

**SUPPORTING STATEMENT**  
**for the Paperwork Reduction Act New Information Collection Submission for**  
***Rule 15c3-1 – Net Capital Requirements for Brokers or Dealers***

**A. JUSTIFICATION**

**1. Necessity of Information Collection**

Rule 15c3-1<sup>1</sup> under the Securities Exchange Act of 1934 (“Exchange Act”)<sup>2</sup> is intended to ensure that broker-dealers registered with the Securities and Exchange Commission (“Commission”) at all times have sufficient liquid capital to protect the assets of customers and to meet their responsibilities to other broker-dealers.<sup>3</sup> Rule 15c3-1 generally defines the term “net capital” as a broker-dealer’s net worth (assets minus liabilities), plus certain subordinated liabilities, less certain assets that are not readily convertible into cash (e.g., fixed assets), and less a percentage (haircut) of certain other liquid assets (e.g., securities).<sup>4</sup>

Rule 15c3-1 is an integral part of the Commission’s financial responsibility program for broker-dealers. In particular, Rule 15c3-1 facilitates the monitoring of the financial condition of broker-dealers by the Commission and the broker-dealer’s designated examining authority (“DEA”). If the information were not required to be collected, the Commission and the DEAs would not be able to monitor the financial condition of broker-dealers, exposing their customers and counterparties to increased risk.

On December 27, 2013, the Commission adopted amendments to Rule 15c3-1 as part of the amendments to remove references to credit ratings under the Exchange Act (“2013 amendments”).<sup>5</sup> This supporting statement describes the impact of these amendments on the current PRA collection for Rule 15c3-1.<sup>6</sup>

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<sup>1</sup> 17 CFR 240.15c3-1.

<sup>2</sup> 15 U.S.C. § 78 *et seq.*

<sup>3</sup> See *Net Capital Rule*, Exchange Act Release No. 39455 (Dec. 17, 1997), 62 FR 67996 (Dec. 30, 1997).

<sup>4</sup> See 17 CFR 240.15c3-1(c)(2).

<sup>5</sup> *Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934*, Exchange Act Release No. 71194 (Dec. 27, 2013), 79 FR 1522 (Jan. 8, 2014).

<sup>6</sup> Due to an oversight, the Paperwork Reduction Act supporting statement and supplementary materials were not submitted to OMB in connection with the proposed rules that served as the basis for the 2013 amendments. The proposed rules were, however, published in the *Federal Register* on May 6, 2011 for public notice and comment. Copies of the *Federal Register* notices for both the proposed rules and the 2013 amendments have been submitted to OMB through ROCIS.

## 2. Purpose and Use of the Information Collection

Rule 15c3-1 is intended to help ensure that broker-dealers maintain at all times sufficient liquid resources to meet all liabilities, particularly the claims of customers, by requiring that broker-dealers maintain a minimum amount of net capital. A broker-dealer's minimum net capital requirement is the greater of: (1) a fixed minimum amount set forth in Rule 15c3-1 based on the types of business that the broker-dealer conducts;<sup>7</sup> or (2) a financial ratio.<sup>8</sup> Exchange Act Section 15(c)(3) and Rule 15c3-1 promulgated thereunder prohibit a broker-dealer from effecting transactions in securities while not in compliance with its minimum net capital requirement.

Various provisions of Rule 15c3-1 require that broker-dealers provide written notification to the Commission and/or their DEA under certain circumstances. For example, a broker-dealer carrying the account of an options market maker must file a notice with the Commission and the DEA of both the carrying firm and the market maker prior to effecting transactions in the account.<sup>9</sup> In addition, the carrying firm must notify the Commission and the appropriate DEA if a market maker fails to deposit the required equity with the carrying broker-dealer relating to the market maker's account within the prescribed time period or if certain deductions and other amounts relating to the carrying firm's market maker accounts computed in accordance with Rule 15c3-1 exceeds 1,000% of the carrying broker-dealer's net capital.<sup>10</sup> In addition, a broker-dealer electing to compute its net capital using the alternative method under paragraph (a)(1)(ii) of Rule 15c3-1 must notify its DEA of the election in writing, and thereafter must continue to compute its net capital in this manner unless a change is approved upon application to the Commission.<sup>11</sup>

There are also certain recordkeeping requirements under Rule 15c3-1. For example, a broker-dealer must keep a record of who is acting as an agent in a securities loan transaction and records with respect to obtaining DEA approval prior to withdrawing capital within one year of a contribution.<sup>12</sup> These records help the Commission and its staff, as well as DEAs, facilitate the monitoring of the financial condition of broker-dealers.

Appendix C to Rule 15c3-1 requires broker-dealers that consolidate their financial statements with a subsidiary or affiliate, under certain circumstances, to submit to their DEA an opinion of counsel.<sup>13</sup> The opinion of counsel must state, among other things, that the broker-dealer may cause that portion of the net assets of a subsidiary or affiliate related to its ownership interest in the entity to be distributed to the broker-dealer within 30 calendar days.<sup>14</sup>

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<sup>7</sup> See 17 CFR 240.15c3-1(a)(2)–(9).

<sup>8</sup> See 17 CFR 240.15c3-1(a)(1)(i)–(iii).

<sup>9</sup> See 17 CFR 240.15c3-1(a)(6)(vi).

<sup>10</sup> See 17 CFR 240.15c3-1(a)(6)(iv)(B); 17 CFR 240.15c3-1(a)(6)(v).

<sup>11</sup> See 17 CFR 240.15c3-1(a)(1)(ii).

<sup>12</sup> See 17 CFR 240.15c3-1(c)(2)(iv)(B); 17 CFR 240.15c3-1(c)(2)(i)(G)(2).

<sup>13</sup> See 17 CFR 240.15c3-1c(b)(1).

<sup>14</sup> See 17 CFR 240.15c3-1c(b)(2).

Appendix E to Rule 15c3-1 provides an alternative method for determining certain net capital charges for certain broker-dealers (“alternative net capital firms” or “ANC firms”).<sup>15</sup> Appendix G to Rule 15c3-1 requires the holding company of an ANC firm that has a principal regulator to file certain periodic reports with the Commission, preserve certain records, and notify the Commission of certain events. The notification provisions of 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 its holding company. These provisions are integral to Commission supervision of broker-dealers that use Appendix E.

### **3. Consideration Given to Information Technology**

The method of computing net capital varies by size and complexity of a broker-dealer. Most large broker-dealers subject to Rule 15c3-1 utilize automated systems for computing their net capital and minimum requirements. Smaller broker-dealers with simple balance sheets may compute their net capital on a manual basis.

### **4. Duplication**

The Commission is not aware of duplication of this information.

### **5. Effects on Small Entities**

Small entities may be affected to the extent they are required to maintain a minimum amount of net capital under Rule 15c3-1. However, there are different requirements for small entities subject to Rule 15c3-1. Most of these entities are not affected by the information collection provisions of Rule 15c3-1.

### **6. Consequences of not Conducting Collection**

If the required activities were not required to be collected, or were required to be conducted less frequently, the Commission and the DEAs would not be able to monitor the financial condition of broker-dealers, exposing their customers and counterparties to increased risk and lessening the protection afforded to the public.

### **7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)**

There are no special circumstances. This collection is consistent with the guidelines in 5 CFR 1320.5(d)(2).

### **8. Consultations Outside the Agency**

The Commission requested comment in the proposing release on the included PRA analysis in April 2011.<sup>16</sup> The Commission received no comments addressing the PRA.

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<sup>15</sup> See 17 CFR 240.15c3-1e.

<sup>16</sup> See Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934, Exchange Act Release No. 64352 (Apr. 27, 2011), 76 FR 26550 (May 6, 2011).

## **9. Payment or Gift**

No payments or gifts have been provided to respondents.

## **10. Confidentiality**

The Commission regards information obtained pursuant to the filings and notices required by Rule 15c3-1 to be confidential. Such information is of a financial nature and generally is not disclosed to the public. The statutory basis for the Commission's refusal to disclose such information to the public is the exemption contained in section (b)(4) of the Freedom of Information Act, 5 U.S.C. 552, which provides that the requirement of public dissemination does not apply to commercial or financial information which is privileged or confidential.

## **11. Sensitive Questions**

Not applicable. No information of a sensitive nature is required.

## **12. Burden of Information Collection**

Based on experience with the industry, the Commission estimates that broker-dealers annually file approximately 902 notices under Rule 15c3-1 and that a broker-dealer will spend approximately 30 minutes preparing and filing these notices. Therefore, the Commission estimates a total annual reporting burden of 451 hours.<sup>17</sup>

Paragraph (c)(2)(iv)(B) of Rule 15c3-1 requires a broker-dealer to make disclosures to, and obtain certain agreements from, securities lending principals in situations where the firm participates in the settlement of a securities lending transaction but wants to be deemed an agent for purposes of Rule 15c3-1. The Commission, in recognition of standard stock loan agreements, designed the amendment to accommodate the continued use of these industry model agreements by incorporating their use into the rule's requirements. However, the Commission estimates that 5% of the 122 broker-dealers, or approximately 6 firms, engaged in securities lending will need to modify their standard agreements. The Commission estimates each of these firms will spend approximately 20 hours of employee resources updating their standard agreement template. Therefore, the Commission estimates that the total one-time recordkeeping burden will be approximately 120 hours.<sup>18</sup>

Paragraph (c)(2)(i)(G)(2) of Rule 15c3-1 requires that a broker-dealer treat as a liability any capital contribution that is intended to be withdrawn within one year of its contribution. The amendment also includes the presumption that capital withdrawn within one year of contribution is presumed to have been intended to be withdrawn within one year, unless the broker-dealer receives permission in writing for the withdrawal from its DEA. The Commission estimates that 90 broker-dealers will seek to obtain permission from their DEA in writing to withdraw capital within one year of its contribution, and that it will take a broker-dealer approximately one hour

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<sup>17</sup> 902 notices x (30 minutes / 60 minutes) = 451 hours.

<sup>18</sup> 6 broker-dealers x 20 hours per firm = 120 hours. The three-year annualized number for this one time burden is 40 hours (120 hours / 3 years = 40), or 6.66 hours per firm.

to prepare and submit the request to its DEA to withdraw capital. Therefore, the Commission estimates that the total annual reporting burden will be approximately 90 hours.<sup>19</sup>

With respect to Appendices E and G of Rule 15c3-1, the following estimates are based on the assumption that nine broker-dealers will ultimately compute deductions for market risk under Appendix E. Currently, there are six ANC firms, and the Commission expects that three additional firms will apply to compute deductions for market risk under Appendix E.<sup>20</sup> The Commission estimates that each broker-dealer that applies would incur a one-time recordkeeping burden of approximately 1,000 hours to create and compile the various documents to be included with the application and to work through the application process, with an aggregate one-time recordkeeping burden of 3,000 hours.<sup>21</sup>

The Commission estimates that an ANC firm using Appendices E and G to Rule 15c3-1 spends approximately 5,600 hours per year to review and update the models it uses to assess market and credit risk and approximately 160 hours each quarter, or approximately 640 hours per year, to back test the models. Consequently, the Commission estimates that the total annual recordkeeping burden associated with reviewing and back testing mathematical models for the six ANC firms will be approximately 37,440 hours<sup>22</sup> and approximately 9,360 hours<sup>23</sup> for the three broker-dealers expected to become ANC firms, resulting in an aggregate annual recordkeeping burden of 46,800 hours.<sup>24</sup>

The Commission estimates that the average amount of time necessary to prepare and file the monthly reports required by Appendix G will be approximately eight hours per month, or 96 hours per year. The Commission estimates that the average amount of time necessary to prepare and file the quarterly reports will be approximately 16 hours per quarter, or 64 hours per year. The Commission estimates that the average amount of time necessary to prepare and file the annual audit reports will be approximately 200 hours per year. Consequently, the Commission estimates that the total annual reporting burden of Appendix G for the six ANC firms will be approximately 2,160 hours,<sup>25</sup> and the total annual reporting burden for the three broker-dealers expected to become ANC firms will be approximately 540 hours,<sup>26</sup> resulting in an aggregate annual reporting burden of 2,700 hours.<sup>27</sup>

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<sup>19</sup> 90 broker-dealers x 1 hour = 90 hours.

<sup>20</sup> The Commission expects that these three firms will register as ANC firms over the next three years. However, until their registrations are complete, these firms will not be subject to the annual burdens discussed throughout Item 12. Therefore, the Commission has taken this fact into consideration in its calculations.

<sup>21</sup> The three-year annualized number for this one-time burden is 1,000 (3,000 hours / 3 years = 1,000 hours), or 333.33 per firm.

<sup>22</sup> (5,600 hours + 640 hours) x 6 broker-dealers = 37,440 hours.

<sup>23</sup> ((5,600 hours + 640 hours) / 2) x 3 broker-dealers = 9,360 hours.

<sup>24</sup> 37,440 hours + 9,360 hours = 46,800 hours.

<sup>25</sup> (96 hours + 64 hours + 200 hours) x 6 broker-dealers = 2,160 hours.

<sup>26</sup> ((96 hours + 64 hours + 200 hours) / 2) x 3 broker-dealers = 540 hours.

The Commission expects that any additional burden associated with the requirements of Appendix G relating to preserving records will be minimal because a prudent firm that manages risk on a group-wide basis will make and preserve these records in the ordinary course of its business. The Commission estimates that the average one-time burden of making and preserving these records will be approximately 40 hours and that the average annual burden will be approximately 290 hours. Consequently, the Commission estimates that the annual recordkeeping burden for the six ANC firms will be approximately 1,740 hours.<sup>28</sup> The Commission estimates that the total one-time and annual recordkeeping burden for the three broker-dealers expected to become ANC firms will be approximately 120 hours<sup>29</sup> and 435 hours,<sup>30</sup> respectively. Therefore, Commission estimates an aggregate annualized recordkeeping burden of approximately 2,215 hours.<sup>31</sup>

The Commission estimates that ANC firms will spend a total of approximately one hour per year to comply with the notification provisions of Appendix G, resulting in a total annual reporting burden of 6 hours<sup>32</sup> for the six ANC firms and 2 hours<sup>33</sup> for the three broker-dealers expected to become ANC firms, resulting in an aggregate reporting burden of 8 hours.<sup>34</sup>

The Commission also estimates that each broker-dealer will spend approximately 250 hours per year reviewing and updating its risk management control system, resulting in an aggregate annual recordkeeping burden of 1,875 hours.<sup>35</sup>

Therefore, the total annual hour burden for Appendix E and G to Rule 15c3-1 is 54,598 hours.<sup>36</sup>

In summary, the Commission estimates that the total annual hour burden for Rule 15c3-1 prior to the 2013 amendments is 55,179.<sup>37</sup>

With respect to the 2013 amendments, the amendments require a broker-dealer to take a 15 percent haircut on its proprietary positions in commercial paper, nonconvertible debt, and preferred stock unless the broker-dealer establishes, documents, maintains, and enforces written

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<sup>27</sup> 2,160 hours + 540 hours = 2,700 hours.

<sup>28</sup> 290 hours x 6 broker-dealers = 1,740 hours.

<sup>29</sup> 40 hours x 3 broker-dealers = 120 hours. The three-year annualized number for this one-time burden is 40 (120 hours / 3 years = 40 hours).

<sup>30</sup> (290 hours/2 years) x 3 broker-dealers = 435 hours.

<sup>31</sup> 1,740 hours + 40 hours + 435 hours = 2,215 hours.

<sup>32</sup> 1 hour x 6 broker-dealers = 6 hours.

<sup>33</sup> (1 hour x 3 broker-dealers) / 2 = 1.5 hours.

<sup>34</sup> 6 hours + 2 hours = 8 hours.

<sup>35</sup> (250 x 6 broker-dealers) + ((250 / 2) x 3 broker-dealers) = 1,875 hours.

<sup>36</sup> 1,000 + 46,800 + 2,700 + 2,215 + 8 + 1,875 = 54,598 hours.

<sup>37</sup> 451 + 90 + 40 + 54,598 = 55,179 hours.

policies and procedures for determining creditworthiness. The staff estimates that approximately 434 broker-dealers would be affected by the requirement that a broker-dealer establish, document, maintain, and enforce policies and procedures that are reasonably designed to determine whether a security or a money market instrument has a minimal amount of credit risk.<sup>38</sup> If the security or money market instrument has a minimal amount of credit risk, the broker-dealer can take haircuts on the security or money market instrument pursuant to paragraphs (c)(2)(vi)(E), (c)(2)(vi)(F)(1), (c)(2)(vi)(F)(2) and (c)(2)(vi)(H) of Rule 15c3-1. The staff estimates that, on average, broker-dealers will spend 25 hours developing policies and procedures or revising their current policies and procedures for evaluating creditworthiness for the purposes of Rule 15c3-1, resulting in an aggregate one-time recordkeeping burden of 10,850 hours.<sup>39</sup> This estimate is based on the Commission's belief that many of these broker-dealers already have their own criteria in place for evaluating creditworthiness and, therefore, most broker-dealers will only be revising their current policies and procedures for evaluating creditworthiness.

The staff also estimates that, on average, each broker-dealer will spend an additional 10 hours a year reviewing and adjusting its own standards for evaluating creditworthiness. Therefore, the Commission estimates that the total annualized recordkeeping burden to the industry will be approximately 4,340 annual hours.<sup>40</sup>

Consequently, the Commission estimates that the total annual burden associated with the 2013 amendments to Rule 15c3-1 will be approximately 7,957 hours.<sup>41</sup>

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<sup>38</sup> The number of 434 broker-dealers was obtained by reviewing broker-dealer Financial and Operational Combined Single (or "FOCUS") Reports for 2012 year-end and then calculating how many firms reported holding proprietary debt positions. For FOCUS Part II filers, the balances examined were "Bankers Acceptances" and "Corporate Debt." For FOCUS CSE filers, the balances examined were: "Money Market Instruments," "Private Label Mortgage Backed Securities," "Other Asset Backed Securities," and "Corporate Debt." For Part IIA filers, the balance examined was "Debt Securities." Broker-dealers that hold preferred stock also may hold positions in debt securities. However, because preferred stock is not a separate line item on the FOCUS Report, broker-dealers that hold only preferred stock and no other debt securities are not included in this estimate.

<sup>39</sup> 434 broker-dealers x 25 hours = 10,850 hours. For purposes of this supporting statement, this one-time burden annualized over the three-year approval period is 3,617 hours ( $10,850 / 3 = 3,616.67$ ), with an average hour burden per broker-dealer of 8 hours ( $3,617 / 434 \text{ broker-dealers} = 8.33$ ).

<sup>40</sup> 434 broker-dealers x 10 hours = 4,340 hours. The Commission estimates that broker-dealers will use a controller to do this work. The Commission estimates the per-firm costs of the controller to be \$10,475 initially and \$4,190 on an annual basis, for an aggregate industry cost of \$4,546,150 initially and \$1,818,460 on an annual basis. This is an internal labor cost. For purposes of this analysis, the Commission is using salary data from the Securities Industry and Financial Markets Association ("SIFMA") Report on Management and Professional Earnings in the Securities Industry 2012, which provides base salary and bonus information for middle management and professional positions within the securities industry, as modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. The Commission believes that the reviews required by the proposed amendments would be performed by the controller at an average rate \$419 per hour.  $\$419 \times 25 = \$10,475$ ;  $\$10,475 \times 434 = \$4,546,150$ ;  $\$419 \times 10 = \$4,190$ ;  $\$4,190 \times 434 = \$1,818,460$ .

<sup>41</sup> 3,617 hours + 4,340 hours = 7,957 hours.

Therefore, the total annual hour burden for the total collection under Rule 15c3-1, including the 2013 amendments, will be 63,136 hours.<sup>42</sup>

### **13. Costs to Respondents**

Approximately 81 broker-dealers file consolidated financial reports, of which approximately 20 obtain an opinion of counsel under Appendix C of Rule 15c3-1. The Commission estimates that the approximate cost to broker-dealers to obtain an opinion of counsel to file the consolidated financial reports as required under Appendix C of Rule 15c3-1 would be \$8,000. This figure is based on an estimate of 20 hours per opinion for an outside counsel at \$400 per hour.<sup>43</sup> The total costs for all respondents would be \$160,000.<sup>44</sup>

### **14. Costs to Federal Government**

Not applicable. Rule 15c3-1 would not result in any costs to the federal government beyond normal full-time employee labor costs, nor does Rule 15c3-1 require the Commission to hire any new employees or reallocate existing employees to ensure compliance with the rule.

### **15. Changes in Burden**

Due to the adoption of the 2013 amendments to Rule 15c3-1, the one-time and annual reporting and recordkeeping burdens increased, as described in paragraph 12 above. There was no change in the cost estimates.

### **16. Information Collection Planned for Statistical Purposes**

Not applicable. The information collection is not used for statistical purposes.

### **17. OMB Expiration Date Display Approval**

The Commission is not seeking approval to not display the OMB approval expiration date.

### **18. Exceptions to Certification for Paperwork Reduction Act Submissions**

This collection complies with the requirements in 5 CFR 1320.9.

## **B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS**

This collection does not involve statistical methods.

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<sup>42</sup> 55,179 hours + 7,957 hours = 63,136 hours.

<sup>43</sup> \$400 x 20 hours = \$8,000.

<sup>44</sup> 20 opinions x \$8,000 = \$160,000.