealer must submit the following documents and information to the Commission as part of the application of the broker or dealer:

- A narrative description of the business and organization of the holding company;
- An organizational chart depicting the holding company and its subsidiaries and affiliates;
- An alphabetical list of the affiliates of the broker-dealer ("affiliate group"), with an identification of the financial regulator, if any, with whom the affiliate is registered and a designation of those affiliates that are material to the holding company ("material affiliates");
- Consolidated and consolidating financial statements;
- Certain sample capital calculations made according to proposed Appendix G to Rule 15c3-1;
- A description of the categories of positions held by the holding company and affiliates;
- A description of the methods the holding company intends to use for computing allowances for market risk, credit risk, and operational risk;
- A description of any differences between the models used by the holding company and those used by the broker-dealer to compute capital charges on the same instrument or counterparty;
- A description of the internal risk management control system used by the holding company to manage group-wide risk and how that system satisfies the requirements of Rule 15c3-4; and
- Sample risk reports that the holding company provides to its senior management.

Because each firm manages its internal risk differently, the Commission, during the application process, must assess each firm's business and internal risk management control systems to determine whether an exemption is appropriate. The documents and information we would require the holding company to file as a condition for the exemption would allow us to evaluate this risk. In certain circumstances, depending on the relationship or the geographic location of the holding company and its affiliates, the Commission may condition its approval on obtaining additional information or documents

necessary to adequately assess the risks to the CSE and to the broker-dealer. Paragraph (a)(3) of proposed Appendix E provides that the application shall be supplemented by such other information or documents relating to the internal risk management control system, mathematical models, and financial position of the broker-dealer or the holding company that the Commission may request to complete its review of the application.

Under paragraph (a)(4) of proposed Appendix E, the application would be considered filed when received at the Commission's principal office in Washington, DC. All information and documents submitted in connection with the application would be accorded confidential treatment under the proposal.

We request comment on the documents and information we propose to require that the broker-dealer and holding company file as a condition for the exemption. For example, are there other documents or information we should require?

As part of its group-wide internal risk management control system, the holding company would be required to establish, document, and maintain procedures for the detection and prevention of money laundering and terrorist financing. These procedures would include appropriate safeguards at the holding company level to prevent money laundering through affiliates.<sup>26</sup>

Under paragraph (a)(6) of proposed Appendix E, the Commission would grant an application by a broker-dealer to use the alternative capital computation if it determines that the broker-dealer has met the requirements of Appendix E and is in compliance with other applicable Exchange Act rules and that the holding company is in compliance with the terms of its undertaking, which are conditions for the approval.

Under paragraph (a)(7) of proposed Appendix E, a broker-dealer would be required to amend and resubmit its application to use Appendix E to the Commission if the broker-dealer or its holding company desires to make a material change to a mathematical model used to calculate market or credit risk or its internal risk management control system as described in the application. Because material changes to the mathematical models may have a

significant impact on the firm's net capital or risk allowances and changes to the internal risk management control systems could result in changes to the amount of risk assumed by the broker-dealer or holding company, Commission review of those changes would be appropriate to determine if the exemption continues to be consistent with the Exchange Act. Under paragraph (a)(8) of proposed Appendix E, the broker-dealer would be required to notify the Commission of any material change to the corporate structure of the broker-dealer or the holding company as described in the application.

Under paragraph (a)(9) of proposed Appendix E, as a condition of the exemption to compute its capital charges pursuant to Appendix E, a broker-dealer would agree to provide 45 days written notice to the Commission if it chose to end its reliance on the exemption. The broker-dealer would also agree that the Commission could determine that the notice would be effective after a shorter or longer period of time if the broker-dealer consents or if the Commission determines that the shorter or longer period is necessary or appropriate in the public interest and consistent with the protection of investors. We request comment on this notice provision. For example, is 45 days an appropriate notification period? Would a shorter or longer time period be preferable?

Pursuant to paragraph (a)(10) of proposed Appendix E, the Commission may, by order, revoke the broker-dealer's exemption that allows it to use proposed Appendix E to calculate certain capital charges if the Commission finds that the exemption is no longer necessary or appropriate in the public interest or is no longer consistent with the protection of investors. A broker-dealer that is no longer permitted to calculate its regulatory capital requirements pursuant to Appendix E must compute its capital charges using the standard haircut method in the net capital rule. We request comment on the revocation provisions. Should paragraph (a)(10) of proposed Appendix E specify certain circumstances where revocation of the exemption would be appropriate?

## 2. Risk Management Control System

Under paragraph (b) of proposed Appendix E, the broker-dealer would be required to establish, document, and maintain an internal risk management control system that meets the requirements of § 240.15c3-4 (with proposed amendments to apply the rule

<sup>26</sup> This parallels requirements in the proposed New Basel Capital Accord. See also Financial Action Task Force on Money Laundering (FATF) Recommendation 22 and see generally the FATF's *Special Recommendations on Terrorist Financing*. (The FATF's documents can be found at <http://www.FATF-GAFL.org>).