

company in the EU.¹¹⁹ The regulatory framework for SIBHCs set forth in the proposed rules is intended to provide a basis for non-U.S. financial regulators to treat the Commission as the principal U.S. consolidated, home-country supervisor¹²⁰ for SIBHCs and their affiliated broker-dealers. In response to a survey conducted during the rulemaking process to promulgate the OTC derivatives dealers rules, firms suggested that they would incur significant costs in creating a new, non-U.S. regulated affiliate. Based on that information, we estimate that it would cost an IBHC approximately \$8 million to with create a new, non-U.S., regulated affiliate,¹²¹ or about \$48 million in the aggregate for the six IBHCs we believe will file Notices of Intention to become supervised by the Commission as SIBHCs. We do not have sufficient information to estimate what additional capital charges may be imposed on securities firms that do business in the EU if they are not subject to equivalent supervision.

Certain broker dealers must create records and file quarterly reports with the Commission regarding the financial condition, organization, and risk management practices of the affiliated group pursuant to Exchange Act Rules 17h-1T and 17h-2T.¹²² Broker-dealers affiliated with IBHCs that meet the criteria set forth in proposed Rules 17i-1 through 17i-8 generally would be subject to Rules 17h-1T and 17h-2T. To the extent that the information collected or made and maintained pursuant to proposed Rule 17i-5 reports are made and filed pursuant to proposed Rule 17i-6 by the SIBHC of a broker-dealer that is subject to Rules 17h-1T and 17h-2T, that broker-dealer will be exempted from the provisions of Rules 17h-1T and 17h-2T. We estimate that, on average, a broker-dealer affiliated with one of the six SIBHCs would save about \$1,215.12.¹²³ In the aggregate, the total

cost savings associated with these amendments would be approximately \$7,291.¹²⁴

In addition, proposed Rules 17i-1 through 17i-8 would not only create a regulatory framework for the Commission to supervise SIBHCs, but they would improve the Commission's ability to supervise the financial condition and securities activities of SIBHCs' affiliated broker-dealers. The proposed requirement that an SIBHC establish, document and maintain an internal risk management control system reduces the risk of significant losses by the SIBHC's affiliated broker-dealers. The proposed internal risk management control system requirement would also reduce systemic risk. We have no way to quantify this benefit.

An additional benefit arises from the reduced borrowing costs, or increased stock price that would result from better risk management practices. Credit rating agencies analyze risk management practices, among many factors, in determining credit ratings. A firm that has better risk management systems may be rated better, and would therefore pay lower interest rates to borrow and realize higher stock prices. However it is unclear to what extent risk management factors into credit ratings. In addition, present internal risk management control systems vary widely from firm to firm. Therefore it is difficult to quantify this benefit.

However, evolving industry best practice for internationally active firms suggests that some of the firms already have group-wide internal risk management control systems in place, and some firms will implement the risk management practices in the near future.

B. Costs

IBHCs that file Notices of Intention to become supervised by the Commission as SIBHCs would incur various on-going costs and one-time costs.

1. Ongoing Costs

Proposed Rules 17i-1 through 17i-8 would cause an SIBHC to incur ongoing

costs relating to: (i) Drafting and reviewing a Notice of Intention; (ii) drafting and reviewing a notice of withdrawal; (iii) updating its internal risk management control system; (iv) creating a record regarding stress tests; (v) creating a record regarding the basis for credit risk weights; (vi) maintaining its records in accordance with proposed Rule 17i-5; (vii) preparing and filing monthly and quarterly reports; (viii) preparing and filing its annual audit; (ix) calculating allowable capital and allowances for market, credit, and operational risk; (x) maintaining its models; (xi) conducting stress tests on its models; and (xii) filing notices pursuant to proposed Rule 17i-8.

Proposed Rule 17i-2 would require that an SIBHC update its Notice of Intention on an ongoing basis. We estimate, that each SIBHC will incur a cost of approximately \$1,358 each year to make any necessary updates to its Notice of Intention.¹²⁵ Thus, we estimate that the total annual cost to make any updates to the notice would be, in aggregate, about \$8,150 each year for all SIBHCs.¹²⁶

Proposed Rule 17i-3 would require that an SIBHC file a notice of withdrawal with the Commission if it wished to withdraw from Commission supervision. We estimate that each SIBHC that withdraws from Commission supervision would incur a cost of about \$2,130 to draft and review a notice or withdrawal to submit to the Commission.¹²⁷ However, we further estimate that one SIBHC may withdraw from Commission supervision only once every ten years. Thus, the annual cost of this rule would be approximately \$213.¹²⁸

Proposed Rule 17i-4 would require an SIBHC to maintain an internal risk management control system. We estimate that an SIBHC would incur a cost of approximately \$14,150

¹²⁵ We estimate that an SIBHC will take about 24 hours each year to assure that its Notice of Intention is accurate and make any necessary updates. We believe an SIBHC will have a senior compliance person perform this task. According to the SIA's *Report on Management and Professional Earnings in the Securities Industry—2002*, the hourly cost of a senior compliance person is \$56.60. (24 hours × \$56.60) = \$1,358.40.

¹²⁶ (\$1,358.40 × 6 SIBHCs) = \$8,150.

¹²⁷ We estimate, based on the staff's experience, that it would take one attorney approximately 24 hours to draft a withdrawal notice and that it would take a senior attorney or executive officer 8 hours to review the notice of withdrawal before submitting it to the Commission. According to the SIA's *Report on Management and Professional Earnings in the Securities Industry—2002*, the hourly cost of an attorney is \$63.75, and the average hourly cost of a senior attorney and executive officer is \$75.00. ((24 hours × \$63.75) + (8 hours × \$75.00)) = \$2,130.

¹²⁸ (\$2,130.00 × 10 years) = \$213.

¹¹⁹ See *supra* note 3.

¹²⁰ See *supra* note 4.

¹²¹ Five firms responded to the survey and estimated that their annual operating costs would increase by at least \$36 million in the aggregate to conduct business as an OTC derivatives dealer. (\$36 million / 5 firms) = \$7.2 million each. (\$7.2 million × an inflation factor of 1.12 (to account for inflation from 1998 to the present)) = approximately \$8 million.

¹²² See *supra*, note 64.

¹²³ We estimate, based on the present burden for 17h-1T and 17h-2T (which has been subject to notice and comment and has been approved by OMB), that each broker-dealer affiliated with an SIBHC that will no longer have to maintain records or file reports will spend 24 hours less each year to perform these tasks. The staff believes that a broker-dealer would have a financial reporting manager perform these tasks. According to the Securities Industry Association's ("SIA") *Report on*

Management and Professional Earnings in the Securities Industry—2002, the hourly cost of a financial reporting manager is \$50.63. ((\$50.63 × 24 hours) = \$1,215.12. Generally, to achieve an hourly cost using the SIA's *Report on Management and Professional Earnings in the Securities Industry—2002*, the staff will take the median (or, if no median is provided, the mean) salary provided in that Report for the position cited, divide that amount by 1,800 hours (in the average year), and then multiply the result by 135% (to account for employee overhead costs).

¹²⁴ (\$1,215.12 × six affected broker-dealers) = \$7,291.