

“substantial presence” in the securities business.⁴³ Supervision of an SIBHC that owns or controls a broker-dealer with a substantial presence in the securities business would permit the Commission to be better informed regarding the financial and operational conditions of broker-dealers and their holding companies whose failure could have a materially adverse impact on other securities market participants, thus reducing systemic risk and furthering the purposes of Section 17. Evidence that an IBHC owns or controls a broker-dealer that maintains \$100 million in tentative net capital would be sufficient to demonstrate a substantial presence in the securities business.

Paragraph (d)(1) of proposed Rule 17i-2 states that all Notices of Intention, amendments, and other documentation and information filed pursuant to proposed Rule 17i-2 will be accorded confidential treatment. We believe it is important to accord confidential treatment to the information and documents an SIBHC would be required provide to the Commission as part of its Notice of Intention because the information and documents would generally be highly sensitive, non-public business information.

The Commission seeks comment on the requirement that an SIBHC own or control a broker-dealer that has a substantial presence in the securities business. In addition, we request comment as to whether maintenance by a broker-dealer of a specified dollar amount of tentative net capital (*e.g.*, \$100 million) is an appropriate method to demonstrate whether a broker-dealer has a substantial presence in the securities business. If so, is \$100 million in tentative net capital appropriate, or should the dollar amount be higher or lower?

C. Proposed Rule 17i-3: Withdrawal From Supervision as an SIBHC

Proposed Rule 17i-3 would permit an SIBHC to withdraw from Commission supervision by filing a notice of withdrawal with the Commission. Pursuant to the proposed Rule, a notice of withdrawal from supervision would take effect one year after it is filed with the Commission (or a shorter or longer period that the Commission deems necessary or appropriate to ensure effective supervision of the material risks to the SIBHC and any affiliated broker-dealer or to prevent evasion of the purposes of Section 17 of the Exchange Act).⁴⁴ The proposed Rule

would also require that an SIBHC include in its notice of withdrawal a statement that it is in compliance with proposed Rule 17i-2(c) regarding amendments to its Notice of Intention to help to assure that the Commission has updated information when considering the SIBHC's withdrawal request.

Paragraph (c) of proposed Rule 17i-3 states that the Commission may discontinue supervising an SIBHC if the Commission finds that the SIBHC no longer exists or is no longer an IBHC, or that continued supervision of the SIBHC is not necessary or appropriate in furtherance of the purposes of Section 17. Among other things, if an SIBHC makes a material amendment to a mathematical model, its internal risk management control systems, or its corporate structure as described in its Notice of Intention (and as modified from time to time), the Commission would review whether the change would cause continued supervision of the SIBHC to no longer be necessary or appropriate in furtherance of the purposes of Section 17 of the Act.

In order to determine whether continued supervision of an SIBHC is necessary or appropriate in furtherance of the purposes of Section 17 of the Act, the Commission would consider the same criteria it initially considered to determine whether an IBHC will be supervised by the Commission as an SIBHC.

We request comment on all aspects of the withdrawal provisions included in proposed Rule 17i-3. Specifically, we request comment on whether the information the Commission intends to use to determine whether continued supervision of an SIBHC is necessary or appropriate in furtherance of the purposes of Section 17 of the Act is appropriate, and whether the Commission should consider any additional factors. In addition, we request comment as to whether the time frames for withdrawal included in the proposed Rule are appropriate, or whether they should be longer or shorter. If the time periods should be longer or shorter, under what circumstances?

D. Proposed Rule 17i-4: Internal Risk Management Control System Requirements for SIBHCs

Participants in the securities markets are exposed to various risks, including

(i) market risk;⁴⁵ (ii) credit risk;⁴⁶ (iii) operational risk;⁴⁷ (iv) funding risk;⁴⁸ and (v) legal risk.⁴⁹ Large broker-dealers and IBHCs generally are more exposed to high levels of these types of risk due, in part, to their intricate corporate structures, the complexity of business activities in which they engage, and the diverse range of financial instruments they trade. Due to the level of risk exposures created by these types of business activities and products, it is important for firms to implement robust risk management control systems. A firm that has adopted and follows appropriate risk management controls reduces its risk of significant loss, which also reduces the risk that those losses will be spread to other market participants or throughout the financial markets as a whole.⁵⁰

The specific elements of a risk management control system will vary depending on the size, complexity, and organization of a firm. Accordingly, the design and implementation of a system of internal controls for a particular firm or affiliate group may differ from other firms. An individual firm must have the flexibility to implement specific policies and procedures unique to its circumstances. However, as we have found before, well-developed risk management systems generally share certain core principles such as establishing clear responsibilities at each level of management, separation of certain key responsibilities, and effective monitoring and reporting.

Proposed Rule 17i-4 would require an SIBHC to establish, document and maintain a system of internal risk management controls to assist it in

⁴⁵ Market risk involves the risk that prices or rates will adversely change due to economic forces. Such risks include adverse effects of movements in equity and interest rate markets, currency exchange rates, and commodity prices. Market risk can also include the risks associated with the cost of borrowing securities, dividend risk, and correlation risk.

⁴⁶ Credit risk comprises risk of loss resulting from counterparty default on loans, swaps, options, and during settlement.

⁴⁷ Operational risk encompasses the risk of loss due to the breakdown of controls within the firm including, but not limited to, unidentified limit excesses, unauthorized trading, fraud in trading or in back office functions, inexperienced personnel, and unstable and easily accessed computer systems.

⁴⁸ Funding risk includes the risk that a firm will not be able to raise sufficient cash to meet all its obligations that are due, which may occur even if the firm has positive net worth if some assets are not readily marketable.

⁴⁹ Legal risk arises from possible risk of loss due to an unenforceable contract or an *ultra vires* act of a counterparty.

⁵⁰ This is commonly referred to as systemic risk. Systemic risk includes the risk that the failure of one firm or within one market segment would trigger failures in other market segments or throughout the financial markets as a whole.

⁴³ As set forth in paragraph (d)(2)(i)(B) of proposed Rule 17i-2.

⁴⁴ See paragraph (b) of proposed Rule 17i-3.