

The proposed rule amendments would require a broker-dealer that elects to use Appendix E to consider a number of issues affecting its business environment when creating its risk management control system. For example, such a firm would need to consider, among other things, the sophistication and experience of relevant trading, risk management, and internal audit personnel, as well as the separation of duties among these personnel, when designing and implementing its internal control system's guidelines, policies, and procedures. This would help to ensure that the control system that is implemented would adequately address the risks posed by the firm's business and the environment in which it is being conducted. In addition, this would enable a broker-dealer electing to use Appendix E to implement specific policies and procedures unique to its circumstances.

In implementing its policies and procedures, the broker-dealer would be required to document and record its system of internal risk management controls. In particular, such a firm would be required to document its consideration of certain issues affecting its business when designing its internal controls. The broker-dealer also would be required to prepare and maintain written guidelines that discuss its internal control system.

The proposed rule amendments would be an integral part of the Commission's financial responsibility program for broker-dealers whose applications under Appendix E are approved by the Commission. The information to be collected under the proposed amendments to Exchange Act Rule 15c3-4 would be essential to the regulation and oversight of major securities firms that voluntarily elect to use Appendix E and to the monitoring of their compliance with the proposed financial responsibility requirements. More specifically, requiring a broker-dealer that elects to use Appendix E to document the planning, implementation, and periodic review of its risk management controls are designed to ensure that all pertinent risk management issues are considered, that the risk management controls are implemented properly, and that they continue to adequately address the risks faced by major securities firms.

The following estimates of the initial and annual PRA burdens associated with the amendments to Rule 15c3-4 are based on the present Rule 15c3-4 PRA burden estimates, discussions with potential applicants, and the Commission's experience with the

implementation of Rule 15c3-4 for OTC derivatives dealers. The present Rule 15c3-4 burden estimate is an average of 2,000 hours on a one-time basis to implement the risk management control system and an average of 200 hours per year to review and update the system. This estimate was based on the implementation of a risk management control system for a single entity: the OTC derivatives dealer. In this proposal, the broker-dealer is required to implement a risk management control system and the holding company is required to implement a group-wide risk management control system. Although the 12 broker-dealers we expect to apply under this proposal have already developed internal risk management control systems, not all of them have implemented and formally documented a group-wide system. We believe that it would take more than 2,000 hours for such a broker-dealer to implement a formal, documented group-wide risk management control system. On the other hand, if a firm already has a formally documented group-wide internal risk management control system, we believe that it would take less than 2,000 hours to bring that system into compliance with amended Rule 15c3-4. Of the 12 broker-dealers we expect will apply under this proposal, we estimate that 6 have formal, documented, group-wide internal risk management control systems, and that 6 have internal risk management control systems that are not formally documented for the affiliate group. We estimate that a firm with a formal, documented group-wide internal risk management control system would spend approximately 1,000 hours on a one-time basis to comply with the proposed amendments to Rule 15c3-4 and that a firm that does not have a formally documented group-wide internal control system will spend up to approximately 3,600 hours on a one-time basis to comply with the proposed amendments to Rule 15c3-4. The total one-time burden for the twelve firms would therefore be approximately 27,600 hours. In addition, we estimate that each of the 12 broker-dealers would spend approximately 250 hours per year reviewing and updating its risk management control system, for an aggregate annual burden of 3,000 hours.

D. Proposed Amendments to Rule 17a-5, Reports To Be Made by Certain Brokers and Dealers

The proposed amendments to Exchange Act Rule 17a-5 would require broker-dealers using Appendix E to submit monthly, quarterly, and annual reports with the Commission. The

proposed amendments would be an integral part of our financial responsibility program for broker-dealers electing to use Appendix E. The information to be collected under the proposed amendments to Rule 17a-5 would be essential to the regulation of these broker-dealers and would assist us and the examining authorities responsible for reviewing the activities of these firms to monitor and enforce compliance with applicable Commission rules, including rules pertaining to financial responsibility. These periodic reports would also aid the Commission in evaluating the activities conducted by these broker-dealers and in anticipating, where possible, how these firms could be affected by significant economic events.

We estimate that the average amount of time necessary to prepare and file the additional monthly reports required by this amendment to Rule 17a-5 would be about 4 hours per month, or approximately 48 hours per year; that the average amount of time necessary to prepare and file the additional quarterly reports would be about 8 hours per quarter, or approximately 32 hours per year; and that the average amount of time necessary to prepare and file the additional supplemental reports with the annual audit required would be approximately 40 hours per year. Consequently, we estimate that the total annual additional burden attributable to the proposed amendments to Rule 17a-5 for the 12 broker-dealers we expect to apply under the proposal would be approximately 1,440 hours.

These estimates are based on our present PRA burden estimate for Rule 17a-12. 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 on preparing the annual audit). However, the estimated burden attributable to the proposed amendments is less than those estimates because the broker-dealer is already required to file monthly, quarterly, and annual reports with the Commission under Rule 17a-5. In addition, the amendments are designed to allow a broker-dealer to provide the required information to the Commission in a form that the firm already produces for internal management purposes.

E. Proposed Amendments to Rule 17a-11, Notification Procedures for Brokers and Dealers

Under the proposed amendments to Rule 17a-11, a broker-dealer that uses