

annual audit report filed by the broker-dealer. The annual audit report must include consolidated financial statements and must be audited by a registered public accounting firm.<sup>61</sup> Paragraph (b)(5) of Appendix G would require that the CSE file accountants' reports prepared by a registered public accounting firm, in accordance with agreed-upon procedures, regarding management controls and inventory pricing and modeling. By performing an independent review of the firm's financial condition and risk management practices, auditors have an important role in the Commission's regulatory framework by helping to assure that the broker-dealer and the holding company are in compliance with the conditions of the exemption. We request comment on these requirements.

The Commission seeks comment on these reporting requirements, particularly regarding the timing and other aspects of the reporting requirements. In particular, we request comment on whether the audit report and accountants' reports should be prepared by a registered public accounting firm. We request comment on whether these reporting requirements should be modified for a CSE with an affiliate required to file information, documents, and reports pursuant to §§ 13(a) or 15(d) of the Exchange Act or that is subject to supervision at the holding company level by a financial regulator or supervisor other than the Commission and, if so, how they should be modified. Should the reporting requirements under paragraph (b) of proposed Appendix G include a requirement that an electronic filing be made with the Commission before a quarterly report filed pursuant to reporting requirements for companies required to file information, documents, and reports pursuant to §§ 13(a) or 15(d) of the Exchange Act must be filed with the Commission?

### 3. Records To Be Made and Maintained by the CSE

The CSE of a broker-dealer that uses proposed Appendix E to calculate its capital charges would undertake to make the records listed in paragraph (c) of proposed Appendix G. The purpose of this requirement is to require that the CSE create records that would allow the Commission to determine whether the CSE is in compliance with the terms of the exemption. Most or all of these records already are generated for internal management purposes because

a prudent firm that manages risk on a group-wide basis would make and maintain these records in the ordinary course of its business. The Commission would accept the records in the format used by the firms. The records that are made must include a record indicating that the CSE has conducted stress tests of the affiliate group's funding and liquidity in response to certain events, including a credit downgrade of the CSE or an inability of the holding company to obtain short-term financing, the results of those stress tests, a record showing that the CSE has a contingency plan to respond to those events, and a record of the basis for determining credit risk weights in certain circumstances. These events are intended to identify possible liquidity and funding stress scenarios that could impose significant financial distress on the CSE and that could jeopardize the financial stability of the broker-dealer. The Commission believes that records of the CSE's contingency plans to respond to those events would provide the Commission with important information during an examination that would be necessary to adequately assess the CSE's financial condition and risk exposures. We request on whether there are any other records that the CSE should be required to create. We also request comment on whether it would be appropriate to expand the list of specified events described above. In addition, we request comment on whether Exchange Act Rule 17a-3 should be amended, or whether proposed Appendix E should be modified, to impose additional recordkeeping requirements on broker-dealers using proposed Appendix E to calculate certain of their capital charges.

Paragraph (d) of proposed Appendix G contains record maintenance requirements for CSEs. The CSE would be required to maintain, for a period of not less than three years, the records it is required to make under paragraph (c) of proposed Appendix G, its application and other documents, reports, and notices it files with the Commission pursuant to proposed Appendix E or proposed Appendix G and any written responses from the Commission, and written policies and procedures concerning its internal risk management system. Exchange Act Rule 17a-4 requires that broker-dealers maintain certain records for this time period, and we believe that this time period is sufficient for purposes of this proposal to allow effective examinations of CSEs.

We request comment on the Commission's proposed recordkeeping requirements applicable to the holding company and its regulated non-broker-

dealer affiliates and whether, and to what extent, they should be modified. With respect to any recordkeeping requirements that should be modified because records are already provided to a financial regulator, please specifically list the records that a holding company provides to its financial regulator that are equivalent to records that would be required in this proposal. Are there reports that holding companies submit to bank regulators that would provide the information required in this proposal? We request comment on whether we should amend Exchange Act Rule 17a-4 to require broker-dealers to retain certain of these records or whether proposed Appendix E should be modified to impose these additional record preservation requirements. Should certain of the record preservation requirements of proposed Appendix G be imposed on the broker-dealer rather than on the holding company?

### 4. Notification Requirements for the CSE

Paragraph (e) of proposed Appendix G requires that the CSE promptly notify the Commission upon the occurrence of certain events, including: the occurrence of any backtesting exception of VaR models that would require the CSE to use a higher multiplication factor; a computation showing the affiliate group's allowable capital is less than 110% of the total of its allowances for market, credit, and operational risk; a declaration of bankruptcy by an affiliate; the downgrading of the credit rating of an affiliate or certain debt of an affiliate; or the receipt of certain regulatory notices regarding an affiliate. The CSE would also be required to file a report if there is a material change in the organization of the affiliate group, the material affiliate status of any affiliate in the affiliate group, or the major business functions of any material affiliate. The notification provisions of proposed Appendix G are designed to give the Commission advance warning of situations that may pose material financial and operational risks to the CSE and the broker-dealer. These provisions are integral to Commission supervision of broker-dealers that use Appendix E.

The Commission seeks comment on all aspects of the notice requirements for CSEs. Are the events for which CSEs must report to the Commission appropriate? Should the CSE notify the Commission regarding other events? We request comment on whether these requirements should be modified for a CSE that is subject to supervision at the holding company level by a financial regulator or supervisor other than the

<sup>61</sup> See *supra*, note 32.