

RULE 17a-5(c)

Supporting Statement

A. Justification

1. Necessity of the Information Collection

Under Section 17(e)(1)(B) of the Securities Exchange Act of 1934 (“Exchange Act”) every registered broker-dealer must send its customers annually its certified balance sheet and such other financial statements and information concerning its financial condition as the Securities and Exchange Commission (“Commission”) prescribes.

The Commission’s Rule 17a-5(c) (“Rule”) requires that each broker-dealer that carries customer accounts furnish the Commission, each national securities exchange and registered national securities organization of which it is a member, and its customers with:

- (a) annual audited financial statements within 105 days after the date of the audited report. The statements may be furnished 30 days after that time limit has expired if the broker or dealer sends them with the next mailing of quarterly customer account statements; and
- (b) semiannual unaudited financial statements not later than 65 days after the date as of which the statements are prepared. The statements may be furnished 70 days after that time limit has expired if the broker or dealer sends them with the next mailing of quarterly customer account statements.

Under the Rule, the audited statements must contain:

- (i) a balance sheet with appropriate notes prepared in accordance with generally accepted accounting principles (“GAAP”);
- (ii) a footnote containing, among other things, a statement of the amount of the broker-dealer’s net capital and its required net capital, computed in accordance with Rule 15c3-1;
- (iii) if the broker-dealer’s independent accountant commented on any material inadequacies, a statement that a copy of such report and comments is on file with the Commission; and
- (iv) a statement that the Statement of Financial Condition of the broker-dealer’s most recent annual audit report is available for examination at the principal office of the broker-dealer and at the Commission.

The unaudited statements must contain the information specified in (i) and (ii) above.

Under the exemption of paragraph (c)(5) of Rule 17a-5, a broker-dealer is not required to send the statements to its customers if the broker-dealer sends the net capital footnote described in item (ii) above and information on how to obtain the annual and semiannual statements via a toll-free number or on the Internet to its customers when it otherwise would have had to send the statements. A broker-dealer that elects to take advantage of the exemption must publish its statements on its web-site in a prescribed manner, and must maintain a toll-free number that customers can call to request a copy of the statements. If a customer requests a copy of the statements, the broker-dealer must send them promptly at no cost to the customer. A broker-dealer cannot take advantage of the exemption if, during the year prior to the “as of” date of the broker-dealer’s balance sheet, the broker-dealer was required by paragraph (e) of Rule 17a-11 to give notice and transmit a report to the Commission.

2. Purpose and Use of the Information Collection

The purpose of the Rule is to ensure that customers of broker-dealers are provided with information concerning the financial condition of the firm that may be holding the customers’ cash and securities. The Commission, when adopting the Rule in 1972, stated that the goal was to “directly” send a customer essential information so that the customer could “judge whether his broker or dealer is financially sound.” The Commission adopted the Rule in response to the failure of several broker-dealers holding customer funds and securities in the period between 1968 and 1971.

Information regarding the broker-dealer’s financial condition, which includes information regarding the broker-dealer’s net capital and its required net capital, is “essential information” customers need in order to gauge whether the broker-dealer is sufficiently financially sound to be entrusted with their securities and cash. The purpose of the net capital requirements is to ensure that broker-dealers have sufficient liquid assets (those assets that can be readily converted into cash) in excess of liabilities to promptly satisfy the firm’s liabilities, including those to customers.

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

On May 9, 1996, the Commission issued an interpretive release (Securities Exchange Act Release No. 37182, 61 FR 24644) regarding, among other things, the use of electronic media by broker-dealers in satisfying their requirements under the Rule. This interpretive release reduces the printing and mailing burden on broker-dealers by allowing them to deliver the financial statements to their customers through electronic media.

Under the exemption of paragraph (c)(5) of Rule 17a-5, a broker-dealer can take advantage of the Internet as an alternative method of delivery to its customers of its full balance sheet.

4. Efforts to Identify Duplication

Not applicable. No other rule requires brokers or dealers to send such information to their customers.

5. Effects on Small Entities

Firms that carry customer accounts are required to comply with this Rule. There are approximately 375 such firms. Of these firms, approximately 14 are small businesses. The complexity and length of financial statements generally varies proportionately with the volume and complexity of the broker-dealer's business. Additionally, the number of financial statements that a broker-dealer must send to its customers is directly proportional to the number of customers of the broker-dealer. Therefore, small businesses should not experience additional or disproportionate burden as a result of complying with the Rule.

It would not be appropriate to provide small firms with an exemption from the Rule because customers must have financial information to evaluate the financial soundness of a broker-dealer that may be holding their cash and securities.

6. Consequences of Not Requiring the Information Collection or Less Frequent Collection

If the required collection were eliminated, the protections afforded to the public would be lessened. If the required collection were conducted less frequently, the financial information would become outdated.

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

Not applicable. This collection is consistent with the guidelines in 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

Not applicable. No consultations outside the agency were made.

9. Payment of Gifts to Respondents

Not applicable.

10. Assurance of Confidentiality

Not applicable. The information is not confidential.

11. Sensitive Questions

Not applicable. Questions of a sensitive nature are not asked.

12. Estimate of Respondent Reporting Burden

Since the time of the previous calculation of the PRA burden, the Commission's estimate of the number of broker-dealers that carry customer accounts has decreased from 375 to 275, the Commission's estimate of the number of public customer accounts has increased from 109

million to 110 million, and the Commission's estimate of the number of broker-dealers that take advantage of the exemption of paragraph (c)(5) of Rule 17a-5 has decreased from 300 to 220. The Commission estimates that it costs approximately 11 cents to mail a full balance sheet to a customer, primarily due to the additional postage required to mail the approximately six pages of footnotes required by GAAP.

Broker-dealers taking advantage of the exemption send the financial disclosure statement, instead of their full balance sheet, twice a year. Some broker-dealers print the financial disclosure statement, which is typically about one paragraph in length, on a separate page and include it with the quarterly account statement, and some broker-dealers print it directly on the quarterly account statement. The Commission believes that the time burden for sending the semi-annual financial disclosure statement with quarterly customer account statements for broker-dealers taking advantage of the exemption should be calculated on a per-broker-dealer basis. Sending the financial disclosure statement will likely involve drafting the statement and making programming adjustments to the computer system that generates the account statements. The cost of sending the statement should not, therefore, depend on the number of account statements sent.

The Commission previously estimated that each broker-dealer that takes advantage of the exemption would spend approximately 40 hours every six months to send the financial disclosure statement to its customers, for a total of 24,000 hours (300 broker-dealers * 2 mailings * 40 hours = 24,000 hours). The Commission now estimates that this burden is approximately 17,600 hours (220 broker-dealers * 2 mailings * 40 hours = 17,600 hours). As in the previous Paperwork Reduction Act filing, the Commission does not expect that broker-dealers will incur additional costs for postage and printing to send the financial disclosure statement, as the statement will be sent with a quarterly mailing of customer account statements.

The Commission previously estimated that broker-dealers that take advantage of the exemption would spend a total of 200 hours per year sending balance sheets to customers who request them via a toll-free number. The burden was calculated by multiplying the estimated number of annual requests (1200)¹ by the estimated average amount of time required to process each request (10 minutes). The Commission now estimates that broker-dealers that take advantage of the exemption hold approximately 88 million customer accounts (220/275 times 110 million = 88 million) and the Commission continues to estimate that the number of annual requests will be approximately 1200 (550/40 million times 88 million = approximately 1200) and that the burden continues to be 200 hours.

¹ The twenty-nine firms (holding a total of approximately 40 million customer accounts) that took advantage of the exemption from December 1999 to July 2002 reported a total of 1384 requests for balance sheets via the firms' toll-free numbers during that period (approximately 550 per year). Based on this data, the Commission estimated that the firms that took advantage of the exemption, which held approximately 90 million customer accounts, would receive a total of approximately 1200 requests annually via their toll-free numbers for copies of their balance sheets (550/40 million times 90 million = approximately 1200).

The Commission previously estimated that 75 broker-dealers carrying approximately 19 million customer accounts did not take advantage of the exemption and that it would take approximately 10 seconds to send each balance sheet. The total annual burden was therefore approximately 100,000 hours (19 million customer accounts * two balance sheets sent per year * 10 seconds). The Commission now estimates that 55 broker-dealers (275-220 = 55) carrying approximately 22 million customer accounts (55/275 * 110 million = 22,000,000) will spend approximately 120,000 hours per year to send the balance sheets (22 million customer accounts * two balance sheets per year * ten seconds = 120,000 hours).

The total annual burden for Rule 17a-5(c) has therefore increased from approximately 124,000 hours to approximately 138,000 hours.

13. Estimates of Total Annualized Cost Burden

Not applicable. The Commission does not expect that respondents will have to incur capital or start-up costs to comply with the Rule.

14. Estimate of Cost to Federal Government

The firms subject to the Rule must send one annual audited financial statement and one semi-annual unaudited financial statement to the Commission each year. The Commission generally gathers the information only to make it publicly available. Therefore, the cost to the Commission is minimal—approximately \$10,000 per year. This amount is based on the Commission's computation of the value of staff time devoted to those activities, the related overhead valued at 35% of the value of staff time. These estimates have been computed based on the GSA, Guide to Estimating Reporting Costs (1973).

15. Explanation of Changes in Burden

Since the time of the last submission, there has been a decrease in the Commission's estimate of the number of broker-dealers that carry customer accounts, from 375 in 2005 to 275 in 2008, and an increase in the total number of public customer accounts, from 109 million in 2005 to 110 million in 2008. Further, the Commission previously estimated that 300 broker-dealers took advantage of the exemption of paragraph (c)(5) of Rule 17a-5 and that 75 broker-dealers carrying approximately 19 million customer accounts did not take advantage of the exemption. The Commission now estimates that 275 broker-dealers take advantage of the exemption and that 55 broker-dealers carrying 22 million customer accounts do not take advantage of the exemption. See item 12 for a discussion of the effect of these and other changes on the reporting burden, which has increased from 124,000 hours to 138,000 hours.

16. Information Collections Planned for Statistical Purposes

Not applicable. The information collected is not used for tabulation, statistical analysis, or publication.

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

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collection of Information Employing Statistical Methods

Not applicable.