

Rule 17a-3

SUPPORTING STATEMENT

A. JUSTIFICATION

1. Necessity of Information Collection

All brokers and dealers in the ordinary course of their businesses need to maintain certain books and records reflecting, among other things, income and expenses, assets and liabilities, daily trading activity and the status of customer and firm accounts. These books and records are, for the most part, standard and would be kept by any prudent individual engaging in a securities business.

The Commission is statutorily authorized by Sections 17(a)¹ and 23(a)² of the Securities Exchange Act of 1934 (“Exchange Act”) to promulgate rules and regulations regarding the maintenance and preservation of books and records of exchange members, brokers and dealers (“broker-dealers”). Exchange Act Section 17(a)(1) provides in pertinent part:

“[all members of a national securities exchange and registered brokers and dealers] shall make and keep for prescribed periods such records...as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the [Exchange Act].”

To standardize recordkeeping practices throughout the industry, the Commission, in 1939, adopted Rule 17a-3,³ which established minimum standards with respect to business records that broker-dealers must create.⁴ Rule 17a-3 requires broker-dealers to make and keep current certain records relating to their financial condition, communications, customer information, and employees.

The Commission adopted certain Amendments to Rule 17a-3 on October 25, 2001 (the “2001 Amendments”), in part as a response to the National Securities Market Improvement Act of 1996 (“NSMIA”).⁵ NSMIA prohibits any State from establishing books and records rules for broker-dealers that differ from, or are in addition to, the Commission’s rules, and also requires the Commission to consult periodically with the States concerning the adequacy of the Commission’s books and records rules.⁶ The 2001 Amendments expanded the types of records that broker-dealers must create to include additional records necessary for State examiners to review for sales practice violations at office locations, and were designed to assist regulators, particularly State securities regulators, in conducting effective examinations.⁷

¹ 15 U.S.C. § 78q(a).

² 15 U.S.C. § 78w(a).

³ 17 CFR 240.17a-3.

⁴ Exchange Act Release No. 2304 (Nov. 13, 1939).

⁵ Pub.L.No. 104-290, 110 Stat. 3416 (1996).

⁶ Exchange Act Section 15(h), 15 U.S.C. § 78o(h).

2. Purpose of, and Consequences of Not Requiring, the Information Collection

The purpose of requiring broker-dealers to create the records specified in Rule 17a-3 is to enhance regulators' ability to protect investors. These records and the information contained therein will be used by examiners and other representatives of the Commission, State securities regulatory authorities, and the self regulatory organizations (e.g., the Financial Regulatory Authority commonly known as FINRA, the Chicago Board Options Exchange, etc.)("SROs") to determine whether broker-dealers are in compliance with the Commission's antifraud and anti-manipulation rules, financial responsibility program, and other Commission, SRO, and State laws, rules, and regulations.

If broker-dealers were not required to create these records, Commission, SRO and state examiners would be unable to conduct effective and efficient examinations to determine whether broker-dealers were complying with relevant laws, rules, and regulations.

3. Role of Improved Information Technology and Obstacles to Reducing Burden

The Commission believes that improvements in telecommunications and data processing technology may reduce any burdens that result from Rule 17a-3. Broker-dealers are not prevented by Rule 17a-3 from using computers or other mechanical devices to generate the records required under the Rule.

4. Efforts to Identify Duplication

Rule 17a-3 was drafted and amended to codify SRO record-keeping requirements and the record-keeping practices of prudent broker-dealers. Because most broker-dealers already create many of the records required by Rule 17a-3 either voluntarily or pursuant to SRO requirements, no duplication of such information is apparent.

5. Effects on Small Entities

The books and records required under Rule 17a-3 are normally created by small broker-dealers. Since small broker-dealers utilize processes that are more manual in nature, while large broker-dealers use more automated processes, the Commission has estimated some of the time factors for small broker-dealers to be higher, as described below.

6. Consequences of Less Frequent Collection

The information required to be collected and recorded under Rule 17a-3 allows the Commission, State securities regulatory authorities, and the SROs to determine whether broker-dealers are in compliance with Commission, State, and SRO anti-fraud and anti-manipulation rules, financial responsibility rules, and other rules and regulations. If a broker-dealer does not make these records, or it makes these records less frequently, the level of investor protection will be reduced. The records a broker-dealer is required to make under Rule 17a-3 are, for the most

⁷ See Exchange Act Release No. 37850 (October 22, 1996), 61 FR 55593 (October 28, 1996) ("Proposing Release").

part, essential to the successful operation of a securities firm, and failure to make the records on a current basis would likely cause the broker-dealer to experience operational difficulties.

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

Not applicable because the collection is not required in a manner inconsistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

The staff of the Commission regularly communicates with and requests the views of staff of the Securities Industry Association, State securities administrators, the New York Stock Exchange, and the National Association of Securities Dealers, Inc. concerning the principal requirements of Rule 17a-3. The Commission staff also communicates with broker-dealers on a continuous basis. None of these organizations have raised any concerns regarding Rule 17a-3.

9. Payment or Gift to Respondents

No gifts or payments will be given to respondents.

10. Assurance of Confidentiality

The records required by Rule 17a-3 are available only to the examination staffs of the Commission, State regulatory authorities, and the SROs. Subject to the provisions of the Freedom of Information Act, 5 U.S.C. § 552 (“FOIA”) and the Commission’s rules thereunder (17 CFR 200.80(b)(4)(iii)), the Commission generally does not publish or make available information contained in reports, summaries, analyses, letters, or memoranda arising out of, in anticipation of, or in connection with an examination or inspection of the books and records of any person or any other investigation.

11. Sensitive Questions

No questions of a sensitive nature are asked.

12. Estimates of Respondent Reporting Burden

All registered broker-dealers are subject to Rule 17a-3. As of July 30, 2007 there were 5,850 broker-dealers registered with the Commission. Recordkeeping requirements will vary depending on the size and complexity of the broker-dealer. Prior to the 2001 Amendments, the Commission estimated that one hour a day was the average amount of time needed by a broker-dealer to comply with the requirements of Rule 17a-3. The number of working days per year is 249, so the total estimated burden for broker-dealers would be 1,456,650 hours per year.⁸

In addition, the 2001 Amendments added additional paperwork burdens, including 1) an amendment to paragraph (a)(12) and the addition of paragraph (a)(19) to require broker-dealers

⁸ 5,850 (the number of broker-dealers as of July 30, 2007) multiplied by 1 hour per day multiplied by 249 working days equals 1,456,650 hours.

to create certain additional records regarding their associated persons, 2) the addition of paragraphs (a)(20) to (a)(22) to require broker-dealers to make additional records regarding their compliance with applicable regulations and create lists of those personnel responsible for establishing compliance policies and procedures and able to explain the information in the broker-dealer's records, and 3) the addition of new paragraph (a)(17) which requires that a broker-dealer provide each customer with a copy of the account information on record relating to his or her account and periodically update customer account information (so that the customer can verify that the account information is correct), and send notices to customers when the account information is changed.

As stated previously, the amendment to paragraph (a)(12) and the addition of paragraph (a)(19) contained in the 2001 Amendments require that a broker-dealer create certain records regarding its associated persons.⁹ The Commission estimates that each broker-dealer spends, on average, approximately 30 minutes each year to ensure that it is in compliance with these amendments, resulting in a total annual compliance burden of about 2,925 hours.¹⁰

The addition of paragraphs (a)(20) to (a)(22) contained in the 2001 Amendments require that a broker-dealer make records 1) indicating that it has either complied with or adopted procedures designed to establish compliance with applicable regulations of certain securities regulatory authorities,¹¹ 2) listing persons who can explain the broker-dealer's records,¹² and that list principals responsible for establishing compliance policies and procedures.¹³ The Commission estimates that, on average, each broker-dealer will spend 10 minutes each year to ensure compliance with these requirements, yielding a total burden of about 975 hours.¹⁴

Estimating the paperwork burden associated with paragraph (a)(17) requires a more complicated formula to calculate the compliance burden because it is based on the number of customer accounts for which a broker-dealer must collect this information as opposed to the number of broker-dealers. In addition, the Commission understands that large broker-dealers have more automated processes to collect and create these records than smaller broker-dealers, and has factored this into its estimates.

As of the end of 2006, 5,754 broker-dealers that filed the FOCUS Schedule I Reports on December 31, 2006 (a report that all registered broker-dealers are required to file with the Commission) reported that they maintained a total of 111,773,638 customer accounts. Forty

⁹ These records include; 1) all agreements pertaining to the associated person's relationship with the broker-dealer and a summary of each associated person's compensation arrangement (17 CFR 240.17a-3(a)(19)(ii)), 2) a record delineating all identification numbers relating to each associated person (17 CFR 240.17a-3(a)(12)(ii)), 3) a record of the office at which each associated person regularly conducts business (17 CFR 240.17a-3(a)(12)(iii)), and 4) a record as to each associated person listing transactions for which that person will be compensated (17 CFR 240.17a-3(a)(19)(i)).

¹⁰ (5,850 broker-dealers x 30 minutes) / 60 minutes.

¹¹ 17 CFR 240.17a-3(a)(20). A similar requirement was also added in paragraph (a)(17)(iii).

¹² 17 CFR 240.17a-3(a)(21)

¹³ 17 CFR 240.17a-3(a)(22)

¹⁴ (5,850 broker-dealers x 10 minutes) / 60 minutes.

eight of those broker-dealers reported that they maintained over 100,000 accounts each (for purposes of this Supporting Statement, the “Large Broker-dealers”), and the remaining 5,706 broker-dealers maintained less than 100,000 customer accounts each (for purposes of this Supporting Statement, the “Small Broker-dealers”). The Large Broker-dealers reported that they held a total of 109,529,017 customer accounts (or 98% of the total customer accounts reported), and the Small Broker-dealers reported that they held the remaining 2,244,621 customer accounts (or 2% of the total customer accounts reported). The Commission estimates that approximately 27.7% of the 111,773,638 total customer accounts would be excluded from the provisions of 17a-3(a)(17) because the accounts are either (i) not accounts of natural persons, (ii) inactive, or (iii) accounts for which the broker-dealer does not have a suitability requirement.¹⁵ Accordingly, the total number of active customer accounts regarding which broker-dealers would need to provide customers with account information is approximately 80,812,340 (79,196,093 held by Large Broker-dealers and 1,616,247 held by Small Broker-dealers).

The Commission estimates that broker-dealers will be required to provide customer account information to approximately 26,937,447 customers per year to comply with paragraph (a)(17)(i)(B)(1).¹⁶ Further, the Commission estimates that this will take Large Broker-dealers an average of 1½ minutes per account, or 659,967 hours per year,¹⁷ and that it will take Small Broker-dealers an average of 7 minutes per account, or 62,854 hours per year.¹⁸ Thus, the estimated total burden on the industry to comply with the paragraph (a)(17)(i)(B)(1) requirement provide account information to customers when an account is opened and periodically thereafter is 722,821 hours per year.¹⁹

If a customer provides a broker-dealer with updated account record information, the broker-dealer must, pursuant to paragraphs (a)(17)(i)(B)(2) and (3), update the customer’s account information and send the revised account information to the customer to verify its accuracy.²⁰ The Commission estimates that approximately 20%²¹ of the customers from whom information is requested will update their account records, resulting in 5,387,489 updated account records each year.²² In addition, the Commission estimates that 5% of active customer accounts, or 4,040,617,²³ will initiate changes to their account records on a yearly basis, just as they do now, with no prompting from any account record mailing. The Commission estimates that it would

¹⁵ See Rule 17 CFR 240.17a-3(a)(17)(i)(D). The Commission arrived at this number using estimates provided by the firms (in their comment letters and otherwise) as to how many of their accounts would fit in to one or more of these categories.

¹⁶ (80,812,340 x (1 every 3 years)).

¹⁷ (26,937,447 account records x 98% x 1.5 minutes / 60 minutes) = 659,967 hours per year.

¹⁸ (26,937,447 account records x 2% x 7 minutes / 60 minutes) = 62,854 hours per year.

¹⁹ (659,967 hours + 62,854 hours) = 722,821 hours.

²⁰ 17 CFR 240.17a-3(a)(17)(B)(2) and (3).

²¹ This estimate was suggested by the comment letter Merrill Lynch provided in response to the reposing release.

²² (26,937,447 x 20%) = 5,387,489.

²³ (80,812,340 x 5%) = 4,040,617.

take, on average, 5 minutes for large broker-dealers to update each account and 10 minutes²⁴ for small broker-dealers to update each account, resulting in an additional burden of 801,389 hours per year to update account record information and provide the new account information to customers as required by paragraphs (a)(17)(i)(B)(2) and (3).²⁵

Thus, the total number of hours attributable to the 2001 Amendments is 1,528,110 hours per year.²⁶ When added to the annual hour burden for the rest of 17a-3 (of 1,456,650 hours), the resulting estimated total yearly hour burden to comply with Rule 17a-3 is approximately 2,984,760 hours.²⁷

The Commission believes that a broker-dealer would have a compliance department employee, at \$245 per hour;²⁸ ensure that the firm is compliant with those portions of Rule 17a-3 that were in effect prior to the 2001 Amendments, as well as the amendments to paragraph (a)(12) and new paragraphs (a)(19), (a)(20), (a)(21) and (a)(22) that were added by the 2001 Amendments. Therefore, the estimated annualized cost to respondents to ensure compliance with those portions of Rule 17a-3 that were in effect prior to the 2001 Amendments, as well as the amendments to paragraph (a)(12)

²⁴ This estimate takes into account the 1½ and 7 minutes it would take large and small broker-dealers, respectively, to provide this updated account information to customers, and the 3.5 minutes and 3 minutes it would take large and small broker-dealers, respectively, to receive the returned data and input any changes into the account record. The estimated total minutes for updating and providing this information to customers of 5 minutes for large broker-dealers and 10 minutes for small broker-dealers were taken from a comment letter to the 2001 Amendments.

²⁵ $((5,387,489 \text{ account records} + 4,040,617 \text{ account records}) \times 98\%) \times (5 \text{ minutes} / 60 \text{ minutes}) + ((5,387,489 \text{ account records} + 4,040,617 \text{ account records}) \times 2\%) \times (10 \text{ minutes} / 60 \text{ minutes}) = 801,389$.

²⁶ $2,925 \text{ hours (attributable to the amendment to paragraph (a)(12) and the addition of paragraph (a)(19))} + 975 \text{ hours (attributable to the addition of paragraphs (a)(20) to (a)(22))} + 722,821 \text{ hours (attributable to providing customers with account information)} + 801,389 \text{ (hours to update and send revised account information to customers)} = 1,528,110 \text{ hours}$.

²⁷ $2,984,760 = (1,528,110 + 1,456,650)$.

²⁸ This figure (\$245/hour) is the salary given for a Compliance Manager in the Securities Industry Association's (now "SIFMA") Report on Management & Professional Earnings in the Securities Industry 2006, modified to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. The SIA recently spoke with the Commission's Office of Economic Analysis to inform the Commission that the multiplier of 1.35 that the Commission has historically used was too low. The SIA informed the Commission that, with increasing health care costs, the fact that the largest firms that pay higher salaries generally fail to respond to the SIA's salary survey, and other factors, the Commission should increase its multipliers. Consequently, the Commission and the SIA worked together to determine the level at which the multipliers should be set.

and new paragraphs (a)(19), (a)(20), (a)(21) and (a)(22) that were added by the 2001 Amendments is approximately \$357,834,750.²⁹

With respect to paragraph (a)(17), the Commission believes that broker-dealers would generally have i) a registered retail sales assistant provide customers with account record information and ii) a senior data entry clerk update customer account information when a customer provides the broker-dealer with new account information. According to the SIA's 2006 Report on Office Salaries in the Securities Industry, the hourly wage of an intermediate retail sales assistant is approximately \$58.51 per hour,³⁰ and the hourly wage of a senior data entry clerk is approximately \$50.40 per hour.³¹ Thus the aggregate cost of the burden hours associated with paragraph (a)(17) of Rule 17a-3 is about \$84,733,995 ((975,809 hours³² attributable to providing customers with a copy of account record information x \$58.51) + (548,401 hours³³ attributable to updating customer account information x \$50.40)).

Therefore total cost of the hourly burden associated with ongoing compliance with Rule 17a-3 is $\$357,834,750 + \$84,733,995 = \$442,568,745$.

²⁹ 1,456,650 hours + 2,925 hours + 975 hours) x \$245 = \$357,834,750.

³⁰ This figure is based on the SIA Report on Office Salaries in the Securities Industry 2006, modified to account for an 1,800-hour work year and multiplied by 2.93 to account for bonuses, firms size, employee benefits and overhead.

³¹ This figure is based on the SIA Report on Office Salaries In the Securities Industry 2000, Table 086 (Data Entry Clerk, Senior) and includes 35% for overhead charges.

³² First, there are 722,821 hours associated with compliance with paragraph (a)(17)(i)(B)(1). Second, (((5,387,489 account records + 4,040,617 account records) x 98%) x (1.5 minutes / 60 minutes)) = 230,989 hours for large broker-dealers to provide customers with updated account information associated with compliance with paragraphs (a)(17)(i)(B)(2) and (3). Third, (((5,387,489 account records + 4,040,617 account records) x 2%) x (7 minutes / 60 minutes)) = 21,999 hours for small broker-dealers to provide customers with updated account information associated with compliance with paragraphs (a)(17)(i)(B)(2) and (3). Consequently, the total hours to provide customers with account information is (722,821 hours + 230,989 hours + 21,999 hours) = 975,809 hours. See *supra*, footnote 24.

³³ The hour burden for large broker-dealers to update account record information is approximately 3½ minutes, and the hour burden for small broker-dealers to update account record information is about 3 minutes. See *supra*, footnote 24. Consequently, it would take large broker-dealers approximately 538,973 hours (or (((5,387,489 account records + 4,040,617 account records) x 98%) x (3.5 minutes / 60 minutes))) to update customer account information in compliance with paragraphs (a)(17)(i)(B)(2) and (3). In addition, it would take small broker-dealers approximately 9,428 hours (or (((5,387,489 account records + 4,040,617 account records) x 2%) x (3 minutes / 60 minutes))) to update customer account information in compliance with paragraphs (a)(17)(i)(B)(2) and (3). Therefore, the total hours to update customer account information is (538,973 hours + 9,428 hours) = 548,401 hours.

13. Estimates of Total Cost Burden

Ongoing operation and maintenance costs include the cost of postage to provide customers with account information, and costs for equipment and systems development. The Commission estimates that under Rule 17a-3(a)(17), approximately 36,365,553 customers (26,937,447 account records³⁴ + 5,387,489 updated account records³⁵ + 4,040,617 updated account records³⁶) will need to be provided with information regarding their account on a yearly basis. Firms may include this information with other communications sent to customers, for instance in customer account statements. In response to requests for comment relating to the 2001 Amendments, those firms that provided estimates of postage costs indicated that postage costs to provide customers with account record information would be about \$0.244 per item mailed.³⁷ However postage costs may have increased since 2001. Consequently, the Commission estimates that the postage costs associated with providing 36,365,553 customers with copies of their account record information would be approximately \$8,176,435 per year (28,390,400 x \$0.288³⁸).

At the time of the 2001 Amendments large broker-dealers that provided cost information³⁹ estimated that their ongoing, yearly costs for equipment and systems development resulting from Rule 17a-3 would be approximately \$0.25 per customer account. The Commission believes that the additional cost for smaller broker-dealers is included in the increased hourly burden costs delineated above.⁴⁰ However costs for equipment and systems development may have increased since 2001. Consequently, the Commission believes that the total ongoing equipment and systems development costs relating to Rule 17a-3 for the industry would be about \$23,362,847 per year (79,196,093 active customer accounts held by Large Broker-dealers x \$0.295⁴¹).

³⁴ This figure is based on the number of active customer accounts (80,812,340) divided by 3 since the broker-dealer must send each customer a copy of his or her account record information once every three years.

³⁵ This figure is based on the number of active customer accounts that receive their account record (26,937,447) times .20, since the Commission estimates that 20% of customers that receive their account record will update their account record information.

³⁶ This figure is based on the number of active customer accounts (74,061,915) times 0.05, since 5% of customers update their account record information each year.

³⁷ See Morgan Stanley Dean Witter comment letter submitted by J.Higgins in response to the 2001 Amendments; See Merrill Lynch comment letter to the 2001 Amendments.

³⁸ The CPI has increased by about 18% since the end of 2001. ($\$0.244 \times 1.18$) = \$0.288.

³⁹ See *supra*, footnote 37.

⁴⁰ Smaller broker-dealers are not as automated, and their processes tend to be more manual in nature. In addition, no smaller broker-dealers provided information regarding any increased equipment or systems development costs at the time of the 2001 Amendments.

⁴¹ The CPI has increased by about 18% since the end of 2001. ($\$0.25 \times 1.18$) = \$0.295.

The total cost burden associated with Rule 17a-3 is approximately \$31,539,282 per year.⁴²

14. Estimated Cost to the Federal Government

There will be no additional costs to the Federal Government.

15. Explanation of Changes in Burden

The annual record-keeping hour burden of 2,984,760 hours listed on Item 13 of the Rule 17a-3 OMB Form 83-I reflects a 563,565 increase over the current OMB inventory of 2,421,195 hours. This change incorporates both a decrease in the number of respondents of 1,050, from 6,900 to 5,850, and an increase in the number of customer accounts held by broker-dealers of 9,242,667, from 102,530,971 to 111,773,638.

The annual reporting and record-keeping cost burden of \$31,539,282 each year as listed on Item 14 of the Rule 17a-3 OMB Form 83-I is \$6,639,282 greater, respectively, than the current OMB inventory of \$24,900,000. This increase reflects the additional costs created by the 9,242,667 additional customer accounts (111,773,638 customer accounts reported in Dec., 2006 vs. 102,530,971 customer accounts reported in Dec., 2003). In addition, the staff increased its cost estimates to account for inflation.⁴³ Finally, approximately \$80,000 is attributable to a rounding error in the 2004 filing.⁴⁴

Due to the facts that i) certain of the paperwork burdens are derived based on the number of broker-dealers and others are derived based on the number of customers, 2) certain records a broker-dealer must create pursuant to Rule 17a-3 must be created daily, others weekly, others monthly, others annually, and still others periodically, and 3) certain time frames are estimated based on the relative size of the broker-dealers, this rule is not easily described in the present Form 83-I. Consequently, for purposes of the Form 83-I, the staff divided the total annual record-keeping hour burden of 2,984,760 (described above in more detail in Section 12) by the number of respondents (or 5,850), to reach 510.215. This would be the average number of hours per year that each respondent would be required to spend to create records in accordance with Rule 17a-3. Similarly, for purposes of the Form 83-I, the staff divided the total annual cost burden of \$31,539,282 (described above in more detail in Section 13) by the number of respondents (or 5,850), to reach \$5,391.33. This represents the average cost per year for each respondent to create records in accordance with Rule 17a-3.

16. Information Collection Planned for Statistical Purposes

No plans for publication of the records and information required exist at this time, nor does the Commission expect to require the publication of these records in the future.

⁴² This includes annual postage costs of \$8,176,435 and ongoing equipment and systems development costs of \$23,362,847 per year.

⁴³ See *supra*, footnotes 38 and 41.

⁴⁴ \$24,979,850 was rounded to \$24,900,000.

17. Explanation of Why Expiration Date Will Not be Displayed

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

18. Exceptions to Certification

The Commission is not seeking an exception to the certification statement.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.