

e. Holding Companies Subject to Supervision by a Financial Regulator Other Than the Commission

Certain CSEs that own broker-dealers are subject to supervision at the holding company level by a financial regulator or supervisor other than the Commission. These holding companies may be required by that financial regulator to compute a capital assessment similar to that required by paragraphs (a)(1) through (a)(4) of proposed Appendix G. To reduce regulatory burdens, and because we think that such calculations will be sufficient to permit us to evaluate the risk to the broker-dealer, paragraph (a)(5) of proposed Appendix G provides that, upon Commission approval of the broker-dealer's original application or amendments to the application, the CSE may compute a capital assessment consistent with the standards issued by the Basel Committee that it is required to submit to a financial regulator or supervisor in lieu of the computations required by paragraphs (a)(1) through (a)(4) of proposed Appendix G, provided these computations are consistent with the Basel Standards. We request comment on this provision.

f. General Discussion of Basel Pillars

This proposal would apply a capital reporting requirement consistent with the Basel Standards to the CSE. The Basel Committee is currently developing a new international agreement (the "proposed New Basel Capital Accord"). The proposed New Basel Capital Accord specifies three "pillars" for the group-wide supervision of internationally active banks and financial enterprises. The first pillar, "minimum regulatory capital" requirements, requires calculations for credit and operational risk and, for firms with significant trading activity, market risk. The second pillar, "supervisory review," requires that capital be assessed relative to overall risks and that supervisors review and take action in response to those assessments.⁵⁸ We request comment on whether the regulatory regime outlined in this proposal together with existing Commission regulation of broker-dealers would meet the requirements of the first and second pillars of the proposed New Basel Capital Accord or whether changes or enhancements should be made. In addition, we request comment on whether, if the proposed New Basel Capital Accord is adopted, there should be a transition period before the Commission requires its use by CSEs.

The third pillar requires certain disclosures which will allow market participants to assess key pieces of information concerning, for example, the capital, risk exposures, and risk assessment processes of the institution. The purpose of the third pillar is to complement the minimum capital requirements and the supervisory review process by encouraging market discipline.⁵⁹

The third pillar is discussed in the U.S. banking agencies' Advanced Notice of Proposed Rulemaking on the proposed New Basel Capital Accord.⁶⁰ As the banking agencies noted, an integral part of the proposed New Basel Capital Accord is enhanced public disclosure practices. Specific disclosure requirements would be applicable to all institutions using the proposed New Basel Capital Accord and would encompass capital, credit risk, credit risk mitigation, securitization, market risk, operational risk, and interest rate risk.

We request comment on whether any additional disclosures by U.S. broker-dealer firms, their holding companies, and affiliates should be required to meet the requirements of the third pillar of the proposed New Basel Capital Accord. If additional, specific disclosure is warranted, commenters are asked to address where that disclosure should be made as well as whether disclosures should be made on a quarterly, annual, or other periodic basis. In addition, we request comment on whether additional required disclosures should depend on whether a firm is privately held or is required to file information, documents, and reports pursuant to §§ 13(a) or 15(d) of the Exchange Act.

2. Reporting Requirements for the CSE

As a condition of Commission approval, pursuant to proposed paragraph (b) of Appendix G, the CSE would be required to file certain monthly and quarterly reports, as well as annual audited statements, with the Commission. The Commission would use the information filed by the CSE to monitor the financial condition, internal risk management control system, and activities of the CSE. This would give the Commission important information regarding activities of its affiliates that could impair the financial and operational stability of the broker-dealer. These reports would also allow the Commission to monitor the condition of the affiliate group to detect

any events or trends that may adversely affect the broker-dealer. Failure to require the reports would undermine the Commission's ability to monitor the financial condition of the CSEs and could jeopardize the financial stability of broker-dealers using Appendix E to calculate certain of their capital charges. Moreover, requiring timely financial and other risk information that identifies which business line or affiliated entity may have incurred particular risks is necessary in order to identify areas for Commission examination.

Pursuant to paragraph (b)(1) of proposed Appendix G, the CSE would be required to file a monthly report with the Commission within 17 business days after the end of the month (the FOCUS reporting period) that includes certain consolidated financial and credit risk information, a graph for each business line reflecting the daily intra-month VaR calculations, and certain reports the CSE regularly provides to its senior management to assist it in monitoring and managing risk. We request comment on all aspects of this requirement, including the timing of the reports.

Pursuant to paragraph (b)(2) of proposed Appendix G, the CSE would be required to file a quarterly report within 35 calendar days after the end of each quarter that includes, in addition to the information required in the monthly filing, consolidating financial information, the results of backtesting of models used to compute its allowances for market and credit risk, a description of all material pending legal or arbitration proceedings required to be reported pursuant to generally accepted accounting principles ("GAAP"), and certain short-term borrowings. Requiring reports to be filed within 35 calendar days after the end of each quarter provides time frames similar to those for quarterly reports due from companies required to file information, documents, and reports pursuant to § 13(a) or 15(d) of the Exchange Act. We request comment on all aspects of this requirement, including the timing of the reports.

Paragraph (b)(3) of proposed Appendix G would require that the CSE provide the Commission upon request with such other reports as may be necessary to monitor the financial condition of the CSE and its risk exposures, as they could affect the financial condition of the broker-dealer. We request comment on this provision.

Paragraph (b)(4) of proposed Appendix G would require that the CSE file an annual audit report with the Commission concurrently with the

⁵⁹ *Id.*

⁶⁰ See Risk-Based Capital Guidelines; Implementation of New Basel Capital Accord, 68 FR 45900 beginning at 45943 (August 4, 2003).

⁵⁸ *Id.*