

Commission.<sup>71</sup> No comments were received in response to the estimates in the proposing release, and those burden estimates were not changed in the final rule release.<sup>72</sup> For purposes of this proposal, we note that firms applying to use Appendix E will have already developed the VaR models that they would use to calculate market and credit risk under the proposal and will have already developed internal risk management control systems. This conclusion is based on information Commission staff has received through the risk assessment rules and meetings with and reports from the DPG and other broker-dealers and the Commission's experience in implementing the OTC derivatives dealer rules. On the other hand, we note that the proposal contains new requirements. For example, the firm must establish and document procedures to detect and prevent money laundering and terrorist financing. We also note that the application under this rule may be more complicated than the OTC derivatives dealer application and may take more time to complete.

We estimate that a broker-dealer using Appendix E would spend approximately 5,600 hours per year to review the models it uses to compute market and credit risk and approximately 160 hours each quarter, or approximately 640 hours per year, to backtest the models. Consequently, we estimate that the total burden under the proposal associated with reviewing and backtesting mathematical models for the 12 broker-dealers we expect to apply will be approximately 74,880 hours per year  $((5,600 + 640) * 12)$ .

#### *B. Proposed Appendix G to Rule 15c3-1, Conditions for Holding Companies of Certain Brokers or Dealers*

Under proposed Appendix G to Rule 15c3-1, the CSE would be required to calculate allowable capital and allowances for market, credit, and operational risk monthly on a consolidated basis, file certain monthly, quarterly, and annual reports with the Commission, make, keep current, and preserve certain records, and notify the Commission of certain events. These proposed conditions are needed to allow the Commission to properly oversee a broker-dealer that uses proposed Appendix E and to monitor the financial and operational condition of its affiliate group.

Based on Commission experience and discussions with industry participants, we estimate that the calculation of allowable capital and allowances for market, credit, and operational risk would require approximately 90 hours per month, or approximately 1080 hours per year. Thus, the aggregate annual burden for the 12 broker-dealers we expect to apply under the proposal would be approximately 12,960 hours. In addition, we estimate that it would require approximately 5,600 hours per year to review and update the mathematical models used to make these calculations. Thus, the aggregate annual burden to review and update the models for the 12 broker-dealers would be approximately 67,200 hours. Finally, we estimate that it would require approximately 160 hours each quarter, or approximately 640 hours each year, to backtest the models. Thus, the aggregate annual burden to backtest the models for the 12 broker-dealers we expect to apply under the proposal would be approximately 7,680 hours.

The reporting requirements of proposed Appendix G are necessary to keep the Commission informed of, among other things, the financial condition, financial and operational risk exposures, backtesting results, and management controls of the CSE and whether the CSE is in compliance with the conditions of the broker-dealer's exemption. These reports would help the Commission to anticipate the effect on the CSE of significant economic events and their related impact on the broker-dealer.

We estimate that the average amount of time necessary to prepare and file the monthly reports required by Appendix G would be approximately 8 hours per month, or approximately 96 hours per year, that the average amount of time necessary to prepare and file the quarterly reports would be about 16 hours per quarter, or approximately 64 hours per year, and that the average amount of time necessary to prepare and file the annual audit reports would be approximately 200 hours per year. Consequently, we estimate that the total annual reporting burden of proposed Appendix G for the 12 broker-dealers we expect to apply under the proposal would be approximately 4,320 hours.

We based these estimates on the PRA burden estimates for Exchange Act Rule 17a-12, Reports to be made by certain OTC derivatives dealers. The PRA burden estimate for Rule 17a-12 is 180 hours per year to prepare and file the information required by the rule (based on an average of four responses per year and an average of 20 hours preparing each response with an additional 100

hours spent preparing the annual audit). However, we believe that the burden under this proposal would be lower than the Rule 17a-12 burden estimates because CSEs already generate many of the required reports for internal management purposes.

We expect that any additional burden associated with the requirements of proposed Appendix G relating to making, keeping, and preserving records would be minimal because a prudent firm that manages risk on a group-wide basis would make and preserve these records in the ordinary course of its business. We estimate that the average one-time burden of making and preserving these records would be approximately 40 hours and that the average annual burden would be approximately 290 hours. Consequently, we estimate that the total burden for the 12 broker-dealers we expect will apply under this proposal would be approximately 480 hours on a one-time basis and approximately 3,480 hours per year.

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 broker-dealer and the CSE. These provisions are integral to Commission supervision of broker-dealers that use Appendix E. We estimate that it would require a total of approximately one hour per year for all 12 of the broker-dealers to comply with the notification provisions of proposed Appendix G.<sup>73</sup>

#### *C. Proposed Amendments to Rule 15c3-4, Internal Risk Management Control Systems*

We propose to amend Rule 15c3-4, which currently applies to OTC derivatives dealers that use Appendix F to calculate certain of their capital charges, to expand its coverage to broker-dealers that use Appendix E. Rule 15c3-4 is designed to ensure the integrity of the risk measurement, monitoring, and management process, and to clarify accountability, at the appropriate organizational level, for defining the permitted scope of activity and level of risk.

<sup>73</sup> The Commission received approximately 1,067 Rule 17a-11 notifications during calendar year 2002, when there were approximately 6,800 active broker-dealers registered with the Commission. Thus, approximately 11% of registered broker-dealers filed a Rule 17a-11 notice in 2002. We therefore estimate that of the 12 broker-dealers we expect will apply under the proposal, one may be required to file an Appendix G notice each year. We estimate that, consistent with the Rule 17a-11 PRA burden estimate, it will take approximately one hour to file that notice.

<sup>71</sup> Exchange Act Release No. 39454 (Dec. 17, 1997), 62 FR 67940 (December 30, 1997).

<sup>72</sup> Exchange Act Release No. 40594 (Oct. 23, 1998), 63 FR 59362 (November 3, 1998).