

managing the risks associated with its business activities, including market, credit, operational, funding, and legal risks.

Proposed Rule 17i-4 would require an SIBHC to comply with present Exchange Act Rule 15c3-4 as though it were a broker-dealer.⁵¹ Currently, Rule 15c3-4 applies to over-the-counter derivatives dealers⁵² ("OTC derivatives dealers"). Based on the Commission's experience with OTC derivatives dealers, we believe this rule would require an SIBHC to develop strong internal controls that would reduce risk at the SIBHC and would require an SIBHC to adequately document those controls so the controls can be examined.

Paragraph (b) of proposed Rule 17i-4 would require that an SIBHC establish, document, and maintain procedures for the detection and prevention of money laundering and terrorist financing as part of its internal risk management control system. These procedures should include appropriate safeguards at the holding company level to prevent money laundering through affiliates.⁵³ This proposed requirement would allow us to adequately inspect members of the affiliate group as required by the statute.⁵⁴ We request comment on all aspects of the internal risk management control system requirements included in proposed Rule 17i-4. We also request comment on whether Rule 17i-4 should incorporate Rule 15c3-4 or should be fashioned as a stand-alone rule. In addition, we request comment as to whether any aspect of Rule 15c3-4 could be better tailored to reflect unique aspects of group risk management practices (as opposed to internal firm risk management practices).

Finally, we request comment on whether Rule 15c3-4 should be amended to require that results of the periodic reviews of the internal risk management control system conducted by an internal auditor and annual

reviews of the internal risk management control system conducted by an accountant should be reported in writing to the SIBHC's Board of Directors. In addition, we request comment on whether results of these periodic reviews should be reported in writing to the Commission.

E. Proposed Rule 17i-5: Record Creation, Maintenance, and Access Requirements for SIBHCs

Pursuant to Section 17(i)(3)(A) of the Exchange Act, an SIBHC would be required to make and keep records, furnish copies thereof, and make such reports as the Commission may require by rule.⁵⁵ Proposed Rule 17i-5 would require that an SIBHC make and keep current certain records relating to its business. In addition, it would require that an SIBHC preserve those and other records for certain prescribed time periods. The purpose of this rule is to require an SIBHC to create and maintain records that would allow the Commission to remain informed as to the SIBHC's activities, financial condition, policies, systems for monitoring and controlling financial and operational risks, and transaction among members of the affiliate group, as well as determine whether the SIBHC is in compliance with the Exchange Act and rules to which it is subject.

1. Record Creation

Paragraph (a) of proposed Rule 17i-5 would require that the SIBHC make and keep current (i) a record reflecting the results of quarterly stress testing of the affiliate group's funding and liquidity with respect to certain specified events; (ii) a record of the SIBHC's contingency plans to respond to certain specified events affecting the affiliate group's funding and liquidity; and (iii) a record of the basis for credit risk weights for each counterparty.

The specified events concerning which an SIBHC would need to conduct stress tests and create a contingency plan would include, (i) a credit rating downgrade of the SIBHC; (ii) an inability of the SIBHC to access capital markets for short-term funding; (iii) an inability of the SIBHC to move liquid assets across international borders when (i) or (ii) occur; or (iv) an inability of the SIBHC to access credit or assets held at a particular institution when (i) or (ii) occur. These events are intended to identify possible liquidity and funding stress scenarios that would impose significant financial distress on the SIBHC. The Commission believes that records of the SIBHC'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 SIBHC's financial condition and financial and operational risks.

We request comment as to whether there are any other records that an SIBHC should be required to create. We also request comment as to whether it would be appropriate to expand the list of specified events described above.

2. Record Maintenance

Pursuant to paragraph (b) of proposed Rule 17i-5, the SIBHC would be required to preserve (i) the records required to be created pursuant to 17i-5(a); (ii) all Notices of Intention, amendments thereto, and other documentation and information filed with the Commission in accordance with proposed Rule 17i-2 and any responses thereto; (iii) reports and notices filed with the Commission in accordance with proposed Rules 17i-6 and 17i-8; and (iv) records documenting the internal risk management control system established in accordance with proposed Rule 17i-4 to manage the risks of the affiliate group.

Proposed Rule 17i-5 would require that an SIBHC maintain the specified records for a period of three years in an easily accessible place. Exchange Act Rule 17a-4 presently requires that broker-dealers maintain certain records for this time period, and we believe this time period is sufficient with relation to the records required pursuant to proposed Rule 17i-5 to allow effective examinations of SIBHCs. The proposed Rule would allow an SIBHC to maintain these records in any manner permitted pursuant to Rule 17a-4(f).⁵⁶

Paragraph (c) of proposed Rule 17i-5 would allow an SIBHC to maintain the records required under the rule either at the SIBHC, at an affiliate, or at a records storage facility, provided that the records are located within the boundaries of the United States. If these records are maintained by an entity other than the SIBHC, the SIBHC would be required to file a written undertaking from the entity with the Commission. This is intended to allow the SIBHC the flexibility to maintain records, while permitting the Commission to obtain those records.

Proposed Rule 17i-5 would not require an SIBHC to maintain its required records in a prescribed standard form. To reduce the recordkeeping burden on SIBHCs, proposed Rule 17i-5 would instead allow the SIBHC to meet its

⁵¹ In a separate release, we also proposed rules and rule amendments that would, among other things, establish optional alternative net capital requirements for certain broker-dealers. See Exchange Act Release No. 48690 (October 24, 2003). In connection with that proposal, we proposed amendments to Rule 15c3-4 that would apply to a broker or dealer that elects to compute its net capital under proposed Appendix E of Rule 15c3-1.

⁵² See Exchange Act Release No. 40594 (Oct 23, 1998), 63 FR 59362 (Nov 3, 1998).

⁵³ This parallels requirements in the *New Basel Capital Accord* (See *infra*, note 67). See also Financial Action Task Force on Money Laundering ("FATF") Recommendation 22 and see generally the FATF's *Special Recommendations on Terrorist Financing*. (The FATF's documents can be found at www.FATF-GAFL.org).

⁵⁴ See generally, Exchange Act § 17(i)(3)(C)(i)(I) [15 U.S.C. 78q(i)(3)(C)(i)(I)].

⁵⁵ See *supra*, note 12.

⁵⁶ 17 CFR 240.17a-4(f).