

Extension of Rule 15c3-3

SUPPORTING STATEMENT

A. Justification

1. Necessity For Information Collection

During the “Paperwork Crisis” of 1967-1970, many brokers-dealers mishandled and misused customer funds and securities because they had inadequate and inefficient record keeping and segregation systems. Furthermore, the “bear market” of 1969-1970 caused many firms that lacked sufficient capital to utilize, properly or otherwise, customer funds and securities to obtain financing for their continued operation. In order to rectify these problems, the Securities and Exchange Commission (“Commission”) adopted Rule 15c3-3 (“Rule”) (17 CFR 240.15c3-3) (“Exhibit A”) to provide increased protection for the funds and securities of customers. The Rule is an integral part of the Commission’s financial responsibility program for brokers-dealers.

The Rule applies to all broker-dealers that hold securities or cash belonging to customers. Under the Rule, these broker-dealers must obtain and maintain possession or control of all the fully-paid and excess margin securities of their customers. In addition, they must make a periodic computation (“reserve computation”) to ascertain the amount of money they are holding that constitutes customer funds or funds obtained from the use of customer securities. If this amount known as “customer credits” exceeds the amount of money customers owe the firm (i.e., customer debits), the broker-dealer must deposit the excess in a special reserve bank account for the exclusive benefit of the firm’s customers (“Special Reserve Bank Account”).¹ In this way, the Rule protects customer assets by requiring firms to maintain possession or control of customer securities, and by permitting firms to use customer money only to the extent necessary to finance customer related business.

The Rule requires broker-dealers to make the reserve computation on either a weekly or monthly basis. It also requires them (1) to maintain a description of the procedures utilized to comply with the possession and control requirements of the Rule; (2) to maintain a written notification from the bank where the Special Reserve Bank Account is located that all assets in the account are for the exclusive benefit of the broker-dealer’s customers; and (3) to give telegraphic notice to the Commission, and the appropriate Self-Regulatory Organization (“SRO”) if they fail to make a required deposit into the Special Reserve Bank Account.

In addition, the Commission adopted changes to Rule 15c3-3 on September 9, 2002 to require that a broker-dealer that effects transactions in SFPs for customers also must (1) establish written policies and procedures for determining whether customer SFPs will be placed in a securities account or a futures account, and, if applicable, the

¹ For purposes of this PRA, the term Special Reserve Bank Account includes accounts set up in accordance with both paragraph (e)(1) and paragraph (k)(2)(i).

process by which a customer may elect the type of account in which SFPs will be held, (2) provide each customer that plans to effect SFP transactions with a disclosure document containing certain information, (3) make a record of each change in account type, and (4) send each SFP customer notification of any change of account type.²

The Commission is statutorily authorized by Section 15(c)(3) of the Securities Exchange Act of 1934 (“Act”) (15 U.S.C. 782(c)(3)) to adopt rules as necessary for the protection of investors and to provide safeguards with respect to the financial responsibility and related practices of brokers and dealers. Further statutory authority is found in Sections 17(a) and 23(a) of the Act (15 U.S.C. 78q and 78w).

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

The Rule is an integral part of the Commission’s financial responsibility program for broker-dealers. Its purpose is to protect the rights of customers to promptly obtain their property from a broker-dealer. The reserve and notice requirements in the Rule facilitate the process by which the Commission and the various SROs monitor how broker-dealers are fulfilling their custodial responsibilities to investors. With the exception of the telegraphic notice requirement, governmental agencies do not regularly receive any of the information described above. Instead, the information is stored by the broker-dealer and made available to the various securities regulatory authorities as required to facilitate examinations and investigations. If broker-dealers were not required to create and maintain this information, the Commission’s ability to fulfill its statutory directive to protect investors would be diminished.

Rule 15c3-3 also requires that a broker-dealer provide each customer that wishes to engage in SFP activities with a disclosure document and notification of any change of account type. Without these disclosures and notifications, customers may be uncertain or confused, if a liquidation were to occur, as to which regulatory scheme is applicable to their account.

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

Nothing in Rule 15c3-3 would prevent a broker-dealer from using computers or other mechanical devices to generate, obtain, disclose or maintain the records and information required under these Rules, and most firms subject to Rule 15c3-3 presently utilize automated systems to comply with it. The Commission is not aware of any technical or legal obstacle to reducing the burden through the use of improved information technology.

4. Efforts to Identify Duplication

Not applicable.

² Exchange Act Release No. 46473 (September 9, 2002), 67 FR 58284 (September 13, 2002) (the “Adopting Release”).

5. Effects On Small Entities

Most small broker-dealers are exempt from the requirements of Rule 15c3-3 pursuant to paragraph 15c3-3(k). In addition, those small broker-dealers that are not exempt from the Rule can make the required computation monthly so long as they have aggregate indebtedness not exceeding 800 percent of net capital and carry aggregate customer funds not exceeding \$1,000,000.

6. Consequences of Less Frequent Collection

If the required information were not collected or were collected less frequently, the level of protection afforded to the public by Rule 15c3-3 would be reduced.

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

The collection is in a manner consistent with the guidelines set forth in 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

All Commission rule proposals are published in the Federal Register for public comment. This comment period is generally thirty days, which affords the public an opportunity to respond to any such proposals.

9. Payments or Gifts to Respondents

Not applicable.

10. Assurance of Confidentiality

The information collected under this Rule is kept confidential to the extent permitted by the Freedom of Information Act and any other applicable law.

11. Sensitive Questions

Questions of a sensitive nature are not asked.

12. Estimate of Respondent Reporting Burden

As of December 31, 2006, there were approximately 344 broker-dealers fully subject to the Rule (i.e., broker-dealers that can not claim any of the exemptions enumerated at paragraph (k)), of which approximately 9 make daily, 245 make weekly, and 90 make monthly, reserve computations.³ The rule requires that each broker-dealer make a record of each such computation.⁴ The variation in size and complexity between these firms makes it very difficult to develop a meaningful figure for the amount of time

³ Per December 31, 2006 FOCUS II reports filed with the Commission by broker-dealers in compliance with Rule 17a-5 (17 CFR 240.17a-5).

⁴ 17 CFR 240.15c3-3(e)(3).

required to make a record of each reserve computation. Based on experience in the area, Commission staff estimates that it takes between one and five hours, and that the average time spent across all the firms is 2.5 hours. Accordingly, Commission staff estimates that the resulting burden totals 45,960 hours annually ((2.5 hours x 240 computations x 9 respondents that calculate daily) + (2.5 hours x 52 computations x 245 respondents that calculate weekly) + (2.5 hours x 12 computations x 90 respondents that calculate monthly)).

A broker-dealer required to maintain the Special Reserve Bank Account prescribed by Rule 15c3-3 must obtain and retain a written notification from each bank in which it has a Special Reserve Bank Account to evidence bank's acknowledgement that assets deposited in the Account are being held by the bank for the exclusive benefit of the broker-dealer's customers.⁵ As stated previously, 344 broker-dealers are presently fully-subject to Rule 15c3-3. In addition, 140 broker-dealers operate in accordance with the exemption provided in paragraph (k)(2)(i) which also requires that a broker-dealer maintain a Special Reserve Bank Account. Broker-dealers generally maintain longstanding relationships with banks where they hold their Special Reserve Bank Accounts and thus do not need to obtain these letters often. The staff estimates that of the total broker-dealers that must comply with this rule, only 25%, or 121 ((344 + 140) x .25) must obtain 1 new letter each year (either because the broker-dealer changed the type of business it does and became subject to either paragraph (e)(3) or (k)(2)(i) or simply because the broker-dealer established a new Special Reserve Bank Account). The staff estimates that it would take a broker-dealer approximately 1 hour to obtain this written notification from a bank regarding a Special Reserve Bank Account.⁶ Therefore, Commission staff estimates that broker-dealers will spend approximately 121 hours each year to obtain these written notifications.

In addition, a broker-dealer must immediately notify the Commission and its designated examining authority if it fails to make a required deposit to its Special Reserve Bank Account.⁷ Commission staff estimates that broker-dealers file approximately 65 such notices per year.⁸ Based on staff experience with the industry, it would take a broker-dealer approximately 30 minutes to file the notice required under the Rule. Therefore, Commission staff estimates that broker-dealers would spend a total of approximately 33 hours each year to comply with the notice requirement of Rule 15c3-3.

⁵ 17 CFR 240.15c3-3(f).

⁶ The language in these letters is largely standardized.

⁷ 17 CFR 15c3-3(i).

⁸ From October 1, 2006 to August 27, 2007, broker-dealers had filed 60 such notices with the Commission. This amounts to approximately 5.45 notices per month. (5.45 x 12 months) = 65.4, or approximately 65 notices per year.

In addition, a broker-dealer that effects transactions in SFPs for customers⁹ also will have paperwork burdens associated with the requirement in paragraph (o) of Rule 15c3-3 to make a record of each change in account type.¹⁰ More specifically, a broker-dealer that changes the type of account in which a customer's SFPs are held must create a record of each change in account type that includes the name of the customer, the account number, the date the broker-dealer received the customer's request to change the account type, and the date the change in account type took place. As of December 31, 2006, broker-dealers that were also registered as FCMs reported that they maintained 38,815,092 customer accounts.¹¹ The staff estimates that 8% of these customers may engage in SFP transactions¹² (38,815,092 accounts x 8% = 3,105,207). Further, the staff estimates that 20% per year may change account type.¹³ Thus, broker-dealers may be required to create this record for up to 621,041 accounts (3,105,207 accounts x 20%). The staff believes that it will take approximately 3 minutes to create each record.¹⁴ Thus, the total annual burden associated with creating a record of change of account type will be 31,052 hours (621,041 accounts x (3min/60min)).

Consequently, the staff estimates that the total annual burden hours associated with Rule 15c3-3 would be approximately 77,166 hours (45,960 hours + 121 hours + 33 hours + 31,052 hours).

Commission staff believes that a broker-dealer would have 1) a financial reporting manager make a record of its reserve computations and send the required notices to the Commission, 2) an attorney obtain the written notifications from banks where it has a Special Reserve Bank Account to evidence bank's acknowledgement that assets deposited in the Account are being held by the bank for the exclusive benefit of customers, and 3) a compliance clerk create a record of each change in account type. The staff estimates that the hourly rate of a financial reporting manager and an attorney are

⁹ Broker-dealers that do not engage in an SFP business with or for customers are not affected by this section of Rule 15c3-3. Broker-dealers that engage in an SFP business must also register with the CFTC as a futures commissions merchant ("FCM"). As of January 31, 2007 there were 64 broker-dealers that were also registered as FCMs.

¹⁰ 17 CFR 240.15c3-3(o)(3)(i).

¹¹ Per December 31, 2006, FOCUS Schedule 1 filings.

¹² The staff derived its estimate from the number of active options accounts and conversations with industry representatives.

¹³ Broker-dealers that engage in an SFP business may choose not to allow customers to change account type because it may be costly to facilitate such conversions. In addition, once a customer has researched the issue and made a choice as to account type, it may be unlikely for the customer to change his or her account type.

¹⁴ In fact, the staff believes that most firms will have this process automated. To the extent that no person need be involved in the generation of this record, the burden will be very minimal.

\$265 and \$292, respectively,¹⁵ and the hourly rate of a compliance clerk is \$56.¹⁶ Consequently, the total cost of the above-described hour burden would be \$13,962,389.¹⁷

13. Estimate of Total Annualized Cost Burden

In addition, a broker-dealer that effects transactions in SFPs for customers¹⁸ also will have an annualized cost burden associated with the requirements in paragraph (o) of Rule 15c3-3 to (1) provide each customer that plans to effect SFP transactions with a disclosure document containing certain information,¹⁹ and (2) send each SFP customer notification of any change of account type.²⁰

Pursuant to Rule 15c3-3(o)(2)(i), a broker-dealer that effects transactions in SFPs for customers must provide each customer that engages in SFP transactions with a disclosure document containing certain information. The costs of printing and sending the disclosure document to customers will be based on the number of customer accounts that will be opened by customers to effect transactions in SFPs. As stated previously, the staff estimates that 8% of the accounts held by broker-dealers that are also registered as FCMs, or 3,105,207 accounts, may engage in SFP transactions.²¹ The staff estimates that the cost of printing and sending each disclosure document will be approximately \$.12 per document sent.²² Thus, the staff estimates that the cost of printing and sending the

¹⁵ The \$265/hour figure for a financial reporting manager and the \$292/hour figure for an attorney are derived from the Securities Industry Association's ("SIA," now "SIFMA") 2006 Report on Management & Professional Salaries in the Securities Industry, 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.

¹⁶ The \$56/hour figure for a compliance clerk is derived from the SIA's 2006 Report on Office Salaries in the Securities Industry, modified to account for an 1,800 hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

¹⁷ $((45,960 \text{ hours} + 33 \text{ hours}) \times \$265/\text{hour}) + (121 \text{ hours} \times \$292/\text{hour}) + (31,052 \text{ hours} \times \$56/\text{hour})$.

¹⁸ Broker-dealers that do not engage in an SFP business with or for customers are not affected by this section of Rule 15c3-3.

¹⁹ 17 CFR 240.15c3-3(o)(2).

²⁰ 17 CFR 240.15c3-3(o)(3)(ii).

²¹ The staff derived its estimate from the number of active options accounts and conversations with industry representatives.

²² This estimate is based on past conversations with industry representatives regarding other rule changes which required similar printing and postage costs. Postage may be minimized by including the disclosure document with other information mailed to customers. In addition, to account for inflation, we have included an inflation factor of 18% (based on the CPI from 2001 to 2007)(the prior conversations with industry representatives regarding postage costs took place in 2001).

disclosure document required pursuant to paragraph 15c3-3(o)(2)(i) will be approximately \$372,625 (3,105,207 accounts x \$.12).

Pursuant to Rule 15c3-3(o)(3)(ii), a broker-dealer that changes the type of account in which a customer's SFPs are held must promptly notify the customer in writing of the date that change became effective. The staff estimates that 621,041 accounts (3,105,207 accounts x 20%) may change account type per year,²³ thus broker-dealers would be required to send this notification to 621,041 customers. The staff believes that firms will use the least cost method to comply with these requirements, and will probably include this notification with other mailings sent to the customer. The staff estimates that the cost of printing and posting each notification will be approximately \$.12 per document sent²⁴ (again, the rule is flexible enough that a broker-dealer may send this notification with other customer mailings, such as confirmations or customer account statements). Therefore, the staff estimates that the cost of sending this notification to customers will be about \$74,525 (621,041 accounts x \$.12).

Consequently, the staff estimates that the total annual cost associated with Rule 15c3-3 would be \$447,150 (\$372,625 + \$74,525).

14. Estimate of Cost to Federal Government

The government would experience no additional costs relating to the records broker-dealers must create pursuant to 15c3-3, but are not required to file with the Commission. However, the government would experience some costs associated with reviewing the notices broker-dealers are required to file pursuant to Rule 15c3-3. The staff estimates that reviewing these filings requires, on average, approximately fifteen minutes of Regulation Specialist staff time per filing at approximately \$70 an hour (based on an annual salary of \$84,000, adding average fringe benefits of 26% and average overhead of 25%, and dividing by 1,800 hours in a year). Consequently, the staff estimates that, the additional cost to the Federal Government associated with reviewing approximately 60 such notices per year would be \$1,050 (15 hours x \$70).

The Form 83-I attached to this rulemaking reflects a Cost to the Federal Government for Rule 15c3-3 of \$47,250. Consequently, the staff's estimate of \$1,050 is \$46,200 less than the previous estimate. This change is due to a correction to the calculation methodology.

²³ As of December 31, 2006, broker-dealers that were also registered as FCMs reported that they maintained 38,815,092 customer accounts (per FOCUS Schedule 1 Filings filed by the broker-dealers with the Commission). The staff estimates that 8% of these customers may engage in SFP transactions (38,815,092 accounts x 8% = 3,105,207). Further, the staff estimates that 20% per year may change account type. Thus, broker-dealers may be required to create this record for up to 621,041 accounts (3,105,207 accounts x 20%).

²⁴ See *supra* note 22.

15. Explanation of Changes in Burden

a. Burdens

The annual record-keeping hour burden of 77,166 hours listed on OMB Form 83-I reflects a 41,385 decrease from the current OMB inventory of 118,551 hours. This change is due to a decrease in the number of broker-dealers and a decrease in the number of accounts of broker-dealers subject to paragraph (o) of Rule 15c3-3, but is partially offset by an increase in the number of notices filed each year.

Due to the fact that the calculation of burden hours is based on a number of factors (e.g., some respondents must make weekly calculations and others make monthly calculations, and certain of the burden hours are based on the number of accounts held by a distinct few of those respondents) for purposes of the Form 83-I, the staff has divided the total number of annual burden hours (77,166) by the number of respondents (344) to reach a number of hours per respondent (224.32). This was broken down by “reporting” (relating to the notices filed with the Commission) and “recordkeeping” (all other requirements described above). Reporting of 33 total hours divided by 334 equals approximately .09 hours per respondent, and $224.32 - .09 = 224.23$.

b. Costs

The annual reporting and record-keeping cost burden of \$447,150 each year as listed on OMB Form 83-I is \$622,850 less than the current OMB inventory of \$1,070,000. This decrease is due to the decrease in the number of accounts held by broker-dealers subject to paragraph (o) of Rule 15c3-3.

Due to the fact that the calculation of costs is based on a number of factors that are not directly related to the calculation of burden hours above, for purposes of the Form 83-I, the staff has divided the total costs (\$447,150) by the number of respondents (344) to reach a number of cost per respondent (\$1,299.85). All of those costs related to reporting of information to customers.

16. Information Collection Planned for Statistical Purposes

This provision is not applicable because compliance with the Rule will not require the employment of statistical methods.

17. Explanation as to Why Expiration Date Will Not Be Displayed

Not applicable.

18. Exceptions to Certificate

Not applicable.

B. Collection of Information Employing Statistical Methods

Not applicable.